

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

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HEARINGS  
BEFORE THE  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES  
EIGHTY-SEVENTH CONGRESS  
SECOND SESSION  
PURSUANT TO  
Sec. 5(a) of Public Law 304  
(79TH CONGRESS)

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AUGUST 7-10, 13-17, 20, 21, AND 22, 1962

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# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

TUESDAY, AUGUST 7, 1962

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

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

Present: Representative Patman; Senators Douglas, Proxmire, Bush, and Javits; Representatives Reuss and Widnall.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will please come to order.

This morning we begin hearings on the state of the economy and on the question of how the policy of the Federal Government might be appropriately amended to help achieve maximum employment, production, and purchasing power.

The purpose of the panel this morning is to present the facts on the state of the economy, and for this purpose we have a distinguished panel of experts:

Mr. Ira Ellis, economist for E. I. du Pont de Nemours & Co.

Mr. James Wishart, research director, the Amalgamated Meat Cutters & Butchers of North America.

And we have two others, who are evidently late, Dr. Daniel B. Suits, professor of economics, University of Michigan, and Dr. J. Frederick Weston, professor of economics, University of California at Los Angeles.

Senator DOUGLAS. May I say these gentlemen are not necessarily late. They may be lost in the effort to find this room. I have heard of the difficulties white rats have in a maze. I have been trying to find this room for 15 minutes, and so I think these gentlemen should be given our condolences.

Senator BUSH. Mr. Chairman, I move that the usual fines be waived for these late or tardy gentlemen.

Chairman PATMAN. Senator Bush desires to make a statement, and he will be recognized for that purpose.

Senator BUSH. Mr. Chairman, I want to take this opportunity to commend you and thank you for the promptness and efficiency with which you and the committee staff responded to the request of the minority members for hearings on the current state of the economy. The public has a vital interest in the subject of these hearings, and can benefit greatly from an open, objective, and dispassionate discussion of the issues and the policy alternatives available to us.

Closed hearings, while benefiting those few fortunate enough to hear the testimony, do not serve to inform either the public or the Congress at large about the problems we face and what we must do to solve them. The Joint Economic Committee has a continuing responsibility in this area, and we are glad to see that it is discharging that responsibility.

The minority believes that the most important objective of these hearings should be the examination of our basic economic situation. We should try to determine whether the Nation is undergoing deep-seated and fundamental economic adjustments.

The near-term economic outlook and the question of whether or not there should be an immediate reduction in taxes is important, and will enter these hearings; but compared to the long-run and basic economic problems before the country, these more immediate questions are but ripples on the stream. We should not permit them to turn our attention too long from the basic economic problems with which we must grapple if the country is to get moving again.

I request that the July 27 letter of the minority members of the committee, addressed to the chairman, asking for these hearings, be made a part of the record at this point.

I thank the chairman and the committee for their courtesy.

Chairman PATMAN. Without objection, the letter will be made a part of the record at this point.

(Letter referred to follows:)

JOINT ECONOMIC COMMITTEE,  
Washington, D.C., July 27, 1962.

HON. WRIGHT PATMAN,  
Chairman, Joint Economic Committee,  
New Senate Office Building,  
Washington, D.C.

DEAR MR. CHAIRMAN: Concern over the state of the economy has mounted in recent months as the recovery from the 1960-61 recession has begun to level off. Some economists believe that we face another recession late this year or early in 1963. In addition to fears of another recession following close on the heels of the last one, there is some opinion that our economy is not growing at a sufficiently rapid rate and that we may be in a period of what has been called high-level stagnation.

One prescription being offered as a cure for our economic ills is an immediate tax cut. The House Ways and Means Committee even now is holding private hearings to study the state of our economy and the need, if any, for an immediate tax cut.

While we recognize and respect the legislative jurisdiction of the Ways and Means Committee over taxation, we believe nevertheless, that the basic issues involved are broadly economic in nature since they involve the proper role of fiscal and monetary policy in the present economic environment. The Joint Economic Committee, through open hearings, could make an important contribution to the clarification and public understanding of these issues.

Therefore, we strongly urge that you schedule hearings by the full Joint Economic Committee on the state of the economy as soon as possible. Such hearings must be open. Not only does the public have the right to know about the health of the economy, but, equally important, it has a need to know. Only a full and frank open discussion of the issues will lead to that broad public understanding and support on which sound economic policies depend.

Very truly yours,

THOMAS B. CURTIS,  
CLARENCE E. KILBURN,  
WILLIAM B. WIDNALL,  
PRESCOTT BUSH,  
JOHN MARSHALL BUTLER,  
JACOB K. JAVITS.

Chairman PATMAN. Senator Proxmire desires to make a statement. He is recognized for that purpose.

Senator PROXMIRE. I appreciate that. I have a short statement.

Mr. Chairman, on July 9 I wrote you suggesting that this committee hold hearings on the economy because I was deeply disturbed by the increasingly restrictive actions of the Federal Reserve Board at a time when our economy is standing still.

I challenge any witness to appear before this committee to justify the high interest rate economy—slowdown policies of the Federal Reserve Board.

For the Federal Reserve Board to force up interest rates and reduce available bank reserves under present economic circumstances is sure to create further unemployment, especially in the homebuilding and construction industries, which are highly responsive to changes in interest rates. Unemployment in construction has been seriously high for a long time.

Americans ranging from the U.S. Chamber of Commerce to the AFL-CIO have become so alarmed by economic stagnation that they have advocated a tax cut that would pile a huge deficit this year on top of last year's unbalanced budget.

Virtually every economist and business leader who has spoken out on the economy has expressed dissatisfaction with our present rate of growth, and concern that we may be about to drift into a recession.

Unemployment has continued at a seriously high level for more than 2 years, and has failed to improve significantly during the past 7 months. For the Federal Reserve Board to deliberately force up interest rates as it has been doing is to throw sand in the engine, when what we need is more fuel.

In 1929, we cut taxes at the same time interest rates were rising to high levels. This contributed to the worst economic crash in U.S. history.

Two significant effects occurred last week which have very profound implications for the problem into which this committee is inquiring. On Friday it was reported that the Federal Reserve System had again tightened credit last week. This recent reduction in free reserves to \$300 million is significant in that it confirms the suspicion of most analysts that the Fed is now committed to a tight money policy.

The indications of such a policy seemed to be clear in June, when for several weeks in a row the Fed reduced free reserves and maintained them at levels lower than had been reached since the tight money policy prior to the last recession. This indication was confused by the temporary easing of credit that occurred in July. But now it is clear that the policy, revealed by their actions in June, does in fact reflect their basic outlook toward the need for credit restraint at this time.

It is thus particularly timely that this committee exercise its responsibility to provide the needed legislative oversight in this vital area. Monetary policy is too important to be left to the bankers. If there ever was a time for Congress to insure that the monetary policy is formulated and executed in the context of the public interest, it is now.

The chronically high levels of unemployment prevailing in this country and the chronic slowdown in our growth rates make it over-

whelmingly clear that no monetary constraints whatsoever should be placed on economic activity.

Federal Reserve monetary policies could easily frustrate any attempt to stimulate the economy through a tax cut, in the same manner that proper monetary policies might possibly preclude the need for significant fiscal action at this time.

The second event that occurred last week which gives special meaning and timeliness to these hearings was the failure of the Treasury's attempt to float a new issue of long-term bonds. The Treasury was willing to sell up to \$750 million worth of 30-year bonds which were priced to yield 4.19 percent. It is significant that subscriptions amounted to only \$316 million. This fell far short not only of the \$750 million that the Treasury was willing to sell, but it fell far short of the \$500 million that the Treasury expected to sell.

This is a very strong indication that there is not the available liquidity at the long end of the market that many have talked about. If investors are not willing or able to take advantage of such attractive rates, they certain must lack significant loanable funds which are seeking a place for profitable investment. The only other reason for the dismal failure of this recent attempt of the Treasury to attract long-term funds is that the investors feel that the rate of interest is about to go higher.

Either of these two possible explanations is very distressing in its implications. The deficiency of the availability of loanable long-term funds suggests that the restrictive policies of the Fed have already had an effect. In any case, it suggests that the Fed is in error if it feels that it must soak up a significant amount of excess liquidity at the long end of the market.

These recent events suggest why it is necessary for Congress to act quickly to prevent the misguided policies of the Fed from continuing to slow down the economy. It is my hope that these hearings, and further report, will help to remedy this situation.

I thank you very much for indulging me in this statement. As you know, I did write you on this matter, and I feel very, very strongly, and I am sure that you share at least some of my sentiments.

Senator DOUGLAS. Mr. Chairman, I wonder if the Senator from Wisconsin would obtain unanimous consent that the letter which he addressed to the chairman on July 6 should be made a part of the record; and if he does so, I will ask unanimous consent that the subsequent letter, which I wrote, addressed to the chairman, some days after that, also be made a part of the record.

Senator PROXMIRE. Yes, indeed, Mr. Chairman.

Chairman PATMAN. I would like to add that the chairman's reply also be inserted.

Senator PROXMIRE. I make that request, Mr. Chairman.

Chairman PATMAN. Without objection, it is so ordered.

(Letters referred to follow:)

JULY 10, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee, Washington, D.C.*

DEAR WRIGHT: I think we should have a few days hearings of the full committee about the state of the economy, and especially we should get Mr. Martin to come before us to explain why he has been tightening credit for legitimate business loans and investments but loosening credit for stock market speculation.

All this has been done at a time where there is some doubt about the economy, and I think we should properly go into it.

With best wishes.

Faithfully yours,

PAUL H. DOUGLAS.

U.S. SENATE,  
Washington, D.C., July 6, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.*

DEAR MR. CHAIRMAN: Present monetary policies are drastically reducing the free reserves of our banking system and sharply increasing interest rates.

The restrictive effect on the economy is sure to diminish business opportunities, increase unemployment, and slow economic growth. Monetary policies are having these adverse effects at a time when unemployment remains steadily high and the economy is operating well below capacity.

Thus the consequences of present monetary policies directly contradict the objectives of our Government as expressed by Congress in the Employment Act of 1946.

For these reasons I am writing to suggest for your consideration that the Joint Economic Committee hold hearings on monetary policies to hear Chairman Martin of the Federal Reserve Board, Secretary of the Treasury Dillon, Chairman Heller of the Council of Economic Advisers and others. In view of the great significance of these hearings I hope that they can be set as soon as possible, preferably within the next week or two.

During the month of June while unemployment continued at the same high level of 5½ percent (seasonally adjusted) that has prevailed since February, the FED followed a restrictive policy of selling FED obligations that contributed directly to a reduction of free reserves in the banking system from roughly \$500 million down to about \$300 million.

Meanwhile, interest rates on Federal, State, local, and private obligations of all maturities rose sharply. Ninety-day Treasury bills rose to a 2-year high.

At the very time these restrictive monetary policies were being followed, the U.S. Chamber of Commerce, the AFL-CIO, and the National Conference of Governors have all endorsed proposals for a substantial tax cut to get the economy moving. At his press conference this week President Kennedy also indicated the possibility that he might favor a big tax reduction.

It appears therefore that the Congress may be on the verge of a tax cut to stimulate the economy. If a tax cut were enacted and monetary authorities refused to change their present restrictive policies, this would perhaps be the first time in the Nation's history when the two great instruments of economic policy in our Nation were deliberately and simultaneously set off in opposite directions.

The results might be an expansion of the economy if the tax cut proves a more potent instrument than contracting credit policies, but any expansion would be dragging an anchor of credit restraint. Or it might very well be that the aggregate effect of these two Government policies might be to shove the economy downhill if the credit restraint proved more potent than a tax cut.

In any event the adoption of both a restrictive credit policy and an expansionary fiscal policy at the same time would seem to be the height of absurdity with the only sure consequences higher interest rates, a bigger national debt, and a greater eventual burden on the taxpayer.

In the event taxes are not cut it is of course even more important that the present restrictive monetary policies be reconsidered so that the economy can move off dead center and start moving ahead.

Sincerely,

WILLIAM PROXMIER, *U.S. Senator.*

JULY 10, 1962.

HON. WILLIAM PROXMIER,  
*Chairman, Subcommittee on Economic Statistics,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR PROXMIER: Thank you for your letter of July 6 concerning the current direction of monetary policy. I know of your deep concern over this matter from having read your speeches in the Senate on the subject.

Needless to say, I agree with the observations you make concerning the adverse effects of restrictive monetary policy on business activity and employment. I, too, am deeply concerned, as I have been over the 15 years the Federal Reserve has been progressively reducing the Nation's supply of money and credit relative to the volume of business transactions requiring money and credit. There have been a few interruptions to the steady reduction in our effective money supply during the past 15 years, but the general trend has been unvarying. Similarly, the Federal Reserve has made numerous changes in margin requirements for purchasing and carrying stocks on the organized stock exchanges, but of course these changes in margin requirements are in no way related to the supply of money, or the supply of other liquid assets, available for carrying on the business of the Nation.

While the United States, among all the principal industrial nations, has made the largest reductions in its effective money supply in the postwar years, and has enjoyed one of the slowest rates of economic growth, those Nations which have maintained or increased their effective money supplies have made the greatest economic gains. To illustrate, Japan's GNP increased 129 percent between 1952 and 1961, and its effective money supply was increased by 13 percent. Germany's GNP increased 104 percent, and its effective money supply increased 6 percent. France's GNP increased 98 percent and its effective money supply increased 17 percent. The U.S. GNP increased by 45 percent, and its effective money supply was reduced by 24 percent.

As to the suggestion that the full committee hold hearings on the recent further tightening of credit, however, it has long seemed to me that the constructive hearings on this subject must necessarily have some relevance to the balance-of-payments problem. This is, of course, the problem which justifies the tight-money high-interest policy, at least in the minds of those responsible for the policy, and our balance-of-payments subcommittee is digging deeply into this problem. I am hopeful, furthermore, that the subcommittee will soon have some constructive suggestions, either as to possible improvements in the money system, or as to a reappraisal of the policies which are leading to a continuous net outflow of dollars.

To me, it would seem to be preferable to find some improvement in the money system which would permit the creation of money claims to wealth in a volume more nearly related to our capacity for wealth production, rather than in a volume limited by our supply of gold. Frankly, I have difficulty seeing the relevance of the "discipline" imposed by a limited supply of gold. True, some of our prices are undoubtedly noncompetitive in world markets, but the fact that we are able to export \$4 worth of goods and services for each \$3 imported seems to suggest that the gold "discipline" is misplaced.

Assuming that the subcommittee finds no improvements in the international money system to be feasible, however, it would then seem to me that a careful evaluation of the sources of the dollar outflow would be most constructive. Restrictions have, of course, been imposed on our military personnel stationed abroad, and reductions have been made in the duty-free goods which American tourists may bring in.

I know of no steps yet taken to discourage American banks and other financial institutions from freely making loans abroad, to discourage U.S. investors from purchasing foreign stocks and bonds, or to discourage American industrial firms from purchasing foreign competitors and building plants in highly developed nations needing no U.S. assistance. Thus, it would seem that the possibility of some disincentive on these activities—perhaps a tax to equalize differences in interest rates—should not be ruled out. A restrictive monetary policy to equalize interest rates and check the flow of funds seems to me to impose a most unequal sacrifice, namely, one falling on the more than 4 million wage earners who are squeezed out of employment by this kind of policy.

With reference to your expressions of concern over the current proposals for tax reductions, I, too, have serious doubts about these proposals. Indeed, I have serious doubts about some of the assumptions concerning the flow of funds in our economy which underlie the kind of proposals being made, and I have been wondering if one of our subcommittees—perhaps the Subcommittee on Economic Statistics—might wish to develop some proposal for an inquiry into the facts of these matters.

The assumption that the volume of savings—corporate and personal—is inadequate to support a high level of investment is, of course, of quite recent origin, and an assumption which seems to me deserving of the most critical examination. If it is still true, as many experts have believed in the past, that our basic problem is one of excess savings relative to consumption expenditures, then the administration's suggestions for cutting corporate taxes and cutting individual income taxes in ways to give disproportionately large tax relief to the high-income families, who can be expected to save much of their added income, then the proposed tax reductions may prove ill-advised. Indeed, a tax cut which stimulates savings without also stimulating a very large expansion in consumption could worsen unemployment and worsen the other conditions which the tax cut is intended to remedy, once the period of a larger Federal deficit is ended.

I also wonder about the assumption that corporate profit margins are inadequate to draw a high volume of savings into investment. On the face of the data now available, the so-called profit squeeze appears to be a bookkeeping fiction, reflecting the fact that the postwar trend has been to count relatively more of corporate net income as "depreciation" and relatively less as "profits."

These changes in bookkeeping practices have been made possible, first, by the certificates of necessity granted in the earlier postwar years to permit "speed-up" writeoffs of new plant and equipment, and, later, by changes in the Internal Revenue Code of 1954 which tended to extend speedup writeoffs to all investment in new plant and equipment. Considering also that the rate of return on corporate investment is closely related to the rate at which capital equipment is utilized, it appears that corporate margins have actually been widening over the past decade rather than being squeezed.

Of course the foregoing does not suggest all of the important questions which need answers. In years past our Subcommittee on Economic Statistics has helped to initiate and bring about improvements in the Federal Reserve's flow-of-funds data, but while these data are intended to provide information that is central to the working of our economy, some of the experts tell me that the reporting system is only in the formative stage and needs much clarification and improvement.

If you feel that there is any merit to the above suggestions, I would appreciate it if you would give consideration to the possibility of a thoroughgoing investigation and hearings on the flow-of-funds data by your subcommittee, and, if such an investigation seems feasible, let me know what the staff and budget requirements of such an investigation would be.

I am,

Sincerely,

WRIGHT PATMAN.

Cc: Hon. Henry S. Reuss, Chairman, Subcommittee on International Exchange and Payments.

Chairman PATMAN. Are you ready to proceed?

Senator BUSH. I might say there was a letter which we all signed, in which we asked for open hearings.

Chairman PATMAN. You may proceed in your own way, Mr. Ellis. I notice you have a prepared statement. You may proceed.

#### STATEMENT OF IRA ELLIS, ECONOMIST, E. I. DU PONT DE NEMOURS & CO.

Mr. ELLIS. Mr. Chairman and members of the Joint Economic Committee, it is a pleasure to discuss with this group the current state of the economy and the outlook.

I like the statements that have been presented so far, which set up a very good basis for discussion. I have prepared a background statement of the current business situation, which I would like to read to the committee and to use as the basis for my subsequent discussion.

The economic activity rate in the United States is at an alltime high level, but it is rising only slowly. The total value of goods and services produced in the country in the second quarter of 1962 was at an annual rate of \$552 billion, compared with \$519 billion for the year 1961. In terms of constant prices, that is, the physical volume of goods and services, the second-quarter level of output of the economy was up 0.7 percent from the first quarter—and, gentlemen, that is almost 3 percent per year—and up 5.1 percent from the 1961 average. And, gentlemen, the 1961 average was the previous alltime high.

The principal gains are occurring in the rate of consumer spending for goods and services, and in construction. Government purchases of goods and services also rose in the latest quarter, and at a rate somewhat higher than the rise in consumer spending. You gentlemen know that Government purchases include State and local purchases as well as those of the Federal Government.

The business inventory accumulation rate in the latest quarter was down significantly from the first quarter rate, but it was at a reasonable level, after being relatively high in the last quarter last year and the first quarter of 1962.

And I call your attention to the fact that that decline in the rate of inventory accumulation had a significant effect on the total change in the gross national product. In other words, final consumption went up even more from the first to the second quarter than the gross national product indicated, because the rate of accumulation of inventories went down.

While we all would like to see the operating rate of our economy at a higher level, the fact still remains that the rate in the latest quarter was at a record high level.

The rate of industrial production in the country in the second quarter of 1962 was also at a record high level, up 2 percent from the first quarter, and up 7 percent from the 1961 average.

The 1961 average was the alltime record high annual average.

Principal gains in production over the past year have occurred in durable goods, where the mild recession of 1961 was largely concentrated. The principal output gains from the low point last year to the latest quarter occurred in primary metals: that is, steel, aluminum, and other metals; machinery; and transportation equipment. And of course in transportation equipment, the big item is automobiles, having an unusually good year. There were also significant output gains over this period in several industries producing nondurable goods, particularly textiles and apparel, paper and products, chemicals and products, and rubber and plastics products.

The production rate of the American economy in 1962 will approximate closely the value indicated by the trend of its growth over the past 11 years; that is, starting in 1951, as may be noted from the attached charts.

Whether we look at the gross national product in terms of constant prices, that is, the physical volume of goods and services, or at the

Federal Reserve Board Index of Industrial Production, which also, of course, is expressed in terms of physical volume, we find the above statement to be correct.

We are maintaining our growth rate of the past 11 years. I would agree with anybody who would desire to see it higher, but I call your attention to the fact that we are maintaining that growth rate.

Wholesale prices are showing very little movement. The index of wholesales prices of commodities other than farm products and foods, that is, largely industrial products, has shown very little net change since January 1959, although there have been significant increases and decreases among the subgroups.

The Consumer Price Index, the prices of goods and services purchased by urban moderate income people, has risen about 1.25 percent per year over this period, and prices of goods and services in the gross national product have risen about 1.5 percent per year in the same time. While the rise in prices in our economy has been slowing down in recent years, it has not yet been stopped—importantly because costs are still rising.

Employment in the country continues to rise, especially employment in nonfarm activities. Total employment in July was recently estimated by the U.S. Department of Labor at 69.6 million, a record high for July, up 1.1 million from July 1961, in spite of a decline of almost 400,000 in reported farm employment over this period.

Nonfarm employment in July 1962, therefore, was up 1.5 million, or 2.4 percent, from a year ago—with the principal gains in durable goods manufacturing, wholesale and retail trade, finance and service industries, and government. The government increase was primarily at the State and local level. Employment in construction and in mining declined over the past year.

Unemployment was down 1.1 million from a year ago, to about 4 million, the reported total in July 1962.

While the reported rate of unemployment is still relatively high, the Labor Department figures show that much of this unemployment is concentrated among boys and girls 14 to 19 years of age, many of whom are single and living at home, or among those out of work for less than 5 weeks.

The unemployment rate in June (July data in detail are not yet available) among boys 14 to 19 years of age was 17.5 percent. That is, among all the boys, 14 to 19 years of age, who said they were in the labor force, 17½ percent reported themselves as unemployed but looking for work.

That figure, of course, is relatively high, importantly because many students were looking for summer work early in June. That 17½ percent for boys 14 to 19 years of age, compared with a rate of only 3.8 percent for men 25 to 34 years of age, 3.6 percent for men 35 to 44 years of age, and 3.4 percent for men 45 to 54 years of age.

In other words, if you are talking about unemployment among the adult male labor force of the country, it is under 4 percent. It was in June. Similar low rates of unemployment were reported for adult women in the labor force.

It seems to me that when we talk about unemployment, we ought to talk about the adult labor force, not boys and girls 14 to 19 years of age. Furthermore, 57 percent of the unemployed potential workers in June 1962 had been out of work for less than 5 weeks. Again, when we talk unemployment, let us talk about serious unemployment, and not about workers who are changing jobs or who have just begun to look for their first job.

Unemployment rates are relatively low among skilled workers, that is, professionals, technical, and kindred workers, managers in farm and nonfarm activities, et cetera.

Unemployment rates rise as the skill level declines. In fact, unemployment rates are relatively high principally among the very young, the unskilled, and the nonwhite potential workers.

As a result of high economic activity, high employment, and high wage and salary rates, the rate of receipt of personal income in the country in June 1962 was also at a record high level—\$440 billion per year, up 1.2 percent from the March rate; that is, up 1.2 percent in the second quarter and up 5.8 percent from June 1961.

The principal gains in personal income over the past year have occurred in employee income, up 6.2 percent. There have also been significant gains in income of nonfarm proprietors, in the rental income of persons, and in interest and dividends.

The rise in income has been widely distributed, and the rising level of income is being spent freely for goods and services. The rate of personal savings from income after taxes in the latest quarter showed very little change from the level of a year ago.

Consumers have money, and they are spending it. They may not spend it for just what each individual would desire. Some people are not selling at the rate they would like to sell. But the total volume of personal spending, personal consumption expenditures, is very much in line with the current rate of personal income.

The level of corporate profits recovered rapidly with the rise in business activity after the recent low point in the first quarter of 1961 until the fourth quarter of last year. There was apparently little change in the level of corporate profits over the past two quarters. The first quarter has been estimated, but the second quarter is not yet available. We are estimating that it may show a slight decline from the first quarter and from the fourth quarter of last year. But earnings in the first half of 1962 virtually assure that the amount of corporate profits this year will make a new high record.

While the amount of profit earned by manufacturing corporations—and here I am concentrating just on the segment of manufacturing industry because that is where we happen to be—the amount of profit earned by manufacturing corporations this year will be significantly higher than it was last year. (It will be a new high annual record, I believe. The rate of profit on stockholders' equity among manufacturing corporations this year will be the lowest since 1945, with the exception of the years 1958, a recession year, 1960, and 1961.)

Senator BUSH. How do you define that rate of profit? Is that return on investment? Or what does it mean?

Mr. ELLIS. Yes; return on the stockholders' investment, using the stockholders' total equity.

Senator DOUGLAS. Just a moment. You mean the market value of stocks?

Mr. ELLIS. No. What the stockholders have put in. The common stock, the preferred stock, and the surplus of a corporation.

Senator DOUGLAS. Excluding bonds?

Mr. ELLIS. It would make very little difference if you did include bonds and took the rate on total investment. It is not readily available.

Senator DOUGLAS. You mean the amount realized from the sale of stock?

Mr. ELLIS. No. I mean corporate profits after taxes, divided by stockholders' equity.

Senator DOUGLAS. That is what I am trying to get at, the definition of the denominator.

Mr. ELLIS. The stockholders' equity is the sum of the book value of common stock, preferred stock, and surplus.

Senator DOUGLAS. Book value?

Mr. ELLIS. Book value. What the stockholders have put in and what has been retained for them, of course, by the corporation in the form of surplus.

Senator DOUGLAS. Does this include capital and surplus?

Mr. ELLIS. Yes; capital and surplus. Common stock, preferred stock, and surplus. That figure divided into the reported corporate profit after taxes.

Senator DOUGLAS. Do you think the denominator might be inflated?

Mr. ELLIS. In what way?

Senator DOUGLAS. Well, I just ask you whether you would accept the denominator as a true mirror of investment.

Mr. ELLIS. Yes; I do. I do not think it would be inflated in the sense that some of this money might have been put in 20, 30, or 40 years ago. That certainly would not be inflated now. That is not changed from the amount put in at that time. It is not the market value of the common stock. It would not be inflated that way. It is the original amount put in.

Senator BUSH. This equity is also the depreciated value of these investments, as reflected in the capital and surplus figures?

Mr. ELLIS. No; depreciation does not affect this. This is the amount put in. It does not change. Once it is put in, it is there, and it is not affected by depreciation.

Senator BUSH. Does it not affect the surplus figure?

Mr. ELLIS. No. Depreciation would not affect the surplus figure. Depreciation would affect the net value of the physical assets, the difference between the cost of a plant and its current depreciated value; but that would not affect the common stock and surplus.

Senator BUSH. But if you charged depreciation in a given year, that comes out of your earnings, and your earnings over what you pay out would go into surplus?

Mr. ELLIS. That is right.

Senator BUSH. So it would seem to me that the depreciated value is reflected in the surplus.

Mr. ELLIS. Not in that sense, any more than any other cost. The payroll cost in that sense would also be reflected.

Starting with the net profit of the corporation: now, whatever has been taken out before you arrive at that, of course, would affect the net profit; but depreciation would have no unusual effect or special effect.

Senator DOUGLAS. Mr. Ellis, I do not want to interfere with your argument, but I just want to mention one qualification that I think should be made.

Some of us have felt for a long time that with the management control of corporations there was a tendency to reinvest a larger proportion of the surplus in companies than was economically justifiable, and hence to diminish the cash distribution to stockholders.

Now, to the degree that this is done, this does give a high figure, some of us believe an uneconomic figure, in the denominator, and consequently decreases the ratio.

Mr. ELLIS. That is right.

Senator DOUGLAS. And the point that Senator Bush made I think is also true, that to the degree that the allowances or depreciation have been increased, and they certainly have been under the double declining balance method of 1954, this operates to reduce earnings as stated in the numerator of your fraction, and consequently the two together would naturally serve to have a redoubled effect in diminishing the ratio of earnings to equity.

Mr. ELLIS. That is right; diminishing below what it otherwise might be. But should you not also take into account whether the depreciation amount is adequate? If the depreciation is insufficient, as it obviously was before 1954, then to raise it, while it does raise the cost, does not necessarily make the depreciation excessive.

You have a good point. It has changed and does affect the ratio.

Senator PROXMIRE. May I just ask one other question, Mr. Ellis?

Is it not also true to say that the profits this year are the highest since 1957, with the exception of 1959?

Mr. ELLIS. Profits? Oh, I think the corporate profits will be at an all-time high this year.

Senator PROXMIRE. I am talking about the profit on stockholders' equity.

Mr. ELLIS. Oh, the rate, the rate of profit?

Senator PROXMIRE. Yes, the rate of profit is the highest in the past 5 years, with the single exception of 1959, according to your own figures, here.

Mr. ELLIS. That is true.

That is right, because this is a pretty good business year in total.

Senator JAVITS. Mr. Chairman, could I make one suggestion—that whatever may be in their written statements, each of the witnesses might try, even in their presentations, to answer for us what seems to me at least to be a very worrisome question in the country?

Why, if all of our indexes are up, are we very worried? And why is there, in my opinion, such a demonstrable lack of confidence in the future of the economy?

Representative REUSS. Would the gentleman yield at that point?

I believe that the state of confidence reflects the facts of the economic situation. Let me refer the gentleman to the July 1962 issue of Business Cycle Developments, published by the U.S. Department of Commerce. It shows that many of the principal leading indicators are now pointing downward.

Senator JAVITS. I was merely addressing myself to the witness's general point.

I run through these statements, and everybody says, "We have more gross national product. We have more people actually employed. We have more corporate profits," as Senator Proxmire properly brought out.

And yet there seems to be something gnawing at the vitals of the American economy, certainly in terms of the minds of the people who make up that economy, whether it is workers, management, investors, or academicians.

Mr. Chairman, I thank you for allowing me to make that observation.

Chairman PATMAN. You may proceed.

Mr. ELLIS. I believe the current relatively low level of corporate profit on investment is a significant factor in the failure of employment to rise more rapidly than it has in recent years.

My reason for that statement, of course, is that managements, faced with what they consider an unsatisfactory rate of profit, have been aggressively reducing costs this year, and cost reduction usually means employment reduction.

In summary, economic activity in the country is growing at about the average rate of the past 11 years. Business inventories seem reasonably adjusted to the current and immediately expected rate of sale. Industrial prices are stable, on the average, but there are significant increases and decreases in some areas.

Employment of the adult labor force of the country is relatively high, and personal income is still rising.

While the amount of corporate profits may reach a new high level this year, the rate of profit on investment is still relatively low.

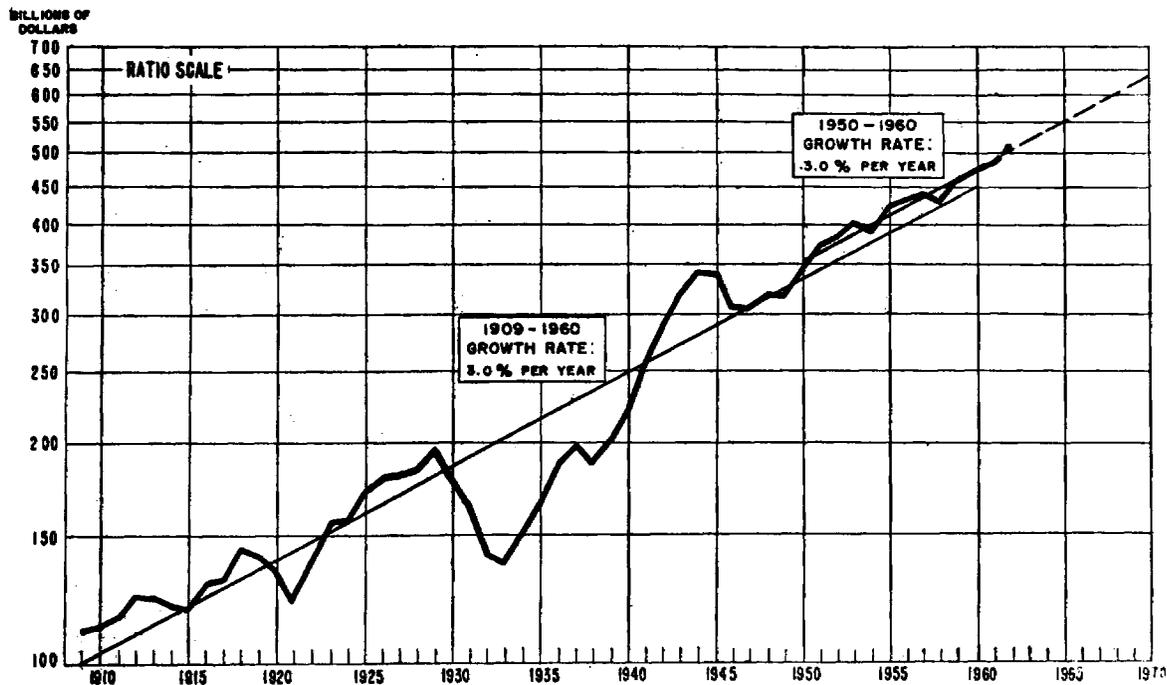
Chairman PATMAN. Thank you, sir.

Without objection, the charts will be inserted in connection with your testimony.

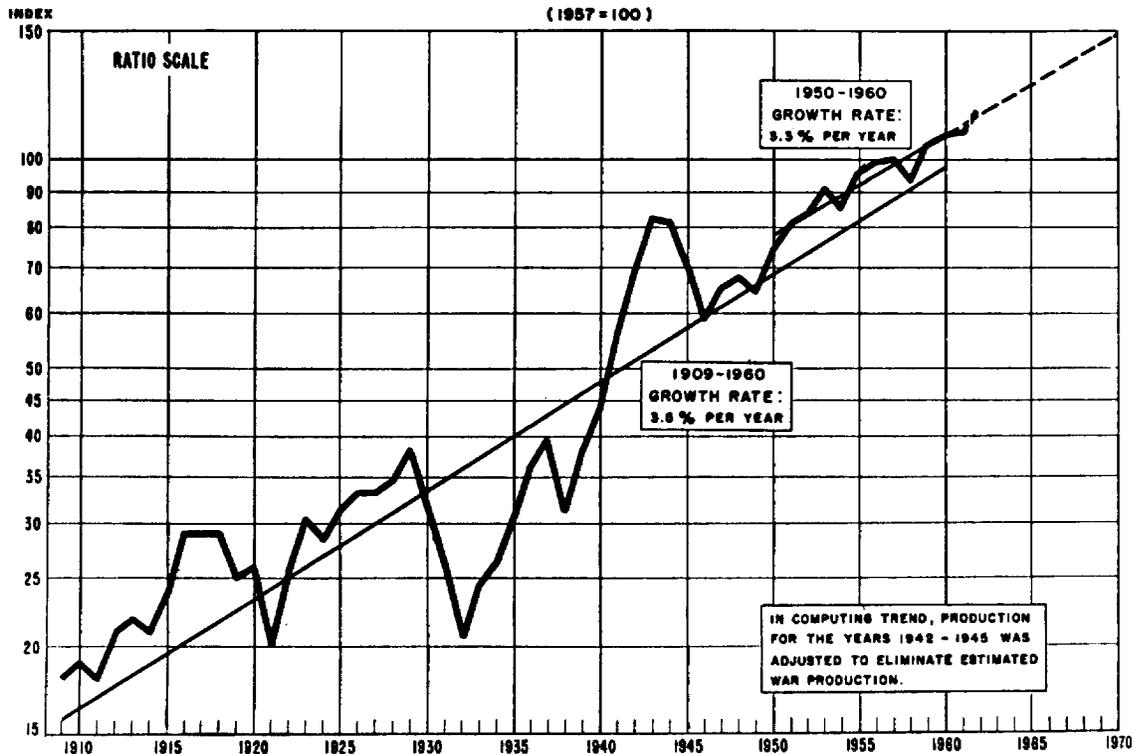
(Charts referred to follow:)

## GROSS NATIONAL PRODUCT: 1908-1961

( IN 1957 PRICES )



F.R.B. INDEX OF INDUSTRIAL PRODUCTION : 1909-1961  
(1957 = 100)



Chairman PATMAN. Our next witness will be Mr. James Wishart, research director of the Amalgamated Meat Cutters and Butchers of North America.

**STATEMENT OF JAMES WISHART, DIRECTOR, RESEARCH DEPARTMENT, AMALGAMATED MEAT CUTTERS AND BUTCHER WORKMEN (AFL-CIO)**

Mr. WISHART. I hope that my statement itself may be addressed to the question which the Senator from New York raised here, concerning the negative elements within the economy, which do give some cause for concern.

Conflicting trends mark both the state of the economy generally and of the industries in which the 370,000 members of the Amalgamated Meat Cutters and Butcher Workmen are employed.

In both the National economy and in our own industries, output recently has reached alltime high levels.

Seasonally adjusted gross national product running at a \$552 billion annual rate, industrial production now 17.8 percent above its 1957 base, and civilian employment peaking out in July at more than 69.5 million—all establish new high records of national achievement.

At the same time, cause for grave concern exists over the future. Even the record breaking \$552 billion of gross national product reported for the second quarter of this year falls far short of the \$570 billion level for 1962 and the \$600 billion rate for the first months of 1963 predicted by the Council of Economic Advisers.

The basic facts show that in the first half of 1962, the pace of recovery slowed down to a tempo substantially below any desired normal rate of national growth.

This is indicated by the table below showing quarterly gains in seasonally adjusted gross national product expressed in constant 1961 dollars.

	<i>Percent gain</i>
1st quarter to 2d quarter, 1961.....	2.1
2d to 3d quarter, 1961.....	1.3
3d to 4th quarter, 1961.....	2.9
4th quarter to 1st, 1962.....	.9
1st to 2d quarter, 1962.....	.7

This suggests a growth rate for the full year 1962 which could be even less than a 3-percent increase.

The pace of recovery from the trough of the recent recession compares with increases over similar time spans in two previous recessions as follows:

*Percentage gains in real gross national product (seasonally adjusted)*

<i>Period:</i>	<i>GNP increase (percent)</i>
1961: 1st to 1962 2d quarter.....	8.5
1958: 2d to 1959 3d quarter.....	10.1
1954: 3d to 1955 4th quarter.....	10.7

The wave of recovery seems to be cresting out and breaking even sooner than in these previous periods of recession. The present phase of recovery could be only an interlude between the recession of 1961 and the recession of 1963.

## THE EMPLOYMENT SITUATION

Recently released labor-force data, showing a seasonally adjusted unemployment rate of 5.3 percent for July, have been greeted as a reassuring high of continued recovery. The June figure had been 5.5 percent.

Officially counted unemployment in July totaled 4,018,000 as compared with 5,140,000 in July of 1961, and 4,968,000 in February 1961.

It is difficult to say how much these figures may be credited as straws in the economic winds.

However, to certify them as indicative of any basic solution to the national problem of unemployment goes beyond credence.

The character of that basic problem is suggested by the Bureau of Labor Statistics' labor force projections for 1962. On the basis of such projections, an increase in the Nation's labor force of 1,134,000 could have been predicted between 1961 and 1962.

In fact, by June of 1962, the total increase in the Nation's workers (including the Armed Forces) over June of 1961 amounted to 63,000. The civilian labor force, calculated with and without seasonal adjustment, actually dropped by more than 285,000 in this 12-month period. This means that, after counting those who went into the Armed Forces, more than a million workers who had been expected to join 1962's labor force were not, by the middle of the year, seeking any employment.

They are not, according to the official definitions, of course, included among the unemployed. Of that million or more workers who disappeared from labor markets, some were undoubtedly students who decided on more schooling, some were older workers who took advantage of social security retirement set at the age of 62, and some were housewives who had worked only on a marginal basis. A sizable fraction of this group were certainly involuntary withdrawals from the labor force.

The key fact, however, is that the Nation had no work to offer a million or more workers who, under normal economic conditions, would have been seeking jobs.

The key fact is that no employment opportunity existed for them, or seems likely to develop for the additional 1.3 million new workers who are expected to come into the Nation's labor force by 1963.

The cushions which operated in 1962 may not soon be available again. Students who continued schooling will presumably seek jobs some day. No expansion in Armed Forces manpower is now planned. No further reduction in the retirement age levels appears to have any serious congressional contemplation. New workers, for whom there are no jobs, may again be among the unemployed in statistics as well as fact.

Assuming a continuation of the present trends—a 3-percent growth rate and a 3-percent annual gain in labor productivity—in the year 1963, there will be no jobs for at least 2 million people who desire work, but are not now numbered among the unemployed. This would be, of course, in addition to those officially numbered, a total of roughly 4 million at the present time.

**Representative REUSS.** If I may interrupt, what would that work out in percentages of the work force unemployed?

Mr. WISHART. Just calculating very roughly, in the neighborhood of 7 percent.

All of this, as has been indicated, assumes continued recordbreaking progress in line with recent trends, and no economic downturn whatsoever.

This is calculated on the most optimistic basis. I might say also that the assumption of a 3-percent annual gain in productivity is a very conservative assumption, too, on the basis of present experience.

Recession, to which some indicators now point, would bitterly augment the totals of next year's unemployment.

#### THE KEY PROBLEM

The economy seems headed at vastly higher levels, toward an impasse of a type it has not faced in more than 20 years. Four million workers are unemployed. At least an additional million would be available for work, were work available for them at the present time. At least 15 percent of productive capacity is now idle.

And, I might say, this represents a minimum estimate. In my opinion, idle capacity runs to a far greater level than is suggested here.

Growth rates everywhere have tended to sag. Recent declines in common-stock prices suggest sharp doubt over the future and perhaps too firm a faith in the prospects for deflation.

Gains in plant and equipment investment have been under expectation. Private construction appears to be continuing at a vigorous pace, though observation in major cities suggests a soon-to-come surplus in high-rise, high-priced apartment units and luxury office space.

I might say that in the city of Chicago, one very eminent real estate man 10 days ago, withdrew from a major construction venture in the downtown Chicago area. He withdrew on the basis that this type of luxury office space construction was already a drug on the market, and there were some indications that the construction of high-rise, high-rental apartments had gone beyond any realizable market potential.

Certainly, recent declines in resale home values suggest a softening in the basic markets for housing. In some areas, the proliferation of supermarkets and discount centers has gone beyond the needs even of an expanding population for some years to come.

All of this suggests one thing all too clearly—that the onetime enormous pressures of postwar consumer demand have been sharply deflated. The total of consumer buying power—representing somewhere between 65 and 70 percent of the Nation's market—is now substantially less than the Nation's immediate power to produce. Buying power is even more dramatically dwarfed by the Nation's potential for giant expansion.

This is the root cause for the relative stagnation which has marked the course of the economy in recent years. The sweep of pent-up postwar demand, the imperatives of the Korean war period, the expansion of consumer credit, the impact of an enormous defense program—all these things have served, in the past 15 years, to accelerate the economy. None of these things can now promise any renewed impetus for vital new expansion. The key problem of 1962 is the shortage of buy-

ing power in relation to the vast potential for production of goods and services.

In view of this, tax concessions to corporations and more generous depreciation allowances seem doubtful tonics for the economy.

Industry faces no shortage of cash for expanding its power to produce, were it assured the markets to make such expansion profitable.

AFL-CIO estimates that such cash flow for American corporations (after tax profits plus depreciation allowances) will come this year to a total of \$51.5 billion. This compares with \$30.1 billion in 1953, and \$48 billion in 1961, as reported by the U.S. Department of Commerce. Cash flow was 8.2 percent of the GNP in 1953, and 9.3 percent in 1962.

Such a sum has been augmented by the Bureau of Internal Revenue's recent changes in depreciation rates for industrial equipment. Even before such sweetening, the rates were more than sufficient to meet the full dollar costs of industry plant and equipment investment at first quarter 1962 rates and provide for stockholders' unimpaired dividend levels. Industry has the cash flow, in other words, to maintain its full dividend rate and its full rate of plant investment without seeking a single new dollar of capital on stock or bond markets.

As of June 1961, Forbes magazine reported that—

Currently, General Motors treasury is all but overflowing with cash and Government bonds to the tune of \$1.6 billion. Of this, a probable \$1 billion is surplus cash by any ordinary standards.

Clearly, if General Motors made no major expansion in 1961, it was not for lack of available cash. Nor, considering its income accounts, was it for lack of profitability in its operations. The inhibitor to General Motors investment initiative could have been nothing other than the conviction that no expanding markets existed to justify, profitably, expansion of basic capacity.

#### GOVERNMENT INITIATIVE

The conditions of 1962 indicate that without massive and prompt Government initiative, economic stagnation may easily become our way of life. The conditions of 1962 suggest that Government has, in fact, been fighting a rapidly evaporating menace of inflation and at the same time giving tacit welcome to the currently live and deadly foe of deflation.

This is a major misallocation of strategic economic resources. The current economic situation calls for a speedy revision before our current momentum drops fully away.

Current practice is to fight for price stabilization, and to hope somehow that the problem of national growth will care for itself.

Sound practice demands that the first and primary battle be for national growth—and that all else be subordinated to this purpose.

Sound practice demands that the disaster of renewed recession, that the specter of mounting unemployment, that the spectacle of a great Nation unable to bend its full economic muscle into production be avoided above all.

The problem is difficult, requiring clear and perhaps "sophisticated" thinking. But above everything else, it is the responsibility of Gov-

ernment now to use every device at its command to create the preconditions of renewed economic progress. In relation to this, the fetish of a quickly balanced budget, the fraction of a percent of GNP represented by unfavorable international balances, and the canons of economic orthodoxy cannot be allowed to exercise a veto.

I might include in that group also the bankers of middle Europe. Chairman PATMAN. Thank you, sir.

Without objection, the tables accompanying your testimony will be inserted in connection with your remarks.

(Tables referred to follow:)

*Employment and unemployment 16 months after trough (seasonally adjusted data)*

[In thousands]

	Employment	Nonfarm employment	Unemployment	Unemployment rate
February 1961.....	66,723	60,922	4,968	6.9
June 1962 <sup>1</sup> .....	67,911	62,847	3,917	5.5
Change, number.....	+1,188	+1,925	-1,051	-----
Change, percent.....	+1.8	+3.2	-21.2	-----
April 1958.....	63,542	57,753	5,070	7.4
August 1959.....	65,794	60,103	3,696	5.3
Change, number.....	+2,252	+2,350	-1,374	-----
Change, percent.....	+3.5	+4.1	-27.1	-----
August 1954.....	60,589	54,242	3,858	6.0
December 1955.....	64,516	57,539	2,824	4.2
Change, number.....	+3,927	+3,297	-1,034	-----
Change, percent.....	+6.5	+6.1	-26.8	-----
October 1949.....	58,057	50,844	4,825	7.7
February 1961.....	60,494	53,402	2,166	3.5
Change, number.....	+2,437	+2,558	-2,659	-----
Change, percent.....	+4.2	+5.0	-55.1	-----

<sup>1</sup> Adjusted to 1950 census population base.

*Projections of total labor force compared with actual labor force*

[In thousands]

	Total labor force (including Armed Forces)		Deviation of actual from projected labor force	Period	Year-to-year increase in labor force	
	Projected	Actual			Projected	Actual
1955.....	68,896	68,896	-----	-----	-----	-----
1956.....	69,692	70,387	+695	1955-56	+798	+1,491
1957.....	70,681	70,746	+65	1956-57	+989	+359
1958.....	71,538	71,284	-254	1957-58	+857	+538
1959.....	72,505	71,946	-559	1958-59	+967	+662
1960.....	73,381	72,820	-561	1959-60	+876	+874
1960 <sup>1</sup> .....	73,687	73,126	-561	-----	-----	-----
1961.....	74,889	74,176	-713	1960-61	+1,202	+1,050
1962.....	76,023	74,532	-1,491	1961-62	+1,134	+356

<sup>1</sup> Includes Alaska and Hawaii.

Source: U.S. Department of Labor. Projections from 1960 forward differ from those published in "Population and Labor Force for the United States, 1960 to 1975" (Bull. 1242) to take account of (1) revised population figure shown by 1960 census and (2) to include Alaska and Hawaii; 1962 actual figures are 2d quarter civilian employment seasonally adjusted plus Armed Forces.

*Summary employment and unemployment estimates*

[Thousands of persons 14 years of age and over]

Employment status	July 1962	June 1962	July 1961
Total labor force, including Armed Forces.....	76,437	76,857	76,153
Civilian labor force.....	73,582	74,001	73,629
<b>Employed.....</b>	<b>69,564</b>	<b>69,539</b>	<b>68,499</b>
Agriculture.....	6,064	6,290	6,453
Nonagricultural industries.....	63,500	63,249	62,046
<b>Unemployed.....</b>	<b>4,018</b>	<b>4,463</b>	<b>5,140</b>
Seasonally adjusted unemployment rate, percent.....	5.3	5.5	6.9
Unemployed 15 weeks or longer.....	921	1,033	1,634
Unemployed 27 weeks or longer.....	576	584	1,026
Nonfarm workers or part time for economic reasons, total.....	2,674	2,630	3,011
Usually work full time.....	962	1,041	1,119
Usually work part time.....	1,712	1,589	1,892

Chairman PATMAN. Our next witness will be Dr. J. Frederick Weston, professor of economics, University of California, Los Angeles.

**STATEMENT OF DR. J. FREDERICK WESTON, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA AT LOS ANGELES**

Dr. WESTON. Economic data give strong indications that the business upswing which began in February of 1961 is now tapering off.

While the effects of the steel settlement and the stock market gyrations make interpretation difficult, there is no question that the rate of increase in business activity has slowed.

Since significant segments of spending are tied to the rate of increase in general business, rather than to its absolute level, volatile segments of spending are subject to sharp declines. Thus we approach the upper levels of a business recovery substantially short of the economy's full employment potential.

The repetition of an abortive business recovery calls for immediate action to alter the impact of what I would call the fiscal choke on the economy. The strong evidence that at full employment the Federal Government would run a surplus of over \$10 billion in its administrative budget calls for counteraction.

I therefore recommend a cut in the normal corporate income tax rate by 5 percentage points, and a decrease in personal income taxes by splitting the first bracket taxable income and halving the rate. This proposal is not made to counter an incipient recession. It is made to change the fiscal structure to remove some of the barriers to full employment growth.

While some may oppose tax reductions until unmistakable evidence of a decline appears, I offer three arguments against the policy of waiting: (1) Substantial professional judgment sees a basis for immediate action. (2) Waiting would require stronger action to counter movements of greater momentum. (3) And on this point I place the greatest weight: monetary policy is relatively tight because of international balance-of-payments considerations. Therefore relative fiscal ease is required to offset relative stringency in monetary policy. If subsequent events indicated that too much fiscal ease had been pro-

vided, monetary policy could be tightened further. This further tightening in monetary policy would be consistent with international balance-of-payments considerations.

This point I would like to emphasize very strongly, because you do not have to answer all of the horribly difficult questions in order to formulate policy. You simply have to develop the strategy that makes sense; and the strategy that makes sense under current conditions, if you have tight money policy, is certainly to move in the direction of greater ease in fiscal policy.

The major opposition to tax reduction is based on the fear that the prospective deficit would be increased; but this was the same argument used against a tax cut in the fall of 1957, and as a consequence, a deficit of \$12.4 billion in fiscal 1958-59 occurred. This was the largest peacetime deficit in U.S. history, and under an administration that put budgetary balance as a No. 1 economic objective.

It is ironical that a major responsibility for the large deficit must be charged to Senator Byrd. Because of his insistence on the rigid debt ceiling in the fall of 1957, the Air Force did not pay its bills for a period. These actions aggravated the weak economic conditions in the summer of 1957, and precipitated the decline. The resulting fall in Federal Government revenues produced the \$12.4 billion deficit.

We have the paradox that apparent fiscal responsibility had the effect of grievous fiscal irresponsibility. Let us not repeat the same mistake under the same arguments. Recasting the fiscal structure in favor of higher economic growth will diminish deficits, not increase them.

The central reason why a tax cut is called for stems from an historical accident. During the Korean war both the corporate and personal income tax rates were increased substantially to deal with the tendencies toward inflation that developed during the Korean hostilities. Those tax rates have never been reduced. As a consequence, since the inflationary pressures have subsided in the economy during the last several years, the fiscal structure that was developed to deal with the Korean inflation actually now inhibits the normal growth of the economy.

The current upswing is beginning to taper off with the economy significantly short of its full-employment potential. This is not a recommendation that the Government use its policies to prevent the economy from ever turning down. The factor that calls for action now is the realization that for the last several upswings the fiscal structure has been a brake on normal recoveries. As a consequence, reductions in taxes are called for, not simply to prevent a downturn, but to alter the fundamental fiscal structure.

A reduction in taxes is particularly called for because monetary policy has been stringent for the past several years in part because of balance-of-payments considerations. The Federal Reserve authorities argue for high interest rates so that money does not flow abroad in quest of higher earnings on deposits in foreign countries. Given that monetary policy is relatively tight and given that the fiscal structure has been inhibiting growth because it has been geared to a strong wartime inflationary economy, a reduction in taxes is essential.

We have the paradox that because our economy does not approach its full employment potential our Federal Government has been run-

ning deficits. Deficits occur because revenues depend upon a high-level economy, with corporate profits and personal incomes growing at vigorous rates. Therefore, the experience of the 1957-58 recession particularly emphasizes that a reduction in taxes, by taking the brake off economic recovery will bring in more revenues. Tax cuts will result in no deficits or smaller deficits than would be the case if tax cuts were not made and the economy did not achieve its normal recovery.

The central idea is that the economy suffers from a harsh fiscal policy growing out of the Korean war economy. The Federal Reserve System, concerned with the international balance of payments, has been pursuing a relatively tight money policy course. In order to offset this tight money policy as well as to release the harsh fiscal choke, a cut in taxes is necessary.

There is another element of the strategy. Because of this situation a rather substantial cut in taxes could be made, on the order of magnitude of \$10 to \$15 billion, to help avoid the repressive effects of fiscal policy on the economy. We have the additional strategic advantage in this situation that if at any point it appeared that fiscal policy were too easy (which is extremely unlikely), the Federal Reserve authorities could tighten monetary policy even further.

Also, the realm where monetary policy is particularly effective is in stopping a too vigorous rise in economic recovery. It is said that monetary policy is like a string—you can pull with it but you cannot push. Hence we are in the position where fiscal policy is so tight that the only thing monetary policy could be expected to do would be to push with the string, and it cannot. Whereas what we need to do is to change the fiscal relationship so that once again we are in a position to use monetary policy effectively in the way that it should be used. But what we have had for several years is both a tight fiscal policy and a restrictive monetary policy. Since the monetary authorities are likely to continue the tight money policy, fiscal policy must be eased in the direction of substantial tax reductions.

Chairman PATMAN. Thank you, sir.

Our next witness will be Dr. Daniel B. Suits, professor of economics, University of Michigan.

Dr. Suits.

Do you have a prepared statement, sir?

#### STATEMENT OF DR. DANIEL B. SUITS, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Dr. SUITS. I have only a manuscript statement.

Chairman PATMAN. That is all right, sir. You may proceed in your own way.

Dr. SUITS. My analysis and economic forecasts are based on the use of an econometric model of the U.S. economy. Essentially, this consists of a system of mathematical equations statistically derived from the interplay of the important factors in our economic life.

This system of equations has been generally described in earlier testimony before this committee, and a complete discussion of it, together with its past forecasting experience, will be found in an article entitled "Forecasting and Analysis With an Econometric Model,"

that I published in the March issue of the American Econometric Review. I have copies of these for the committee.

The forecast levels of economic activity for 1960, 1961, and 1962 are shown in table I.

(Tables I and II follow :)

TABLE I.—*Economic forecasts 1960, 1961, 1962*

[Figures, except as noted, are billions of 1954 dollars]

	1960		1961		1962
	Forecast	Actual	Forecast	Actual	Forecast
Gross national product.....	432.0	439.2	450.1	447.9	474.3
Consumption expenditure.....	287.1	296.8	304.3	304.3	318.6
Automobiles.....	16.7	15.6	14.6	15.5	18.8
Other durables.....	25.2	25.2	25.1	26.1	26.7
Nondurables.....	138.9	141.9	144.7	143.3	148.0
Services.....	106.3	113.7	119.9	119.4	125.1
Private gross capital expenditure.....	62.4	60.5	61.3	57.8	61.1
Plant and equipment.....	40.5	39.3	39.0	37.7	38.6
Residential construction.....	19.7	18.0	19.9	18.2	17.8
Inventory:					
Durable goods.....					2.6
Nondurable goods.....	2.2	3.2	2.4	2.0	2.1
Government purchase of goods and services.....	83.7	80.3	84.7	84.0	92.3
Net exports.....	-1.3	1.6	.2	1.8	2.3
Civilian employment (millions).....	65.5	66.7	67.0	66.8	68.9
Unemployment (millions).....	4.4	3.9	4.3	4.8	3.6
Percent of labor force.....	6.8	5.6	6.0	6.7	5.0

TABLE II.—*Changes in basic economic factors, 1960, 1961, and 1962*

[Figures except as noted are billions of 1954 dollars]

	1960	1961	1962
1. Government expenditures for goods and services:			
Federal.....	-\$0.5	\$4.4	\$7.5
State and local.....	3.6	4.4	3.9
2. Plant and equipment (producer durables plus other construction).....	3.4	-1.2	+2.1
3. Nonfarm residential construction.....	-1.2	.1	+4
4. Automobile demand.....	.7	-1.6	+3.0
5. Civilian labor force (millions).....	1.3	1.0	.9

Senator BUSH. This forecast is your forecast ?

Dr. SUITS. This is my forecast ; yes, sir.

Each of these forecasts covers the average for a calendar year and was prepared and presented in the preceding November, before the Conference on the Economic Outlook at the University of Michigan. Moreover, many of these forecasts had additional publicity. For example, the forecast of 1960 was placed in the record of this committee in the fall of 1959.

The general agreement between the forecast values and the subsequent economic events speaks for itself, but the important point shown in the table is the fact that there is nothing unusual or extraordinary about the present state of our economy. It is the result of the same underlying factors that generated the recession of 1960, and the recovery of 1961.

The most important of these factors are the level of government expenditure for goods and services, the expenditure of business firms for new plant and equipment, the volume of residential construction, and the behavior of the market for consumer durables, particularly automobiles, and finally, the growth in the labor force. The behavior of these factors is shown in table II.

The recession of 1960 can largely be traced to the slackening of Federal expenditure for goods and services. During calendar 1960, the Federal Government expenditure for goods and services declined by one-half billion dollars, and the State and local expenditures increased by a relatively small amount, \$3.6 billion.

These were combined with a decline in residential construction of about \$1.2 billion, and were somewhat offset by a rise in plant and equipment expenditure.

Despite the decline in activity in the fall, the average level of activity in 1960 stood somewhat higher than 1959, and indeed was almost adequate on the average to absorb the normal growth of the labor force; we experienced only a slight growth in unemployment.

The rapid recovery following the first quarter of 1961 was almost entirely the result of the sudden acceleration of U.S. defense activity. This is reflected in the enlarged rate of expenditure by the Federal Government. In contrast to the decline of one-half billion dollars in calendar 1960, the expenditure of the Federal Government for goods and services during 1961 increased by very nearly \$4.5 billion over the 1960 average. State and local expenditures were also somewhat higher.

Despite the rapid rate of recovery during this year, the average was insufficient to absorb the growth in the labor force, and the rate of unemployment rose to the level of over 6.7 percent.

For 1962 Federal expenditures are projected to rise by \$7.5 billion. This, coupled with a very substantial rise in automobile sales, has brought us to our current position.

The average level of GNP for 1962 in current dollars will be somewhat short of \$560 billion. But, combined with the low rate of growth in the civilian labor force, this will bring unemployment down to about 5 percent of the labor force.

The present state of the economy is the best it has been in many years. We are experiencing a record level of output and sales, and the proportion of unemployment this year will average less than in any year since 1957. Yet we are uncertain, uncomfortable, and even somewhat fearful. There is good reason for this.

The defense buildup is rapidly approaching its new steady level, and under present programs we can expect little further expansion from the Government sector beyond the continued growth of State and local services required by our growing population. The modest showing of profits, coupled with substantial existing unused capacity, promises no marked expansion of new plant and equipment expenditure. The present level of rental vacancy rates casts a shadow over the residential construction picture, and no one expects the automobile market to hold its own in face of the present rapid buildup in the number and quality of cars on the road

In view of these considerations, the apparent sluggishness of the recovery hardly comes as a surprise, and there is every chance of a downturn within the next 6 months.

But while the prospect of a downturn occupies the center of attention at the present time, it seems to me to be a secondary matter. The real problem is not so much the prospect of a downturn as the obvious fact that at the peak of a year of great prosperity we did not reduce unemployment below 5 percent of the labor force. This fact is underscored by the current abnormally low growth in the civilian labor force itself. Had the labor force grown by what I would consider a more normal annual rate of 1.2 million, instead of the projected 0.9 million, the rate of unemployment would be another half percent higher. Even at its best, the growth of production and employment has barely kept pace with the growth in the labor force. In the absence of action to the contrary, we may expect the level of unemployment in the next four quarters to again rise to over 7 percent of the labor force.

What accounts for this current sluggishness in the midst of prosperity? The answer is essentially this: The tremendous heritage of inflationary pressure from World War II made it essential to operate this economy with a tight tax brake, applied to control inflation. The defense buildup of the Korean period required the continuation of this tight tax brake. But the inflationary forces are now abating, and the brake is bearing directly on the level of production and employment. In my opinion, it is now time to release this brake and cut taxes.

The amount of tax cut required may be substantial. My calculations suggest that with the continuation of the existing level of Government expenditure, a cut in the personal income tax of \$10 billion would be expected to raise the level of employment by about 1 million jobs. Of course this means that in the traditional accounting definition, the Government will operate at a deficit, but the deficit will be substantially less than the \$10 billion of the tax cut. The expansionary effect of the cut itself will operate to recoup something in the neighborhood of 40 percent of the tax cut, and the so-called deficit amounts to only about \$6 billion.

I do not propose that a cut of this magnitude be made at once. So long as we are aware that larger tax reductions are probably necessary, we can ease off the brake little by little and find that point which is consistent with the maximum growth of the economy. In this way, we can use the fiscal power of the tax brake, together with the Government expenditure accelerator, for their proper purpose, to balance the growth of a prosperous American economy.

Chairman PATMAN. Thank you, sir.

Senator Douglas, we will start with you, and we will observe the customary 10-minute rule, if that is satisfactory with the committee.

Senator Douglas?

Senator DOUGLAS. I would like to start with a proximate issue, and not with basic issues.

The issue I want to ask about is the high incidence of unemployment among juveniles, to which Mr. Ellis referred, and which Mr. Wishart touched upon.

Mr. Ellis pointed out the percentage listed as unemployed among the age group of 14 to 19 years of age. I suppose it is true if you narrow the age grouping to from 16 to 19, this percentage would be even higher, would it not, Mr. Ellis?

Mr. ELLIS. Yes. The lower levels would be higher. I do not have them cut that fine, but the lowest levels are highest.

Senator DOUGLAS. Mr. Wishart made the point that there is a great deal of suppressed unemployment, or unemployment not shown, of people who would like to get work if work were available, but who, because they do not have employment records, as I understand it, are not included as part of the labor force.

Mr. WISHART. Because they are not actively seeking work. I am sure there are hundreds of thousands of individuals who are out of the labor market because their experience, their knowledge, has indicated to them that there is no work for them in the labor market.

Senator DOUGLAS. Do you not think that these are concentrated among the juveniles who have dropped out of school, and have not been able to find work, and are more or less drifting?

Mr. WISHART. That could be one large element.

Of course, another and more favorable side of the picture would be those juveniles who have continued in school, rather than going on to the labor market. But a substantial factor of this could be represented by the kids who are hanging around street corners. This is the sociological economic basis for juvenile delinquency, of which we have heard a great deal.

Senator DOUGLAS. Last year, of course, Dr. Conant made his study of slums and schools and, as I remember it, he estimated that there were a million boys and girls of high school age who were dropped out of school and were not at work. And I think every large city in the country knows what is happening as a result of this. The warfare which broke out on West 94th Street in New York City just a few days ago is connected with this.

Mr. WISHART. I should say this is a symptom of the unemployment picture.

Senator DOUGLAS. I understand. And, therefore, while the unemployment is concentrated, as Mr. Ellis says, in the juveniles, its incidence is extremely high among them.

Now, I think Conant's estimate of last year was on the whole a conservative one. Now, if you take the changes since last year—I have the economic indicators before me, and comparing June 1961 with June 1962, the increase in the labor force was only something like 70,000.

Mr. WISHART. That is correct.

Senator DOUGLAS. And that was the figure you gave. I was somewhat startled when Mr. Suits estimated the change in the labor force had been 900,000.

Mr. WISHART. This may have been on an annual basis.

Dr. SUITS. This was on an annual basis, yes.

Mr. ELLIS. Would you not still question that it will rise that much this year? It has not risen that much in the first 7 months.

Senator DOUGLAS. That is exactly right.

I think it is fairly clear that the economy has not absorbed these youngsters, the new entrants, who normally would have been absorbed,

during this last year, and therefore that the amount of nonstated unemployment is greater than when Conant made his estimate of last year.

**Mr. WISHART.** I should say also that the fact that this unemployment has hit more heavily the younger groups by no means mitigates its social seriousness or its gravity.

**Senator DOUGLAS.** Not at all. That is the next point I wanted to pass to: that, to my mind, this calls for a frontal attack on the problem of juvenile employment. It calls for the necessity of a revival of CCC, a beginning of job training on the job. It calls for the other features of the youth employment opportunities bill on a much larger scale than contained in that bill.

This, it seems to me, is the basic necessity. And I find it somewhat difficult to see how people are thinking of certain forms of communication at 3,000 miles distance with other portions of the earth, and neglecting the need for giving employment to the kids here in the United States of America.

**Mr. WISHART.** I might add this, Senator, that our studies of automation in the meatpacking industry have indicated that the primary impact of automation does not come on employed workers, except where a plant may be closed down. The impact is felt by the young people who are not hired in the first place, because their potential jobs have been taken over by new technology and new machines. And in farm communities this has been a very serious thing.

**Senator DOUGLAS.** In other words, the avenues of entrance are being closed?

**Mr. WISHART.** That is correct.

**Senator DOUGLAS.** Now, Mr. Ellis properly says that this incidence falls with greatest weight upon the young, the unskilled, the minority groups. Now, if you have all three of these combined in one set, a youngster who is unskilled, and who is also a member of a minority group—this means that it is intensified among them. I think this accounts in large part for the wolf packs which are organizing in the cities of the country, that it is really the most serious social problem that we have in the country, and it is an economic problem.

That is all I want to say, Mr. Chairman. That is the point I wanted to bring out.

**Chairman PATMAN.** Senator Bush?

**Senator BUSH.** Mr. Wishart, in your statement, you say:

But above everything else it is the responsibility of Government now to use every device at its command to create the preconditions of renewed economic progress.

What devices do you have, there?

**Mr. WISHART.** My understanding had been that we were not to present organizational programs, or specific listings of legislative proposals. However, I would include first of all a tax cut, lifting the burden of taxes, particularly on the lower income brackets, where a tax cut becomes immediate purchasing power, with volatility and circulation, to multiply its economic impact.

**Senator BUSH.** You would suggest that irrespective of any reduction in Government expenditures. Is that so?

**Mr. WISHART.** I would suggest that without reduction in Government expenditures.

Senator BUSH. Without any reduction in Government expenditures?

Mr. WISHART. That is correct, sir. I would suggest it as a means of shoring up essential purchasing power.

Senator BUSH. I did not quite understand this. Is there some inhibition about witnesses recommending relief, here, in the situation that we are talking about? Was there any advice?

Mr. WISHART. There was no absolute prohibition. I should go on to say that basic urban renewal, a more substantial investment in education, a more substantial investment, if I may use the controversial term, in medical care, all of these are essential.

Senator BUSH. Would you increase Government expenditure and at the same time reduce taxes, especially in the lower brackets?

Mr. WISHART. Yes, especially on the short-term basis. The question of the long-term balance of the budget I would say is perhaps another issue. But in terms of the immediate impasse, it seems to me that the Government responsibility here is to provide the lacking purchasing power, which Mr. Suits and others have indicated, along with my own testimony, is at the root of the present loss of acceleration in the economy.

Senator BUSH. So in your judgment it calls for increased Government expenditures along the lines that you said, and at the same time a reduction in taxes. What order of magnitude do you have in mind, there?

Mr. WISHART. This is a question which I have not studied. I am not in a position to give an authoritative answer.

Senator BUSH. Mr. Ellis, toward the end of your statement, there, you say:

I believe the current relatively low level of corporate profit rate on investment is a significant factor in the failure of employment to rise more rapidly than it has in recent years.

Would you care to expand on that a little bit, there?

Mr. ELLIS. Yes, Senator. I would be glad to.

We have to keep in mind that in this country most of the employment is private employment. It is not Government employment. And private employment depends on the outlook for profit. If the outlook for profit is good, the employer will make additional investment and hire additional people.

At the moment, and in recent years, in the last 5 years, as was mentioned by the gentleman over here, there has been a definite profit squeeze in this country, in the sense that it is becoming more and more difficult to get the profit rate up to a satisfactory figure or to find new things which, with today's costs and today's taxes, can be produced at a satisfactory profit.

Therefore, the effort to find additional employees has been somewhat blunted.

If the profit level were higher, if the opportunity to earn a profit were one of the objectives of the present administration, the stimulation of profit, I think you would find the level of employment rising.

We talk about the level of unemployment being 5.3 percent, but if you look, as I mentioned, at the level of the adult labor force, it is under 4 percent, and it would not take much of an increase in employment to reduce that to perhaps 3 percent.

We are not talking about very large magnitudes.

Senator BUSH. Why is the rate of profit declining? Why is it so disagreeably low, in your estimate? What are the principal factors that bring about that condition, which is so serious in your mind?

Mr. ELLIS. Importantly because costs have risen and are still rising, and foreign competitive prices are lower than prices in the United States.

The steel industry is an outstanding example. It is difficult to sell steel abroad at the prices that apparently are necessary in this country to make a profit on the steel investment. It is difficult to sell American automobiles abroad, with our costs.

Senator BUSH. What do you think we can do about that?

Mr. ELLIS. We must do what has been mentioned here at the table: Increase the productivity per man, and per man-hour, so that we can get our costs down and therefore our prices down to a competitive level. That is the ideal.

At least we ought to hold costs in this country, so that if other countries, as in Western Europe, for example, do inflate their prices, it would be to our advantage.

Senator BUSH. Do you think American industry is doing a pretty good job of holding costs in line now?

Mr. ELLIS. Steel wage rates recently went up. Other wage and salary rates are rising. Social security taxes are going up the first of the year. State and local tax rates are rising. Transportation costs are rising. Postal rates may be raised. A lot of costs are still rising. In construction, for example, it may be that one of the difficulties with construction is the very high level of cost of construction. I think this committee has heard frequently about the difficulties caused by rising residential construction costs.

Senator BUSH. Principally in high costs of labor. Is that right?

Mr. ELLIS. Well, basically labor, because most costs are labor costs.

Senator BUSH. In construction?

Mr. ELLIS. In everything. Most costs of production are labor costs. By labor I do not mean wages only. It includes salaries. It includes the research people. It includes the sales people, the clerical people, everybody. Payroll is the primary cost item in anything.

Senator BUSH. What do you think is needed to sort of bring the realization of this thing home to those in authority? What do you think can be done about it to help us stabilize this cost situation?

Mr. ELLIS. We need to recognize the function of profit in the American economy. Profit is the stimulator in the American economy. If we had the acceptance of that fact, rather than the attitude that frequently prevails—that profit is a nasty word—the American economy would grow faster. To put it bluntly, if the administration would come out for a satisfactory rate of profit, I think businessmen would increase the purchases of capital equipment and their employment.

It could not be done overnight. It is not something sudden. But I think that is the direction in which we have to go. We have to recognize that the American economy is a profit-stimulated economy; not a Government-stimulated economy.

Senator BUSH. You do not feel that the business authorities have a sense of real security in the attitude of their Government toward this important point. Is that right?

Mr. ELLIS. That generally is correct; yes. I do not get the impression that the administration is in favor of seeing profits rise. They seem to apologize for them, when profit rates go up.

Certainly there is no outstanding program that would stimulate a profit rise. When businessmen come to Washington to talk about profit, the reception is not very favorable.

Senator BUSH. I would like to ask the gentleman from Michigan one question if I still have the time.

You spoke about the gradual release of the tax brake. Would you amplify that a little bit?

Dr. SURRIS. By this I mean, sir, that I am not certainly sure myself how large a tax reduction would be needed to stimulate the demand that I think is needed for the growth that we ought to get from our economy. I would recommend, therefore, that we proceed with reasonable caution, but with all due dispatch.

I would suggest, therefore, a tax reduction in the neighborhood of \$5 billion. I do not believe that this is adequate for the purpose but I proposed reducing a little at a time. If this \$5 billion proves to be inadequate, we should follow with another \$5 billion.

Senator BUSH. With the prospects of a tax reform bill, a general sweeping reform of our whole tax structure, being fairly good, I think, for next year, do you think we ought to release the tax brake, as you say, right now, rather than wait until we can do a comprehensive overhaul job on our tax structure in the light of extensive studies by the Treasury and by the House Ways and Means Committee?

Dr. SURRIS. This is, of course, a problem of political procedure in which I am by no means competent.

Surely, if we could, tomorrow, bring in a completely reformed tax structure, with generally reduced tax rates, this would be something that everyone would be in favor of. But we must probably wait a year for a tax reform bill to get through hearings and through the Congress. I would think it would be better to proceed at once to reduce taxes within the context of the existing tax structure and then make the reform later within the new level of rates.

Senator BUSH. My time is up.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Mr. Chairman, all the witnesses appear to agree that this country's rate of national growth has continued at the unsatisfactory 3-percent rate which it achieved during the 8 years of the Eisenhower administration. I commend our Republican colleagues for being alarmed about this, and I join with them in thinking that this merits consideration by the Joint Economic Committee.

I would like to call the attention of the panel to the July 1962 issue of the U.S. Department of Commerce publication, *Business Cycle Developments*. I think you all have a copy in front of you.

The leading indicators shown on page 5 have turned downward in the last month or two. The average workweek has gone down. The rate of new hirings in manufacturing has gone down. In all industry, it has gone down. The layoff rate is higher. The average weekly unemployment compensation claims have increased.

I notice that these changes also preceded the 1949, 1953, 1957, and 1960 recessions. I am disturbed at the similarity in the movements

of the leading indicators to those which occurred before previous cyclical downturns. I'd like your opinions.

Mr. Ellis?

Mr. ELLIS. Gentlemen, I think you have to accept the fact that our economy fluctuates. Sometimes it is rising. Sometimes it is falling. When it has risen to a peak, it is likely to go down rather than up.

I think there is entirely too much discussion of the fact that we have business fluctuations in this country. Do you expect to eliminate business fluctuations? Is that the ideal?

Dr. WESTON. I think the fact that causes concern, however, is that as we approach this business cycle peak, we still have very high excess capacity in the industry.

Now, one can argue about the unemployment rate, but there is no question about the high excess capacity, high unused capacity. And I think the thing that causes alarm is that we have reached our turning point far short of using our national potential.

And this particular point suggests that probably an increase in the rate of the economic growth would do more for corporate profits than any single Government action. There is clear evidence that corporate profits are a function primarily of rate of capacity utilization, and the greatest increases in productivity you obtain when you are utilizing capacity to a high extent and spreading relatively fixed costs over a much larger rate of output.

Representative REUSS. I am sure you would not disagree with this last point, Mr. Ellis.

Mr. ELLIS. I would not disagree. But I would point out that businessmen spend a great deal of money on developing new products, on sales forces, and on advertising to do just what the gentleman mentioned. If someone has a plan to increase sales volume, I certainly would like to hear about it.

Dr. WESTON. Well, I think the answer there is the difference between a microeconomic approach and a macroeconomic approach. When the general level of business activity is declining, all the efforts on the part of individual businessmen are likely to come to naught. Income elasticities of demand are going to be pretty substantial, and particularly in a producer goods industry, such as Mr. Ellis' industry.

Certainly the individual businessman would like to do everything in his power to help contribute to economic recovery, and I think he can make some contribution. I do not say this is a job entirely for Government. But it seems to me that the central fact here is that you have a fiscal system now that does put a brake on recoveries, as Professor Suits described it. And in that total environment, particular efforts come to naught. You have to get at the fundamental cause.

Mr. WISHART. The individual businessman by investing in advertising does not create any new purchasing power. He may succeed in taking a share of the consumer dollar from another manufacturer. But in terms of the total economic system, he creates nothing new in terms of expanded capacity.

Mr. ELLIS. I would question that statement. But let us look first at this matter of capacity, which receives a great deal of attention. The Du Pont Co. has some excess capacity. In the case, for example, of viscose rayon yarn, we built it 30 years ago. It was very good

capacity at that time. The world has moved on. We have developed some new synthetic fibers that do a better job than viscose rayon did. But we still have maintained some of that viscose rayon capacity in operating condition.

Now, gentlemen, where did we make a mistake? We have excess capacity here, but only because the world is moving on. We have developed something new, something better.

Dr. WESTON. Would you say that the largest proportion of existing excess capacity is represented by technological obsolescence, or even a significant portion?

Mr. ELLIS. Yes, a significant proportion is. But, gentlemen, do not use the 100 percent of capacity as your ideal operating rate. Do not assume that we always should be operating at 100 percent of capacity. We are operating at about 85. Ninety would be a good figure. If we get much above 90, we start to build more capacity.

It takes 2 years to build a large plant. Suppose we decide this year that demand for our products in 1964 will be enough to absorb more than 90 percent of our present capacity. Then we had better get started building more capacity.

Our excess capacity in this country is not very large in total. Even in the steel industry, is not some of that excess in steel in a sense a defense reserve? Suppose we got into a shooting war. Would we not need that apparent excess capacity in steel? Is not some of the other excess capacity in a sense a defense reserve?

We ought to have a little leeway in capacity, even in normal commercial operations. We do not shift easily from one item to another. We may overestimate the demand here. We may underestimate it in another product.

Representative REUSS. Would you carry this argument to the point of saying that the 17 or 20 percent of our young people around 20 years of age who are now unemployed are a necessary soil bank?

Mr. ELLIS. No. But a lot of that 17 percent are boys and girls living at home looking for summer jobs. They are not looking for full-time work. Should we reorganize the economy so that every boy who wants a job cutting grass can find it or every boy who wants a high-income job can find it before he goes back to college?

Representative REUSS. Let me say that this committee takes seriously its mandate under the Employment Act of 1946, which says that it is the goal of the United States to have maximum employment, production, and purchasing power. And this means that, to the maximum extent possible, we do try to iron out extremes in business cycle movements. This view is shared by Republicans and Democrats alike. That is why the Republicans asked for this hearing.

Mr. ELLIS. I would question that statement, gentlemen. I think you are getting on very dangerous ground if you put as your idea a smooth, steady growth with no fluctuations.

Representative REUSS. I did not say "no fluctuations."

Mr. ELLIS. That is the business cycle. Remember, gentlemen, the business decline in the spring of 1961 was the mildest we have had in this country since 1926. That was not a very serious fluctuation. Now, if you mean to eliminate things like that by pouring in massive Government spending which is financed by selling securities to the

commercial banking system, I think you are presenting a dangerous ideal.

If you can sell securities to savers, that is something else. But I am not in favor of massive Government spending to iron out that kind of fluctuation.

Representative REUSS. I believe we must remember that we are not talking of fluctuations around a rapidly rising upward trend in the economy but those which have occurred at a time of inadequate long-term growth.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Gentlemen, I see a full debate shaping up right here, and I would like to state it.

Mr. Wishart, who represents one point of view, says the key problem of 1962 is the shortage of buying power in relation to the vast potential for production of goods and services.

Mr. Ellis, at the other pole, says the rate of profit on investment is still relatively low. And being in management, he naturally understates, whereas Mr. Wishart says it right out. But I think we get the point.

Now, what I would like to ask you gentlemen: Are these two ideas, which do represent the debate this fall, perhaps even the political debate between the parties—are they mutually exclusive?

If I may just finish my question: In other words, is the only thing we can do, according to Mr. Wishart, to get more urban renewal, pass aid to education, win for medical care, pass, as my distinguished colleague Senator Douglas says, the Youth Opportunities Act? And that will do it?

Or must we go with Mr. Ellis in a mutually exclusive way, and say, "Let's put a roof, not in law but in national climate, on wage increases and price increases, and let's give a real boost to automation, and let's go to town with giving business the expectation of more profit"?

Are these mutually exclusive?

Mr. WISHART. Might I say this: The increase of purchasing power which would expand industry's markets is by no means inconsistent with a certain profit return to industry. In fact, in my opinion the profit squeeze, about which we have heard so much, reflects primarily the underutilization of equipment. The cost of equipment, the cost of research and development, the cost of the sales force, the cost of the salaried personnel, does not decline with the drop in production. That cost remains relatively fixed.

The wage cost does go down in relation to production cutbacks.

So that the way out of the cost squeeze does not lie along the avenue of a wage freeze. The way out lies along the lines on which we have been talking here, the increase in purchasing power, to make it possible for industry to operate at something close to a desired level of capacity utilization. I think industry generally is quoted as saying that 94 percent is roughly the preferred level of operation.

I might add also that in my opinion the deterrent in business investment policy—and here, obviously, I am not speaking from the inside—the deterrent on investment policy is not profit as such, but the estimate of the market, the estimate, in other words, of the available buying power.

Obviously, Du Pont and General Motors are not going to build new plants if, in their opinion, the products of those plants cannot be sold. If the market demand for that output does not exist, the new plants are not going to be built, no matter how profitable current operations may be. And a move simply to jack up industry profits will have no long-range multiplier effects in reviving the economy as such.

Senator JAVITS. I would like to have Mr. Ellis's view on that. I would like to add to my question for him, which is the same question as for Mr. Wishart, that he owes us an explanation of why the forceful administration action on the steel price increase is said to have shaken business confidence more severely than even what he considers an inadequate rate of profit.

Mr. ELLIS. Let us take, first, this idea of purchasing power.

Gentlemen, it is a myth that there is any source of purchasing power that can be poured into the economy. Where do you get the purchasing power? Does it not come from the sales dollar? If you sell a product, some of it goes to pay salaries, some goes to wages, some goes to research. It all gets distributed. Is not income generated by production?

I think it is very easy to imply that what we need are massive injections of purchasing power, without saying where it is to come from. Where is this purchasing power to come from? If Europe would give us massive doses of foreign aid, of course we would be prosperous. There is no hope for that.

Purchasing power must be generated by production. There is no other place to get it. Temporarily, of course, you can supplement it by bank loans, which presumably get repaid later, and the same purchasing power then is withdrawn. You cannot rely on bank credit to provide large amounts of purchasing power, nor can you rely on printing dollar bills.

Senator JAVITS. Or Government appropriations—is that not right? You would add Government appropriations to that. It is still production that makes—

Mr. ELLIS. I would consider the receipts side rather than the expenditures side. You cannot consider selling Federal securities to the commercial banking system as providing purchasing power.

I agree with the gentleman on my right, who had a very specific statement. It would be fine if the total growth rate of the country, the total output of industry and finance, insurance, and real estate, wholesale and retail trade, could be expanded. That is why I stress this 3-percent growth rate in the physical volume of the gross national product. We are expanding at that rate. I would like to see it faster, but I do not know of any small changes that would give us a faster growth rate. If you want a faster growth rate, significantly faster, then you have to make some major changes in the economy, improve the educational level of the labor force, particularly these young people, 14 to 19 years of age.

It takes a long period of training to do that. You do not do it suddenly. Also increase the productivity, reduce the cost, so that we could sell a wider volume of goods.

But I would also call attention to the fact that while personal consumption expenditures do account for two-thirds of the gross national product, there is another third. What about new construction? If

it is not profitable, it will not be built. What about producers' durable equipment, that is, the machinery used in production? If it is not profitable, it will not be bought. What about changes in business inventories? If it is not profitable to accumulate inventory, businessmen will not do it.

Let us not confuse the purchasing power of the American economy with the purchasing power of individuals. That is part of it. That is the bulk of it. But that is not all of it. Businessmen also spend large amounts of money in our economy.

That is why I like the Joint Economic Committee presentation of the gross national product. It shows immediately the pattern of spending, the relative importance.

In that pattern, of course, you have government spending—Federal as well as State and local. State and local spending is rising, has risen every year since 1941, will continue to rise, should continue to rise. That is primarily spending for roads and schools and public welfare, goods and services provided for people. There is no serious problem there. There is not much objection to tax rates there.

I also call your attention to the suggestion, with which I strongly disagree, that all we need to do is to make our personal income tax rates more progressive and you improve the outlook for the American economy. I think the current very high progressivity is one difficulty, as the gentleman on my immediate right has suggested. It is providing a tax brake. At some levels, you take 91 percent of a portion of income. Now gentlemen, reducing the first bracket tax is not going to help that upper income recover very much; it is not going to make him interested in contributing for college construction or investing money in new ventures, for example.

I think our personal income tax structure is very restrictive, especially because of the nearly confiscatory rates at the top. If you consider permanent tax reduction, I suggest that you do it across the board, for the reason that we ought to loosen restraint on the sources of saving in this country. It is not only purchasing power. We also have very large amounts of spending financed by investment funds, from savings for consumption spending that concerns us. There should also be substantial reductions of corporate income tax rates, and some reductions in Federal spending.

Senator JAVITS. Mr. Ellis, thank you very much.

My time is up, but I would like to make a statement before I yield my turn. I may not be here later.

I think one thing you gentlemen have not dealt with is one of the causes for our dissatisfaction with the 3-percent growth rate. It is not enough to sustain our world obligations, and our world responsibilities, as shown by our balance of payments, which is, as it were, the thermometer of our temperature. And that shows that we are fine if we were not giving foreign aid, if we were not maintaining large military forces abroad, if we did not have the world responsibilities we do.

The second thing I would like to lay upon this record is this: You have all agreed pretty much on a tax cut; yet a tax cut itself is nothing but a shot of adrenalin. None of you have told us, in my view, except possibly Mr. Wishart, with his thesis that we need Government programs—none of you have told us how you essentially deal with the American economic problem, which is a problem of automation, a

problem of foreign trade and investment, as well as a problem of domestic improvement.

After all, the growth potentials in our country apparently are now limited, and we have got to look to the world in order to give the American economy the new plateau upon which to stand, in the world and in science. And these are the things I would hope, as we go along in these hearings, may be developed.

Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Before I ask Mr. Weston about his very provocative reply to my challenge on monetary policy, I would like to say I am delighted to see so much of this discussion revolving around excess capacity. Our Statistics Subcommittee of this committee held hearings, and we have just filed a report. I put the report in the Congressional Record only yesterday, the recommendations from the report.

I think this would be an extremely useful area for further exploration. The data on statistics on industrial capacity is very unsatisfactory, very incomplete. We have some fine people working on it, and they are doing the best they can, but we have a long, long way to go.

And this is one of the reasons why I feel that we cannot make decisions as confidently or as surely or as effectively as we should because we just do not have the statistics necessary for them.

And I would like to ask, Mr. Weston—

Dr. WESTON. I was just going to say that although there is quite a bit more work to be done on measuring capacity utilization for purposes of comparison all you need for judgment in a situation like this is to compare the measures of capacity utilization in this recovery with previous recoveries.

And although as absolute measures the measures may be imperfect, the measures themselves have not fundamentally changed in their concept and techniques. And when you compare the degree of capacity utilization in this recovery with previous recoveries, it falls significantly short.

And it does not have to fall very much short to have a significant negative impact on the profits, because with a higher degree of fixed costs, now, as a percentage of total cost, a smaller decline from some norm of full capacity utilization will produce a much more repressive effect on profits.

I just wanted to make that point.

Senator PROXMIRE. Yes. Well, I do not want to get sidetracked.

We have an excellent chart in the Economic Report on page 55, showing the distinct, direct, constant relationship between capacity utilization and corporate profits. There is just no question about it.

At the same time, I think that much of what Mr. Ellis says is true, that 90 percent seems to be the optimum level.

There is about the same degree of excess capacity that there is of unemployment.

But let me get into this right now, because I think this is so crucial and so important.

You seem to share the view that we should not put on fiscal brakes, but you seem to think that we should put on monetary brakes, slowly, gradually, but we ought to put them on. You say that monetary policy is relatively tight because of the international balance-of-pay-

ments considerations. You go on to say this further tightening in monetary policy would be consistent with international balance-of-payments considerations.

Now, the two people in the country who are perhaps most responsible for monetary policy, particularly in relation to balance of payments, are Mr. Martin, of the Federal Reserve Board, and perhaps Mr. Roosa of the Treasury Department.

Mr. Martin earlier this year, in response to a question from this committee, said this with relation to this very question:

Interest rates are necessarily a factor affecting the movement of funds—short term and long term—between the money markets and capital markets of developed countries. There is, however, no invariable relationship between relative interest rates in such markets and capital movements. While interest differentials can be an important factor in movements of capital, other factors also exert a conditioning influence. These other factors include the availability of credit, the supply of credit instruments of ready marketability, the demand for credit for borrowers of good standing, and—of predominant importance at some times—expectational and confidence factors.

Capital movements are sometimes viewed in the narrow context of funds seeking liquid investment in prime market paper of short maturity. The differences that existed last year between money rates here and abroad on this kind of paper do not appear to have been a primary determinant of international movements of funds of this type.

Mr. Roosa has said almost the same thing. He also indicated that interest was not a highly significant factor in balance-of-payments considerations.

Mr. Gemmill, a very distinguished economist with the Federal Reserve Board, in an article I just put in the Congressional Record recently from the Journal of Finance, said exactly the same thing, only with more emphasis, saying that this was not very significant.

I notice that the statistics show that our interest rates are already substantially higher than they are in Germany, higher than they are in the Netherlands—and these are short term rates, which are most important—higher than they are in Switzerland.

And on the basis of all this data, it seems to me that to rely on international balance of payments as the only alibi for higher interest rates when we know that this does exert a restraining influence on the economy, is inexcusable.

And when the economy, as you testified so well, and everybody here has, is not moving fast enough, is not growing, and we have unemployment and excess capacity—it just does not make sense.

Now, how do you justify it?

Dr. WESTON. I think you misunderstood my statement. I was not advocating higher interest rates.

What I was saying was this: that I am talking to the Joint Economic Committee of Congress. And Congress, under our traditions, does not control monetary policy.

Senator PROXMIRE. Oh, bless you for saying that. And we should. The Constitution gives that power, as you know, in article I, section 8. And this is something we ought to stand up and insist on.

Dr. WESTON. Why do you not do it, then?

Senator PROXMIRE. I am glad you said that, too. The Federal Reserve Board is our creature. They are accountable to us.

Dr. WESTON. Being a practical person, I look at the facts of life, and I say that over recent years you have not exercised this preroga-

tive of yours. And so I address myself to the realm of powers which you do have, and which you have exercised, and this is in the realm of fiscal policy.

Senator PROXMIRE. Do you feel we should exert this influence?

Dr. WESTON. Let me take one point at a time. Let me clarify my basic position, which is that the kind of monetary policy that we have had has been relatively tight. When you refer to the circumstances of last year and say that very little of capital movement was due to differentials in interest rates, this would certainly be true for last year, because our short-term interest rates were relatively high.

Senator PROXMIRE. They are higher, now.

Dr. WESTON. All right. What I am saying is that given this external factor over which you have chosen up to this point not to exercise control, given relative monetary stringency, then in the area in which you have presumably the power and have historically acted in the area of fiscal policy, certainly you should act here.

Senator PROXMIRE. Let me say: Is it not true that historically, speaking now of the Government as an entity, the Government has acted consciously at least more with regard to monetary policy than fiscal policy? Fiscal policy is a relatively new tool of stability. For the last 40 years at least we have had a conscious attempt on the part of the Government to influence the economy through controlling the supply of money. But the fiscal policy, tax-cut notion is a very new notion, and from the Gallup poll and other indications the public does not accept at all that we should use fiscal policy.

This is a radical new idea, that you should deliberately create a deficit, and particularly in a time of relative prosperity—lower taxes and increase spending or maintain spending. That is something it seems to me that is quite radical; as compared with the far more conservative notion that when conditions do not look so good you ease up a little bit on credit.

And I am not asking for pegging bonds at par. I am simply asking for a little easier credit; not having just \$300 million worth of free bank reserves, but \$500 or \$600 million.

Why is this not a more traditional and a more conservative approach? And also from what you are saying—and tell me if this is not true—if we did not have this tight money policy, you would not need as big a tax cut? Is that not what you are telling me? That because we have a tight money policy, you are going to need a bigger tax cut than you would have to have without it?

Dr. WESTON. That is correct.

Senator PROXMIRE. Therefore a bigger deficit than you would have without it?

Dr. WESTON. I would disagree with the bigger deficit. I think it is questionable whether you would have a larger deficit if you had a tax cut.

Senator PROXMIRE. No, no. I am not talking about that. You indicated we have about a \$6 billion bigger deficit with a \$10 billion tax cut. But I am not talking about that.

Dr. WESTON. That was Professor Suits. I would feel that the dynamic consequences of a \$10 billion tax cut would substantially eliminate the deficit.

Senator PROXMIRE. It was my fault. I should have emphasized: I am saying you will need a bigger tax cut if you have higher interest rates.

Dr. WESTON. Yes. That is absolutely true.

Senator PROXMIRE. In order to do the same job?

Dr. WESTON. Certainly.

Senator PROXMIRE. And the higher interest rates do restrain employment? They do restrain expansion?

Heaven knows in the construction industry, it is just as clear as the nose on my face that between 1955 and 1957, when we had an increase in income, an increase in population, a big increase in family formations, in spite of all this housing starts just nosedived—because the interest rates were climbing. And here is a tremendous area of employment.

Dr. WESTON. Yes. But given that we are near the top of an upswing, the ability of monetary policy to stop a turn is questionable. This is why I argue for moving in the realm where you do have authority, in the realm of fiscal policy.

Yes, I would agree to ease up on the monetary side, also. But on this you have exercised no control. Ease up on fiscal policy, because this has the greater power to stop the downturn.

Senator PROXMIRE. My time is up. I just want to say that I think we have all the control in the world, far more as a matter of fact, over monetary policy than we have over fiscal policy. All we need is the resolution to exercise it.

Chairman PATMAN. I want to interrogate the panel after Mr. Widnall, but first I would like to congratulate you, Dr. Weston, on reprimanding Congress for failing to assume its constitutional monetary powers.

Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

I will ask this question of the entire panel.

If an immediate tax cut is enacted, should it be limited as to length of time?

Dr. WESTON. I would say no, because certainly my basis for recommending the tax cut is not for the cyclical problem, but for the fiscal structure problem.

Structurally, the taxes just levy too large a burden on spending power.

And incidentally, with regard to where you provide the tax cuts: While it is true that we have very high rates on high incomes nominally, it is questionable as to the extent to which our personal income tax program is de facto progressive. Look at the facts; taxable incomes over \$20,000 a year account for only 26 percent of the total revenues, of the revenue system.

As Prof. Henry Simons so aptly put it, we dip deeply with a sieve in our personal income tax rate, and it really does not make too much difference. The Harvard Business School studies of effects of the progressive personal income taxes on incentives have very clearly concluded they did not have negative effects on incentives.

And this is why I argue that if the structural problem is inadequate spending, you do it at the low end of the scale. You cut taxes there.

Representative WIDNALL. Am I right in stating that none of you have advocated an increase in exemptions on the income tax?

Mr. WISHART. I would certainly argue for an increase in exemptions applying with major impact, of course, on the lower brackets.

I think it is interesting that if you apply the cost-of-living index to the \$600 exemption, you will find that in constant dollars, the \$600 exemption is now about a \$480 exemption; that even the 1948 exemption, in other words, is no longer effective in terms of the real buying power of the lower bracket family.

Representative WIDNALL. Is it your thought that you should not only have an increase in exemptions, but also a decrease in the rates?

Mr. WISHART. Yes.

Representative WIDNALL. Particularly in the lower brackets?

Mr. WISHART. Yes.

Dr. SUITS. I think I would differ with that. Our personal income tax as it stands is an immensely complicated thing to administer, and it is a terrible nuisance for a person to fill out. We very badly need reform in the entire structure of the tax.

I should certainly not—and this comes back to Mr. Bush's question—want, in connection with an immediate tax cut, to run counter to the longrun need for tax reform. I think this would be a step in the wrong direction.

Personally, I think it would be politically expedient and economically efficient to think in terms of some kind of an across-the-board cut that would yield \$5 billion reduction in tax revenue at our current level of employment and income.

Representative WIDNALL. You all agree, then, that there should not be any specific length of time. It would be permanently effective?

Dr. SUITS. That is correct.

Mr. ELLIS. I would support that position. I think the current business level is sufficiently high that we should not stimulate the economy at this level. If at some other time it is not satisfactory, you might do that. But I think there is extreme danger in the Federal Government taking the position that they will determine the level of income, they will reduce tax rates over short periods and then they will put them back up again.

I think the Federal Government should reduce the magnitude of its spending, rather than increase it. I would not be in favor of a quickie or temporary tax cut. I would be in favor only of basic reform in tax rates. And I think that would take at least until the 1st of January.

Secondly, I do not think the economy now needs a quickie tax cut. I think there is danger of implying that we can set the level of growth at anything we want by just changing tax rates a little bit in a mild recession and putting them back at some other time. You gentlemen know how difficult it is to raise tax rates. It would never be appropriate to put them back up.

Let us have basic tax rate reform, and not use tax changes as a regulator of the economy.

After all, businessmen have to make plans for several years in advance. We would like to know what the conditions are going to be 5 or 10 years from now. What will the tax rate be then?

Let us not use tax rate changes as a minor adjusting factor. There are too many factors to consider now in business investment. Do not add any.

Dr. WESTON. I think it should be pointed out in this connection that not to take any action at all is a policy matter. The fact of life is that the Federal revenue system now accounts for something like 20 percent of gross national product. This means that even if you do not make any change, there is a significant impact, and it is a policy decision in effect to say that what we have is the correct thing.

Now, among all of the multitudinous things that can affect business decision making, technological change, and so forth, changing the structure of taxes on the side of easing up on the fiscal brake should pose few problems for business planning. In the first place, it is a favorable change for business. In the second place these changes are so infrequent, so episodic, that compared to the many other uncertainties that business faces, you certainly cannot use this as an argument against a tax reduction.

Mr. ELLIS. I was using only the argument against a quickie tax reduction which may be for a short time. I am very much in favor of permanent reform.

Mr. WISHART. I might add to that the concept of a quickie tax reduction, even a temporary one, on a countercyclical basis, is one which has great support.

For example, in a period of declining employment, or in a period where recession may be threatening, a \$100 deduction of Government tax withholding would I think have a strongly stimulating effect. It can be used as a short-term offset.

Dr. WESTON. I would add that a permanent tax reduction enacted promptly is not a quickie.

Mr. ELLIS. No, I was thinking of a reduction which would be rescinded at some time in the future. That is what I meant by a quickie.

Dr. WESTON. We were certainly proposing a permanent reduction.

Mr. ELLIS. Yes. One without a time limit, then.

Dr. WESTON. Without a time limit, and done promptly.

In this connection, it should be pointed out that such a great need for tax reduction exists that a tax cut now does not rule out the need for another tax reduction at the time the tax reform proposals come before Congress. The present proposals for tax cuts would so stimulate the economy that the revenue loss would be very small. Tax cut measures with initial cuts totaling at least \$10 billion could well accompany the tax reform proposals.

Representative WIDNALL. We have heard much recently about budget deficits promoting prosperity. Now, in fiscal 1961 and fiscal 1962, we have budget deficits, and we are going to have one in fiscal 1963. Why has the economy been so sluggish, then, that we have been incurring deficits?

Dr. WESTON. It is the difference between a deficit incurred passively, and one incurred actively. When a deficit is incurred passively, because of lighter economic growth, this has no stimulating economic effect. A deficit that is planned for turns out not to be deficit.

Representative WIDNALL. Government spending has incurred the deficit, and you are going to increase the Government spending? I do not see the difference between the two.

**Dr. WESTON.** The cause of the deficit is the lag in Government revenues as a consequence of the lag in the rate of economic activity.

**Dr. SURTS.** May I answer that question this way: I think we have entirely too much emphasis on the "deficit," which is a number, an accountants' number, associated with particular accounts dealing with selected activities of only one government in our Federal structure, organized as we are.

It is elementary that any expenditure by anybody—a business, a State government, a school board, the Federal Government—stimulates economic activity and employment. It is elementary that any taxation by anybody, by a school board, by the Federal Government, by the State government, retards and brakes economic activity.

The extent to which we get stimulation or braking in our economy depends on the extent to which we manipulate these two controls. The difference between the tax revenues that we take in, and the expenditures that we make on certain specified accounts we call our deficit. But neither the magnitude nor the direction of this difference tells us what effect the fiscal activity will have on the economy. With equal deficits we can have either expansion or contraction.

In principle, by increasing taxes and by increasing expenditures by more or less, we could have a runaway inflation in a situation in which we were accumulating budgetary surpluses at a record rate, or we could have the world's worst depression in a situation where we had the largest budgetary deficits that we have ever had, as we did, indeed in the 1930's.

We ought not to think of the deficit itself as doing anything. It is expenditure that promotes, and it is taxes that retard. The deficit is merely an accounting difference.

The purchasing power that we have been talking about already exists. The profits that we are talking about already exist. Corporate profits are at a record rate, I believe.

**Mr. ELLIS.** That is right.

**Dr. SURTS.** If we want corporate profits after taxes to be higher, all in the world we have to do is to cut a couple of points off the corporate income tax.

If we want consumer purchasing power to expand, it is not a question of asking where this purchasing power originates, it is already there. All we have to do is take off the tax brake and let it free.

Now, there are two sides to this current problem that we are in. And this is, it seems to me, the proper approach to the fiscal side.

On the other hand, there is an aspect of this problem which is not a fiscal matter. This refers to the points that were raised by Senator Douglas a moment ago: The question of the proper preparation of our young people to take their place in a world in which we have an entirely new technology; the proper provision of steps to the employment and training for these people. This is another matter. Nothing we can do with the purely fiscal powers—tax, spend, deficit, or what you will—will attack these underlying problems.

There is nothing about the lack of education or preparedness of a 16-year-old young man that we can fix by any kind of Government action except training and education, and related projects.

**Chairman PATMAN.** Thank you, sir.

It is about 12 o'clock, but I want to ask one or two questions.

The question of what kind of a tax cut we should have has been discussed by the panelists. I believe you said, Dr. Suits, that your calculations show that a reduction of \$10 billion in taxes would result in 1 million new jobs. I assume that you meant an across-the-board reduction.

Dr. SUITS. I meant across the board in the personal income tax.

Chairman PATMAN. In the personal income tax?

Dr. SUITS. That is right.

Chairman PATMAN. Suppose you were to increase the exemption on the lower income groups.

Dr. SUITS. I think that the difference in effect would not be very much greater.

Chairman PATMAN. It would not be very much?

Dr. SUITS. I do not think so.

Chairman PATMAN. During the depression in the early 1930's, many of us recognized that it was primarily due to an absence of purchasing power, and the main thing we wanted to do was to increase purchasing power.

We accused those who differed with us of being members of the trickle-down group. They favored pouring in money at the top, so that it might trickle down, but it never did get down to the masses, where real purchasing power was most needed in our economy.

Do you not think that it is better for an economy to have what you might call the percolate-up type? In other words, shouldn't it start at the bottom? If purchasing power is made available at the bottom, it can always percolate up. Isn't that better than pouring it in at the top and expecting it to trickle down?

Dr. SUITS. This is certainly correct. I want it clearly understood, however, that my view here is with regard to the immediate situation. I am a great and a long-term advocate of tax reform. And I think we should keep these two problems completely separate.

If we become involved in internecine discussion of whether it is Mr. A or Mr. B who is most deserving, or is most conducive to economic expansion, we can get locked in dead center and not have what I believe to be essential; namely, immediate tax relief. So that I would propose, from the standpoint purely of fiscal policy, without regard to justice, or without regard to the longer run problems of tax balance, that we simply cut taxes across the board by enough to yield, let us say, an initial \$5 billion reduction.

Chairman PATMAN. Thank you, sir.

I shall not take more time. If any other member would like to ask questions, of course, we will be glad to listen to you.

Tomorrow morning, Wednesday morning, in this room, we will start with a panel—Douglas Greenwald, director of research, McGraw-Hill; Mona E. Dingle, economist, Board of Governors, Federal Reserve System, and George Katona, professor of economics, University of Michigan.

I want to thank you gentlemen very much. You have made a great contribution to the success of our hearings.

Representative WIDNALL. Mr. Chairman, I wonder if the members of the panel could submit some answers to us on what they feel have been the primary determinant of the rapid rate of growth in Western

Europe and Japan, and whether there are any lessons we can learn from that, in fiscal policy and other matters.

Chairman PATMAN. That is a good question.

When you get your transcripts to correct, if you will extend your remarks and provide an answer to Mr. Widnall's question, it will be appreciated.

(The following was later received for the record:)

COMMENTS SENT IN ANSWER TO REPRESENTATIVE WIDNALL'S QUESTION, BY IRA T. ELLIS, ECONOMIST, E. I. DU PONT DE NEMOURS & Co.

The more rapid growth rate of economic activity in Western Europe than in the United States over the past decade was due to a variety of reasons:

1. It was a period of extensive rebuilding in Europe to repair the damage of World War II. No similar rebuilding was necessary in the United States. Now that the rebuilding phase in Europe is largely completed, stimulation from this source has declined significantly.

2. The growth rate of the American economy since 1939, or 1936, compares very favorably with the growth rate of any other large industrial country over this period. We enjoyed a great stimulation of production during World War II and the early postwar years, when Western Europe was suffering extensive destruction of their productive capacity. Concentrating on growth rates since 1953, for example, ignores the very much larger growth in output in the U.S. economy from 1939 to 1953 than occurred in Western Europe over this period.

3. The burden of defense expenditures in Western Europe was very much less over the past decade than it was in the United States.

4. Western Europe resumed her usual place in the export business of the world over the past decade, while U.S. exports were declining from their abnormally high levels immediately after World War II.

5. There was a concerted drive by national political administrations, management, and labor in Western Europe to hold down production costs and increase output. In this country, on the other hand, much of the political and union effort was directed toward increasing the share of labor in the production pie rather than reducing costs or increasing output.

6. Substantial reduction in U.S. Federal personal and corporate income tax rates, with significant cuts in some low-priority Government spending programs, would stimulate the U.S. economic growth rate—at a time when there is clear evidence of some slowing in the economic growth rate of Western Europe. There should also be a concerted drive in this country to reduce production costs, even at the cost of some shifts in employment, to widen our domestic market, and to improve our competitive position in world markets.

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#### GROWTH IN WEST EUROPE

Statement by James Wishart, director, research department, Amalgamated Meat Cutters and Butcher Workmen (AFL-CIO)

What have been the determinants of growth rates in West Europe and Japan which have, in recent years, substantially exceeded those of our own economy?

If a single generalization may be submitted in tentative answer to this question it would seem that the one unifying principle behind recent European experience has been the acceptance of government responsibility for the creation and growth of markets for industry. Table I compares various measures of growth abroad with our own.

Although tax policy in West European countries has favored capital investment through depreciation allowance and other stimulants, the government's basic economic role has been that of assuring present and future markets at home and abroad.

1. Government fiscal and monetary policy has not been fettered by orthodox concepts of budget balancing. Table II indicates that all countries of the European Economic Community have accepted budget deficits running far above the American level. Such deficits have been recorded through accounting methods, which, in comparison with those in effect here, understate actual deficits in-

curred. And such deficits were tolerated as matters of national policy, even in years of high level economic activity and growth. Government expenditures have been used as a tool for assuring desired economic growth rates.

If this country were to accept deficits equal to the Italian deficit as a proportion of gross national product, our budget would fall short of Government income by \$15 billion annually. At the French level, our deficit would run substantially over \$25 billion.

2. The basic stimulant of the Common Market has been the clear prospect it holds out for expanding continental markets. This has been sufficient to float a boom in capital expansion for the six EEC countries, which, in turn, has shored up the economies and rates of capital investment for other countries of the hemisphere, with the possible exception of Great Britain.

In addition, government itself has taken direct responsibility for projecting various sectors of domestic markets. France, for example, using input-output analysis has projected a 5-percent growth in gross national product for 1962. Although this is less rigid than a fixed national plan, it is more substantial than a mere forecast of trends. It becomes a key and goal for the patterns of initiative from both private and government sectors of the economy. Although the decisionmaking power remains officially in private hands for the most part, such private decisionmaking is influenced and guided by specific knowledge of national, sector, and industry patterns, and by the more basic assurance that markets to absorb output of newly created capacity will also be created.

Government policy in all EEC countries has called for various forms of guidance to private investment.

3. Direct government support and stimulus has gone to the creation of foreign markets, which account for a larger sector of each nation's output.

Export subsidies in various forms, import limitations or levies, and other forms of control, have been used substantially by all EEC countries. They are continuing in use, though to a lesser degree in relation to other members of the Common Market, for the purpose of maximizing imports and favorable balances of trade.

To assume any rigid application of strict free-trade principles among EEC countries is currently unrealistic.

4. Unemployment levels have been kept low (see table III), and, as a consequence of relative shortages of labor, wage levels have risen rapidly. As the New York Times reported (Jan. 9, 1962):

"For the workingman, despite occasional headlines about strikes, 1961 was the best year ever, particularly in the private sector.

"Wages in Europe are not easy to measure, partly because of the large social security element. But in some countries they went up by more than 10 percent in 1961, and in almost all by more than 5 percent. The major reason, no doubt was the labor shortage and the classic operation of the law of supply and demand.

"This huge increase in mass incomes—to the extent it was not taken away again by higher prices—laid the foundation for a big burst of consumer spending. This was already being felt in such countries as Germany and France as the year ended.

"This 'push' from the consumer side, was one main reason why forecasts for 1962 remained, on the whole, optimistic."

No restraints from government so far have been placed on wage gains running far above gains in productivity of European labor.

The Wall Street Journal of July 17, 1962, reported some pressures developing in this direction in West Germany: "Mr. Erhard (Economic Minister for the Bonn government) has warned that soaring wages and prices threaten to price German manufactures out of world markets."

The Journal account of this declared that West German wages rose 11 percent last year, as compared with a 4-percent productivity gain.

Secretary of Labor Goldberg reported, early this month, that wage settlements this year in the United States have averaged 3.2 percent. This figure does not, of course, include substantial areas of industry in which no wage changes have been reported.

It is beyond question that recent gains made in wage levels and in purchasing power by the mass of West European peoples have been proportionally much greater than those achieved in this country. They have been gains from a lower base than our own. But to fail to see a correlation between such gains and gains in gross national product, also from a base far below our own, is to ignore basic economic fact.

TABLE I.—*Increases in gross national product, industrial production and consumption, selected countries, 1953-60*

	Percent increase, real GNP	Percent increase, real GNP (per capita)	Percent increase, index of industrial production	Percent increase, per capita, private consumption
Belgium.....	21	16	27	17
France.....	36	28	68	24
Germany (Federal Republic).....	61	48	80	46
Italy.....	49	44	82	29
Netherlands.....	42	30	57	26
Austria.....	58	55	69	49
Sweden.....	30	24	35	17
United Kingdom.....	22	18	30	21
Canada.....	22	1	30	11
United States.....	19	6	19	12

Source: Organization for European Economic Cooperation, General Statistics, July 1961, No. 4.

TABLE II.—*Government deficits and surpluses as a percent of gross national product, selected countries, 1952-59*

[Key to symbols: D, deficit; S, surplus]

Countries	1952	1953	1954	1955	1956	1957	1958	1959	Number of deficits	Average deficit, relative to gross national product <sup>1</sup> (percent)
Germany.....	S	S	S	S	S	D	D	D	3	1.17
France.....	D	D	D	D	D	D	D	D	8	4.61
Italy.....	D	D	D	D	D	D	D	D	8	2.70
United Kingdom.....	D	D	D	D	D	D	D	D	8	1.37
Sweden.....	S	D	D	D	D	D	D	D	7	2.20
Belgium.....			D	D	D	D	D	D	6	2.21
Netherlands.....	S	S	S	D	S	D	D	S	3	.71
United States.....	S	S	D	D	S	D	D	D	4	.95

<sup>1</sup>The deficit for each year in which a deficit was incurred was converted into a percentage of gross national product. These percentages were then averaged over the total number of years in which deficits occurred.

Source: Derived from International Monetary Fund data.

TABLE III.—*Average annual rates of unemployment in selected countries, percent of labor force*

Country	1953	1954	1955	1956	1957	1958	1959	1960	Source of data
United States.....	2.9	5.6	4.4	4.2	4.3	6.8	5.5	5.6	Survey, Registration. Do. Do. <sup>1</sup>
Germany.....	7.5	7.0	5.1	4.0	3.4	3.5	.7	1.2	
Netherlands.....	2.8	1.9	1.3	.9	1.3	2.4	1.9	1.1	
Sweden.....	2.8	2.6	2.5	1.5	1.9	2.5	2.0	1.5	

<sup>1</sup> Trade union returns prior to 1956: Registration only of insured workers.

Source: National statistics; International Labor Organization, international labor statistics.

(Reply to Mr. Widnall's question, by Daniel B. Suits:)

This important question could well become the basis of a large, important study by this committee. It is one that deserves careful research by experts in the field of foreign economic development. Unfortunately, I am not one of these, and any serious expression of opinion on such a matter would be presumptuous.

Senator PROXMIER. I would like to ask a couple more questions. I apologize to the panel and to the members, but I think this is such a good panel, and so well balanced, and the statements have been so provocative that I just cannot resist.

Mr. Ellis, you pointed out, and I think rightly so, that a substantive proportion of our unemployment problem is the young people. I am persuaded, as Senator Douglas brought out so well, that this is true. I am wondering if one constructive way of solving this situation and contributing very greatly to the long-term reduction in unemployment is not to do all we can to persuade the States to increase the age at which students leave school from 14 to 16 up to a higher level as they in their best judgment can do it; combine this with a much more vigorous vocational education program and a dovetailing of this in cooperation with management, labor, and others, so that when young people leave the school there is a job for them available.

Now, one of the things that President Conant, former president of Harvard, brought out in his book was that in communities where this is done—and there are many communities in America where they do that—there is very little problem of youthful unemployment.

Now, if we could somehow use what influence we have, here, the President and Members of Congress, to work on the States to do it, it seems to me we would do two things. No. 1, we would reduce unemployment; No. 2, we would solve a very vital problem of training more skilled people in a technological society. Is that not correct?

Mr. ELLIS. I think you are going in exactly the right direction. It takes time, of course, but we have made a start in that direction when we began to put this greater stress on mathematics and science in the schools, and pointed out the shortage of engineers and the high salaries they receive when they finish the training. We are trying to pull them through the school system. And it is all to the good.

It would of course also be desirable to increase the level of vocational training which would be importantly at the high school level rather than the college level, because unemployment is a very definite function of lack of skill.

If you can provide more skill in the jobs where there are shortages of people for the jobs, you can increase employment. And in that connection, I would like to point out that the fact that we have 4 million unemployed does not mean there are no jobs available. Some of those people prefer not to work at the jobs that are available.

I think that is another point that we must keep in mind: that there are a lot of jobs available in this country, but for some reason people prefer not to take them.

I think you are going in exactly the right direction. Let us increase the level of skill of our young people, particularly the ones that now drop out of school.

I do not take the figure for June 1962 as typical of the labor market. Many of those boys and girls reported as unemployed in June are merely looking for summer work. They are going back to school in the fall.

Senator PROXMIRE. I know. I am seasonally adjusting all these figures, and in October, November, and all during the school year there will be millions of those teenagers who will be out of school and out of work.

Mr. ELLIS. Look at October, for example, when the schools are in full session. I think you are going in the right direction. Let us increase the level of skill of these boys and girls.

I do not know whether raising the school dropout age would do it. That is at 14 primarily in the Southeast, and in most of the rest of the country it is now 16. I do not think you could make it 18.

Senator PROXMIRE. No, but it could be from 16 to 17 in some parts of the country.

Mr. ELLIS. I would prefer to see it done in pulling them through and point out the opportunities. Point out how much better life they will have later if they increase their education now.

Senator PROXMIRE. When I have spoken in most of the high schools in my State and everywhere, they stress the commercial or monetary value of staying in school. But I think if you could make it mandatory—after all, we used to permit students to leave after grade school, and very few people had a high school education, many years ago, and we have been making progress, but it has been slow.

Mr. ELLIS. Right.

Senator PROXMIRE. Secretary Goldberg said just the other day that now for the first time labor leaders are really serious about a 35-hour week, and about this approach to the problem. I do not blame them for being concerned.

I do not blame them for feeling this way. They see their people unemployed. They do not know whether or not these tax-reduction proposals are going to work. And frankly, I do not think a \$10 billion or even a \$15 billion tax reduction is going to do the big job that many people expect it to do. It may help some.

Therefore I feel we should pay some attention to the supply side of this equation. One way would be to keep our young people in school. That would help a lot.

Another way: Imagine the massive unemployment problem we would have today if we did not have social security. The fact that we have 14 million people receiving social security checks, and therefore it is unnecessary for them to work, and they are able to retire—I can see if we can continue what we did very constructively, I think, in the first part of this session, and reduce the retirement age from 62 to 60, but make it voluntary, and at the same time reduce the benefit that will be received under these circumstances—

What is the cost? If a person chooses to retire at 60, and believe me, on the basis of the petitions I have received, thousands and thousands would do so—you open up jobs and industry for younger people, and you do not have to have this very heavy cost of reducing hours from 40 hours to 35 and trying to maintain the same wages, which would really aggravate our problems.

I cannot see what is wrong with trying to look at the supply side of the equation, as well as the demand side. I think it has been overlooked badly.

Mr. ELLIS. In the first place, Senator, I do not think there is any strong push back of the 35-hour week. Labor does not want to work less and enjoy more leisure at the cost of a lower standard of living.

Senator PROXMIRE. They want more jobs. But I think while I would concede there is no strong push now, believe me, if the cycle does what it has almost always done, and we move into recession and get 7 or 8 percent unemployment, there is going to be terrific pressure.

Mr. ELLIS. What I meant to say is that you cannot reduce the hours of work and pay the same weekly wage.

Senator PROXMIRE. Not without a punishing increase in costs. I do not favor it now.

Mr. ELLIS. I do not, either. I do not think labor wants a shorter workweek with a lower standard of living. And it is impossible, without increasing productivity correspondingly, to have a lower workweek at the same weekly income rate.

Our standard of living is based upon what we produce.

Senator PROXMIRE. I will not argue with you on the facts. I would say Mr. Meany has indicated that he is serious about this. And he is the spokesman for 16 million workers.

Mr. ELLIS. But would it not result in more moonlighting?

Senator PROXMIRE. Again, I am not arguing the merits. I think perhaps moonlighting has been somewhat exaggerated. But whether it would or would not, I think it is something we should be concerned with. And I think there is a legitimate reason behind this, because the working people are really concerned about seeing a situation in which, even in periods of recovery and economic prosperity, there are 4 million people unemployed.

And while your figures are perfectly correct, I call your attention to the charts on page 43, which show that about 2 percent of the unemployed have been unemployed for more than 15 weeks, and some 3.6 percent of the married men are out of work, and of the experienced wage and salaried workers, a very, very high percentage, over 5 percent, are out of work.

Mr. ELLIS. Senator, would you say that it is possible that the wage rate is also affecting unemployment, that labor in some cases has priced itself out of the market?

Mr. WISHART. At certain points administered prices in industry have reduced possible demand to a level which has created unemployment. In terms of wage costs, the fact is that the wage costs per unit of output have been declining in absolute terms over the past 3 years. And I refer you to an exhibit submitted by Mr. Reuther before this committee last February.

Senator PROXMIRE. This is certainly true in many industries. It seems to be true in steel and in some other areas, even though they have had very substantial wage increases.

Mr. WISHART. These are overall figures, covering manufacturing industry as a whole.

Senator PROXMIRE. There is an indication of this, too, in the fact that we have had fairly stable prices over the last couple of years.

Mr. WISHART. Might I say, too, that labor's proposal for a shorter workweek—and I am speaking on behalf of a labor organization, here—is not one to be underestimated in any sense of the word. Obviously, we would prefer full employment, with a 40-hour workweek, but without full employment, without the prospect of full employment, the proposal for a shortening of work hours is one which has behind it genuine force, momentum, and support.

Senator BUSH. Do you really believe that union members would want to reduce their workweek from 40 hours to 35 hours without substantial increase in pay?

Mr. WISHART. Not without substantial increases in pay; no.

Senator BUSH. So it is not just a reduction in the workweek they want. It is really to get an increase in pay through that device. It that right?

Mr. WISHART. An increase in hourly rates would be involved in such a reduction.

Senator BUSH. So as to mean a stabilization in wage costs? It would result in a net income increase to the members. Is that true?

Mr. WISHART. I would not concede that a rate increase is necessarily an increase in wage costs. Under the impact of automation—

Senator PROXMIER. What the workers want to do is to preserve their present annual income or weekly income. You speak for the AFL-CIO, and they want a shorter workweek not because they are lazy or do not want to work 40 hours, but because they know so many people who are relatives and friends and so forth who cannot get work, and they see in the auto industry and the steel industry people who have worked for 10 and 15 years and are thrown out because the automation has created a situation in which far fewer people can do more work. Is that not correct?

Mr. WISHART. Yes. And in some sectors of the auto industry there has been the deliberate application of a 6-day workweek, creating conditions under which the unemployed may lose their right to pension, to hospital, surgical, and other coverages. This has been part of the operation in the Detroit area.

Senator BUSH. This is why I raise the question, then, as to this 35-hour workweek, as to whether it would not result in considerable more overtime payment, beginning at the 35-hour level, and whether it would actually result in decreased employment for those who need the work.

Mr. WISHART. This would certainly not be the purpose.

Senator BUSH. I beg pardon?

Mr. WISHART. There has been a proposal for the increase of overtime premium to obviate this tendency on the part of employers to work a limited work force an unreasonable number of hours per week, in order to avoid certain fringe benefit costs.

Senator BUSH. The thing that puzzles me about the proposition is this: If you have a reduction in the workweek to 35 hours, whether employers would rather pay—they are going to work 40 hours anyway, maybe more—whether they would rather pay the overtime rate to those employed, rather than train a bunch of new workers to take up the one-eighth slack, or whatever it would be, and whether they would not find the latter more expensive than paying the overtime.

What is your judgment on that?

Mr. WISHART. My judgment is that in most industries today the choice would be for the 35-hour workweek. This might be a problem which we will face down the road, assuming the achievement of the 35-hour workweek. All the problems flowing from that have not been given total analysis at the present time.

Senator BUSH. Do you think the 35-hour workweek would actually increase employment?

Mr. WISHART. This is the reason that labor is solidly and substantially supporting the idea of reduced hours, without reductions in weekly take-home pay.

Very frankly, the preference would be for not only the maintenance of weekly take-home pay, but for the increase in take-home pay, an increase in annual earnings. Organized labor generally would be willing on a short-term basis to sacrifice this goal of increased annual earnings, were it possible, through this action, to provide jobs for those currently unemployed.

Senator BUSH. They believe, then, that it would provide more jobs—this 35-hour workweek proposal. Is that right?

Mr. WISHART. This is the reason that proposal has been seriously advanced. And in the New York City area, in a number of construction industries, it has been applied at a level below the 35-hour level, as I am sure you know, Senator.

Senator BUSH. Twenty-five; yes.

Representative WIDNALL. Normally, when you talk about a 35-hour workweek, you are talking about mass employment in an industry. Are there not thousands of jobs, union jobs, that have been lost recently because of pricing out of the market individual home repair work, electrical work, plumbing work, building a gameroom, building an extra room? You have had this tremendous increase of do-it-yourself, because labor has priced itself out of the market with the individual homeowner.

Now, those are all jobs, but they are odd jobs, they are not the type of job people want, because there is not enough employment in them. And it is increasingly difficult to fill such jobs.

Mr. WISHART. I am not familiar enough with that, except from the view of the putative and injured do it yourselfer, to be able to say anything authoritative on this.

I would like, if I may be pardoned, to refer back to one earlier statement in regard to the educational approach on the problem of unemployment.

The Armour Automation Committee did a good deal of work in this general area in seeking jobs for displaced packinghouse workers. We found that there were in certain labor markets a number of unfilled jobs, jobs as computer programmers, jobs as missile designers, jobs as electronic engineers. But we found also that a worker who had had perhaps 4 or 5 years of primary education, and who spent 25 years cutting hides off steers, somehow could not qualify for these openings.

In regard to vocational training, our conclusion was one of some hesitation. Our feeling was that training in very specific skills in this period of automation, with very rapid shifts in skill requirements, was not necessarily the most desirable thing. Our feeling was that the concentration should be on basic education, in reading and writing and arithmetic, to provide workers who are then available for industry to go through the usual procedures of on-the-job training in the specific skills required in a given situation.

Senator BUSH. I would agree that is probably the case.

Senator DOUGLAS (presiding). Any further questions?

We want to thank you gentlemen very much.

(Whereupon, at 12:30 p.m., the committee was recessed, to reconvene at 10 a.m., Wednesday, August 8, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

WEDNESDAY, AUGUST 8, 1962

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

The committee met at 10 a.m. in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, Thomas B. Curtis, and Widnall; Senators Douglas, Proxmire, Pell, Bush, and Javits.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will please come to order.

This morning we have as our panel Mr. Douglas Greenwald, Mr. George Katona, and Miss Mona Dingle of the Board of Governors of the Federal Reserve System.

This morning we continue hearings on the state of the economy. We have with us a panel of distinguished economists who are specialists in surveys of business and consumer expectations.

Before we begin, I would like to say a special word of thanks to Miss Dingle and her associates on the staff of the Board of Governors, who worked over the weekend in order to speed up the tabulation of their most recent survey of consumer plans for purchases.

We will proceed now with Mr. Greenwald first, and then the members of the committee may put questions to the panel. If there is no objection, the committee will ask questions under the 10-minute rule.

Mr. Greenwald, you may proceed in your own way, sir.

## STATEMENT OF DOUGLAS GREENWALD, MANAGER, DEPARTMENT OF ECONOMICS, MCGRAW-HILL PUBLISHING CO., NEW YORK, N. Y.

Mr. GREENWALD. Thank you, sir.

My assignment is to discuss the current and short-run health of the economy with particular reference to the key area of the economy—private investment in new plants and equipment. My contribution, for the most part, will be based on recent important factual information from McGraw-Hill's surveys of business' anticipations. And results of these surveys indicate that capital investment intentions by business constitute an element of strength in the business outlook.

In my department of the McGraw-Hill Publishing Co. we have made surveys of plans for business' spending on new facilities for 15 years. We also maintain a monthly index of new orders for non-electrical machinery which reflects the new incoming business of pro-

ducers of capital equipment, and a quarterly forecast index of machinery orders, which reflects the producers' expectations for four quarters ahead. The indexes cover a relatively small number of large manufacturers of machinery.

We generally survey business on its plans for domestic investment twice a year—in the spring and in the fall. The spring survey is very comprehensive and is geared to longer range plans; the fall survey covers fewer questions and is geared to short-range plans.

In October 1961 we carried out our fall survey of business' plans for 1962 and 1963. Our comprehensive survey of business' plans for 1962 to 1965 was made during March and early April of this year. At the end of June we carried out a special checkup of plans.

The McGraw-Hill checkup of spending plans showed that business, in general, is planning to invest approximately the same amount in new plants and equipment in 1962 that it reported to us in our comprehensive survey taken earlier this year, and a considerably higher amount than it anticipated last fall. The table below shows the results of the three McGraw-Hill surveys and actual 1961 capital expenditures as reported by the U.S. Department of Commerce.

(The table follows:)

*Business plans for capital spending in 1962*

(Billion dollars)

Industry	1961 actual <sup>1</sup>	1962 planned—		
		As of October 1961	As of March and early April 1962	As of end of June
All manufacturing.....	13.67	14.59	15.41	15.30
Mining.....	.98	.99	1.09	1.08
Railroads.....	.67	.64	.85	.87
Other transportation and communications.....	5.07	5.03	5.50	5.50
Electric and gas utilities.....	5.52	5.87	5.74	5.82
Commercial.....	8.46	8.72	9.39	9.39
Total, all business.....	34.37	35.84	37.98	37.98

<sup>1</sup> U.S. Department of Commerce.

Mr. GREENWALD. Our fall 1961 survey indicated that business had plans to invest \$35.84 billion in 1962, an increase of about 4 percent over 1961. Over the past several years our fall surveys of business' plans have always provided the correct direction of change in investment as well as fairly reliable indications of the degree of change.

The McGraw-Hill comprehensive survey of business' plans for new plants and equipment taken early this spring indicated that business firms had raised their investment sights significantly from the fall. Planned investment for 1962 was \$37.98 billion, up 10.5 percent over 1961. During the years that we have been making these spring surveys, they have proved remarkably accurate in indicating the trend of overall investment for the year ahead, except in 1950, when all plans were altered by the Korean war. During the last decade, the average error between the McGraw-Hill survey's planned percentage change and the Department of Commerce's percentage change for actual data is only 3.5 percent.

Senator BUSH. That doesn't mean 3½ percent annually?

Mr. GREENWALD. Yes, sir. The average annual error.

Senator DOUGLAS. Somewhere in the range of a billion dollars.

Mr. GREENWALD. In the earlier years it would be smaller in dollar terms, and in the current years it would be bigger.

Senator DOUGLAS. But the average range would be about a billion dollars?

Mr. GREENWALD. Yes, sir.

We do not conclude from this experience, however, that we have a sure-fire forecasting device. We claim nothing for the results of our surveys except that they report present plans. We heavily emphasize the proposition that our surveys are not promises of what is actually going to happen.

Our special checkup in late June showed that business planned to spend \$37.96 billion on new plants and equipment this year, up 10.4 percent over 1961.

This checkup was based on plans of a substantial cross section of business, accounting for 35 percent of total capital investment. For the most part the results reflect the plans of large companies. This recheck provided no indication of what small companies were doing about their investment. To begin with, investment plans of small companies were not up as much for 1962 as those of larger companies.

The downward movement of the stock market in May and June may have had some impact on their investment plans. However, small companies account for a relatively small percentage of total capital investment.

Our checkup pointed up the fact that business in general had not cut back or canceled plans for investment in new facilities in 1962 as a result of the sharp drop in stock prices in May and June or the so-called loss of business confidence.

Manufacturing industries overall planned to invest \$15.3 billion this year, down about \$110 million from plans reported to us in the spring. Steel, machinery, electrical machinery, stone, clay and glass and miscellaneous manufacturing industries plan to invest less in 1962 than they did earlier. However, transportation equipment (aircraft, railroads and shipbuilding) fabricated metal products and instruments, chemicals, rubber and food industries plan to increase their capital expenditures this year more than planned originally.

Among manufacturing industries, railroads and utilities planned slightly higher capital investment for 1962 than they did earlier, while the mining industry cut its plans.

About 80 percent of the companies that answered in our recheck indicated they had made no change in their 1962 plans for new plants and equipment. The remaining 20 percent indicated some changes in their planning. But this group was split right down the middle, with half increasing plans and half cutting them.

Among the companies indicating investment cutbacks, only a very few cited economic conditions as the reason. In most cases where investment plans were lower than they were earlier, the reasons given had absolutely nothing to do with a lack of business confidence or the drop in the stock market. Instead, technological delays and construction delays were the reasons given.

We should point out that in the past years of high and rising business activity a large number of companies increased investment plans during the year. This has not been the case so far in 1962.

This recheck was taken before stock market prices began to recover, before margin requirements were reduced from 70 percent to 50 percent and before revenue procedure 62-21, with its more realistic depreciation guidelines regarding lives of machinery and equipment, became effective. It is conceivable that these three factors, along with the 7 percent tax credit for new machinery and equipment purchases, which Congress may soon make a part of the Nation's law, could result in higher capital expenditures at the end of this year than are now anticipated by companies and by business economists in general.

However, it is my opinion that their impact on capital spending may be slow in coming. We have some factual evidence on this point.

In our spring survey, we asked the question :

If the administration's program of tax incentives for investment were enacted, how much would this increase your capital expenditures in 1962?

Business as a whole indicated that it would raise its 1962 plans by only 1 percent, or about \$300 million. Nine out of every ten companies replying indicated that they would not use such a program at all in 1962.

The fact that American business is going ahead with its investment plans for 1962 was not a surprise to us. It confirmed our belief that business plans for new plants and equipment, once made for the year ahead, are generally carried out. In the past, wars, recessions and booms have led to significant changes in investment plans. But in my view, we are not likely to be in any of these three situations this year.

Also, it makes good sense for businessmen to go right ahead with their modernization programs in 1962. Business firms reported to us in our recent checkup that this year's capital investment programs are stressing modernization, with the hope that these cost-cutting projects will result in better profit margins.

In our earlier survey this year, manufacturers reported that they planned to devote 70 percent of their 1962 investment dollar to modernization. The reason for their concern is obvious. About 40 percent of U.S. plant and equipment dates back to before 1951, and nearly 25 percent goes back to World War II or even before that. These significant statistics were also revealed by our spring survey.

Only a very small percentage of investment is going for new capacity this year. Most of this is going for capacity for new products which are an important part of the payoff of industry's tremendous expenditures on research and development during the last decade. Little investment is going for additional capacity for existing products.

Based on the McGraw-Hill measures of manufacturing operating rate, we estimate that manufacturers, on the average, are currently utilizing 84 percent of their capacity, whereas they prefer to operate at about 90 percent. Therefore, it is true that industry has a modest amount of excess capacity at present. And the gap between the operating rate and the preferred rate may widen if manufacturing output were not to continue to expand during the rest of the year.

As this committee well knows, my department compiles the only direct measure of manufacturing capacity. Only a few months ago I testified on the McGraw-Hill measures of capacity before the Sub-

committee on Economic Statistics of the Joint Economic Committee. In its report on measures of productive capacity, the committee recommended and I quote—

an exploration of the McGraw-Hill techniques would offer an excellent opportunity for a joint public-private project in which McGraw-Hill, the pioneer of this technique, might work in cooperation with a suitable Government agency.

We at McGraw-Hill are giving this project serious consideration.

Another piece of evidence that confirms our belief that investment will continue to expand throughout the rest of this year is provided by the quarterly McGraw-Hill nonelectrical machinery new orders forecast index. For today's hearings, I have had computed, earlier than usual, a preliminary estimate of our forecast index for the four quarters ahead. Although this index does not provide a precise gauge of the future level of new orders, it provides an indication of relative changes in the confidence of machinery manufacturers.

Capital goods manufacturers now expect to book a far bigger dollar volume of new orders in the current quarter than they ever did before. They anticipate that new orders will subsequently fall off and that the decline will continue into the first quarter of 1963. They forecast that the second quarter of 1963 will see a slight pickup in their new orders.

The group of machinery manufacturers reporting forecasts to us in our current quarterly survey are slightly less optimistic about prospects for new orders for the last two quarters of 1962 than they were 3 months ago. One reason for decreasing optimism about the immediate future among this particular group of companies is the fact that their actual incoming new orders in June dropped by about 10 percent.

But despite this sharp drop for one month, their anticipations for the last half of 1962 are only off about 2 percent from what they were back in April. And most of the returns for this calculation arrived in my office before the new procedure for depreciating machinery became effective.

Corporations now have a high enough rate of cash flow to finance a considerably higher level of investment than is now planned for 1962. Our comprehensive survey taken early this year showed that businessmen anticipated increasing their volume of cash flow, composed of retained earnings and depreciation, at a faster rate than their investment in new plants and equipment. At that time they expected to increase cash flow by 14 percent and investment by only 10.5 percent.

It is my belief that the McGraw-Hill data on plant and equipment expenditures indicate that this key segment of the economy will continue to expand this year. If plans hold up for the year as a whole, then the quarterly rate of capital expenditures may be expected to reach \$39 billion in the fourth quarter compared with a rate of about \$37 billion in the second quarter.

I now turn briefly to other major areas of the economy: Inventories, consumer spending, housing, the net export balance and Government spending.

Inventories are currently being built up at a much more moderate pace than earlier this year. In the first quarter, business was accumulating inventories at an annual rate of about \$6.7 billion. In the second quarter the rate dropped to about \$3.5 billion. In the cur-

rent quarter, it probably is still lower. The rate of addition to inventory will continue to slow down during the rest of the year.

However, considering the relatively low inventory-to-sales ratios, it is unlikely that business will reverse its policy soon and let its inventories run off. However, a declining rate of inventory addition means that the negative impact on our Nation's total dollar volume of business has already taken place.

Consumer expenditures, which are by far the largest sector of the total business picture, are dependent on many psychological factors. I will leave the discussion of this sector to George Katona, except to note that as long as personal income rises, and at this time we cannot see any reason to expect it to turn down before yearend, consumer spending on goods and services may be expected to follow the same general path.

Housing is booming. Private starts in the second quarter were exceedingly high at an annual rate of nearly 1.5 million units, despite a drop in June. And because of the lag between a start and put in place construction, we can look for the dollar volume of new housing construction to break through previous record highs.

The net export balance is just about holding its own. Exports have been holding up very well, while imports have not increased significantly. We do not expect to see a significant change from the current rate of surplus of exports over imports during the rest of the year. Thus the net export situation will have a neutral effect on the economy in the months ahead.

This year's Federal budget guarantees a modest rise in Federal spending right through the end of the fiscal year, June 30, 1963. However, the increase during the current fiscal year will be considerably smaller than the big gain registered during fiscal 1962.

Meanwhile, State and local spending on highways, schools, and other projects is due for a large increase over the coming months. States and cities are taking advantage of relatively easier money markets to issue a record volume of construction bonds.

In conclusion, the pluses and minuses of the various sectors of the economy add up favorably for the rest of the year. There is nothing now in sight which clearly indicates that in the next few months there will be a marked change in the direction of the economy.

Chairman PATMAN. Thank you, sir.

Senator DOUGLAS. There is just one question I would like to ask, Mr. Chairman. This is a very able statement, but the witness stated that States and cities are taking advantage of relatively easy money markets. I wonder what your evidence is for the money markets being easier.

Mr. GREENWALD. We were looking at the rates on State and municipal bonds, and we found that they were around 3.27 in early June.

Senator DOUGLAS. 3.29 as of July 14.

Mr. GREENWALD. But this compares with 3.40, 3.50, and 3.60 in earlier periods of this year.

Senator DOUGLAS. In April it was 3.08 and in the last 3 months they have gone up 21-hundredths of a percentage point, or relatively speaking, have gone up 7 percent.

Mr. GREENWALD. I think, Senator Douglas, you are looking at the figures on the triple A State and local.

Senator DOUGLAS. That is right.

Mr. GREENWALD. If you look at the total for States and local bonds which is in the Federal Reserve Bulletin, you get a slightly different picture.

Senator DOUGLAS. That is you don't think this index on page 29 of the indicators is useful?

Mr. GREENWALD. I think it is useful, but I look at the total for State and local bonds.

Senator DOUGLAS. What is that?

Mr. GREENWALD. Starting with January, it was 3.55, February 3.40, March 3.30, April and May 3.21, and the week to which I referred, which was June 2, it was only 3.27.

Senator DOUGLAS. An increase of 2 percent.

Mr. GREENWALD. Yes sir. But relative to the earlier periods in the year, it is still low.

Senator DOUGLAS. Recently, as compared to April, there has been an increase?

Mr. GREENWALD. That is right, sir.

Senator DOUGLAS. Thank you.

Chairman PATMAN. Miss Dingle, economist from the Board of Governors of the Federal Reserve System, we are glad to have you, and you may proceed in your own way.

**STATEMENT OF MONA DINGLE, CHIEF, CONSUMER CREDIT AND FINANCES SECTION, DIVISION OF RESEARCH AND STATISTICS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

MISS DINGLE. I understand you are interested in receiving from me a report on the most recent quarterly survey of consumer buying intentions. Unlike Mr. Greenwald and, I assume, also Mr. Katona, I will not attempt to make any forecast of what is likely to happen in the next 6 months but will merely report my best interpretation of what the most recent Quarterly Survey of Consumer Buying Intentions shows.

We do appreciate your recognition for our weekend work, but I would like to add that a great deal of appreciation is due to the Bureau of Census staff, which was on an around-the-clock schedule part of last week and which spent a great deal of weekend time itself checking the data and seeing that their interpretations of the data generally tallied with ours.

Before I refer to the data that were collected, let me say something about the nature of the buying plans data themselves. Taken alone, these data are by no means a direct forecast of subsequent sales. They represent individual consumers' best estimates of the likelihood of their subsequent purchases as reported in sample surveys, and thus give a measure of consumers' interest in a market as of the interview date. Purchases that consumers subsequently make reflect not only the strength of their interest as expressed in the plans data but also supply conditions and developments affecting consumer spending such as changes in employment and income.

In general, consumers who report plans to buy are substantially more likely to purchase than those who do not, but many planners do not purchase and many nonplanners do purchase. Survey experi-

ence shows that purchase rates of nonplanners are particularly affected by changes in economic conditions, while purchase rates of planners show somewhat more stability.

Senator DOUGLAS. Is this an argument for planning?

Miss DINGLE. We would certainly appreciate it if all consumers did plan definitely far in advance. I hope that you as a consumer will do so.

The interpretation of buying plans data is complicated by their seasonality. Plans show seasonal movements that are not identical with those of purchases, and unfortunately the Quarterly Survey of Consumer Buying Intentions has not been in existence long enough to enable us to develop seasonally adjusted series. This is the fourth year of interviews, but all four of these years have shown different types of economic developments.

The year 1959 was one of general economic expansion characterized by strong consumer demand, but expansion was interrupted by a prolonged steel strike in the second half of the year. The first half of 1960 was strong, and the decline in economic activity in the second half was tempered by continued strength in the automobile market. Most of 1961 was characterized by recovery, but consumer expenditures for durable goods lagged compared with other recent cyclical recoveries.

This year has shown mixed developments, with consumer purchases of durable goods declining in the first quarter and picking up in the second and with the strong demand for automobiles accounting for a substantial part of the second quarter rise. These differences among years create problems of comparison by affecting quarter-to-quarter movements in plans as well as the relationship between plans and purchases.

There are special problems involved in relating plans to buy automobiles at this time of year to developments over the coming months. Important factors in realized purchases are the supply of old model automobiles, and of new ones once they are introduced, and consumer reception of new model automobiles. Shortages due in part to strikes kept purchases down in 1959 and to a lesser extent in 1961, while in 1960 sales were encouraged by the large supply of old model automobiles which were sold at discounts from list prices.

As is illustrated in the material that has been distributed, information is obtained in the Quarterly Survey of Consumer Buying Intentions covering buying plans reported for varying time periods and with varying degrees of certainty, and data are tabulated for various groups of consumers. We have always considered it desirable to make the data available in detail in order to enable analysts to make their own interpretations.

I hope the other members of the panel and the committee will take advantage of that. I tried to show as much detail as I could, given the limitations of time.

Tables 1, 2, and 3 and the chart showing the movements of buying plans are being released today with our quarterly press release on buying plans data. Additional tabular material will be included in an article which will appear in the Federal Reserve Bulletin for August and which will be released earlier in preprint form.

Table A and the bar chart have been especially prepared to facilitate the comparison of current plans and recent movements with those in the corresponding period of earlier years. I might say I do not plan to refer directly to tables and charts but to summarize what they show. Most of my statements can be followed in table A. In comparing the level of plans this year with those in earlier years, it should be kept in mind that the data given show percentages of all families in the United States and that the total number of families has been increasing at the rate of about 2 percent per annum.

Thus, in terms of numbers of families reporting plans, a figure of 5 percent in 1962 is equivalent to 5.1 percent in 1961 and 5.3 percent in 1959, and a figure of 20 percent in 1962 is equivalent to 20.4 percent in 1961 and 21.2 percent in 1959. Movements are shown for the period April-July for all items except used cars, for which January-July movements are shown. Movements of course reflect cyclical as well as seasonal developments.

As would be expected, the July data do not all point in the same direction, and they may lend themselves to varying interpretations depending in part on one's analysis of related developments. In general, however, reported buying plans were at or close to highs for the current cyclical upswing. Automobile buying plans may have weakened slightly from the strong April level.

Plans to buy household durable goods, however, after lagging throughout 1961 and picking up from January to April, strengthened further from April to July. Buying plans for houses have shown little change since earlier this year.

Reports of plans to buy new cars within 6 months were unchanged from April to July this year, compared with increases in the corresponding period of the expansion years 1959 and 1961 and a small decline in 1960. Plans to buy in 3 months and in 6 to 12 months were down somewhat. Buying plans reported in July were about equal to those in July 1961 and higher than in either 1959 or 1960.

Plans to buy used cars continued strong in July. Since this figure was abnormally high in April of this year, I have shown changes from January to July for used cars rather than from April to July. For this period, 6-month plans increased, compared with reductions in each of the 3 preceding years. Reported plans to buy used cars in July were higher than in any of the 3 preceding years.

The Quarterly Survey, while concentrating on buying plans, also asks several other questions pertaining to the automobile market. In July, the proportion of families that expressed dissatisfaction with the car currently owned, which had been running above year-earlier levels, declined to a level below that in July 1961 but above 1959 and 1960 levels. The proportion of families that reported shopping for a car in recent weeks also declined to a level about the same as in 1961 and below that of other recent Julys.

As in each of the 2 preceding years, reported plans to buy houses within the next 12 months showed little change from April to July, but short-term plans and definite plans apparently strengthened somewhat. In July total plans to purchase within a year were slightly higher than in 1961 but slightly lower than in 1960. The increase from a year ago was concentrated in plans to buy new houses.

Plans to buy household durable goods, which had continued weak throughout 1961, showed greater strength in July than in any other recent survey. Plans to buy such goods declined less from April to July than in either 1960 or 1961, as a less than seasonal reduction in plans to buy air conditioners was offset by an increase in plans to buy most other items covered.

As in the second half of last year and the first half of this year, but in contrast to the 1959 to early 1960 expansion period, strength was concentrated in plans to buy within 3 months and in definite plans, as opposed to plans to buy in 3 to 6 months and in more tentative plans. Three-month plans were at the highest July level since the survey began, while total 6-month plans were only moderately higher than in 1961 and below earlier July levels.

In general, planners expressing plans to buy within 3 months and those saying that their plans are definite are more likely to purchase than those expressing tentative plans to buy or plans to buy after a longer period. On the other hand, such planners account for a relatively small share of total purchases in any period, and a high level of aggregate purchases requires large purchases by tentative planners and by consumers classified as "nonplanners."

It is possible that the tendency for 3-month plans and definite plans to rise while the more tentative plans remain low may mean that people are willing to make those purchases to which they have given considerable thought but that they are adopting a wait-and-see attitude with respect to making longer range plans.

It should be noted that the weakness of 6-month plans for household durable goods compared with earlier years was concentrated particularly in refrigerators and washing machines; plans to buy television sets and growth items such as air conditioners and clothes dryers are generally close to or above 1960 levels. The strength in 3-month plans, however, was particularly great for refrigerators and washing machines.

There has apparently been some shift recently in the income structure of plans to buy new cars and household durable goods. While total plans to buy these items were generally equal to or above year-ago levels, plans on the part of families with incomes of \$7,500 or more—about 25 percent of all families—were at the lowest July level in the 4-year history of the Survey. Plans to buy houses and used cars on the part of this upper income group, however, were equal to or above year-earlier levels.

Plans to purchase household appliances by high-income respondents have remained weak during the entire period of economic expansion, while plans of lower income groups have strengthened. Recently there has been some pickup in plans on the part of high-income respondents to buy growth items—air conditioners, clothes dryers, dishwashers, and radio and phonographic equipment—but their plans to buy the items labeled as major durables—washing machines, refrigerators, and television sets—were at new July lows.

Senator BUSH. Why do you call those growth items?

Miss DINGLE. They have been expanding more with respect to ownership in recent years than washing machines, refrigerators, and television sets. Like other items, at the time of introduction they

were purchased primarily by the higher income groups and are now expanding into the lower income groups.

Senator BUSH. Thank you.

Mr. GREENWALD. It might also be that these are relatively new items, if I might add a point here, and fast growth begins in the period when you first market new items, air conditioners, and so on.

Miss DINGLE. Washing machines, refrigerators, and television sets are owned by an extremely high proportion of all families. The demand is either the result of necessary replacements or obsolescence. Practically all purchases of those items are made by families that already own one. Most families don't have much need for more than one washing machine or refrigerator, except perhaps for summer camps. There is expansion in the numbers of owners of television sets.

One might refer to color television as being a growth area, but television sets are generally very, very widely owned.

This reduction in plans may reflect in part saturation in the ownership of such appliances by high-income families and a tendency to make expenditures in other directions, rather than any significant change in their willingness to spend. Plans to buy new cars on the part of the high-income group appear to have weakened from April to July.

While I don't feel that I am in a position to explain this decline, it is possible that it may reflect in part the recent stock market developments and perhaps some sense of economic uncertainty on the part of this group.

A shift of buying plans from higher to lower income groups does not necessarily presage a decline in purchases on the part of all planners, since purchase rates for planners generally differ little among income groups. Purchase rates of nonplanners are higher in the upper income group, however, and any sign of caution on the part of this income group might be reflected in a reduction in overall purchase rates.

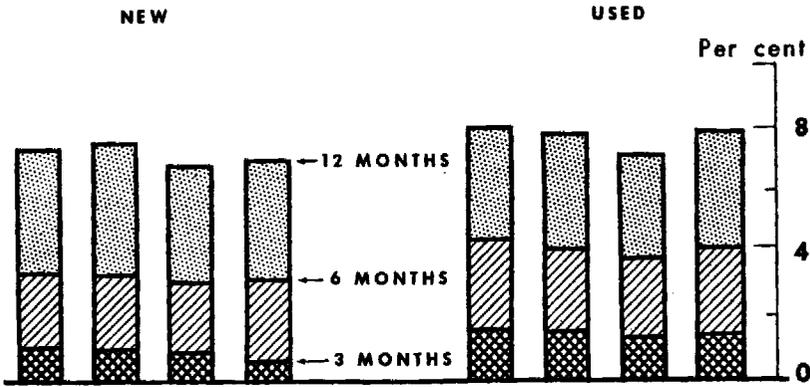
In looking at data for families with incomes of \$7,500 or more, it should be recognized that these families constitute a relatively small part of the total, and hence that the data are subject to more sampling variability than data for all families or for families with incomes below \$7,500. Planning rates of this group over a period of years may also be affected by general increases in consumer incomes and the movement of new families into the higher income group.

Unlike the surveys conducted by Professor Katona, the Quarterly Survey of Consumer Buying Intentions has only a limited number of questions directed toward general economic attitudes and financial developments. I hope he will say a great deal more about this area in the course of his discussion.

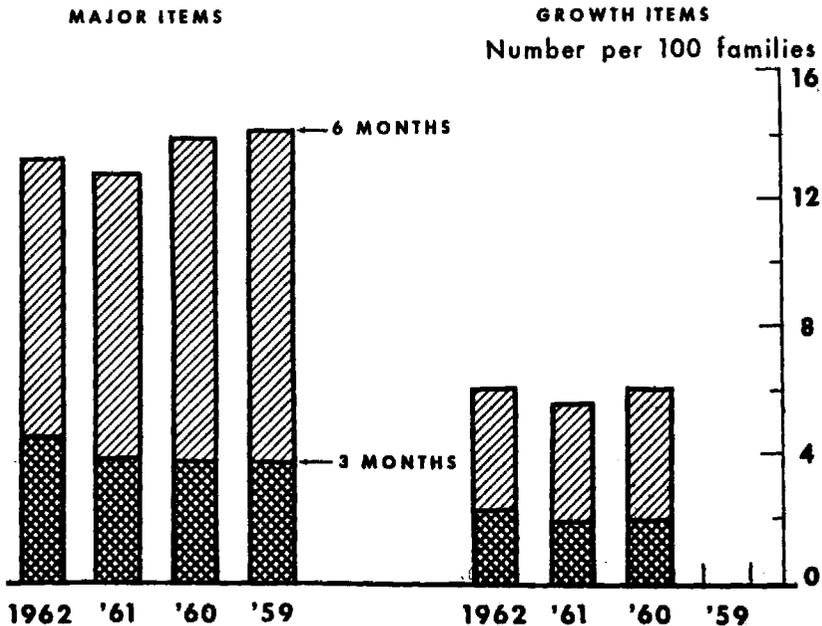
Concerning income prospects, slightly fewer consumers than in other recent quarterly surveys expected their incomes to increase over the coming year, and a correspondingly higher proportion expected their incomes to be unchanged. There was no change, however, in the number expecting lower incomes or uncertain about their income prospects. Slightly fewer families than in other recent surveys also reported an increase in income compared with a year earlier.

(The tables and charts referred to follow :)

**BUYING PLAN LEVEL - JULY**  
**WITHIN 3, 6, AND 12 MONTHS**  
**AUTOMOBILES**



**WITHIN 3 AND 6 MONTHS**  
**HOUSEHOLD DURABLE GOODS**



NOTE. — THOSE INDICATING UNCERTAINTY ABOUT TIMING WITHIN THE 6-MONTH PERIOD ARE INCLUDED IN THE SECOND 3 MONTHS.

SEE NOTES TO TABLE A FOR ITEMS INCLUDED IN HOUSEHOLD DURABLE GOODS GROUPS.

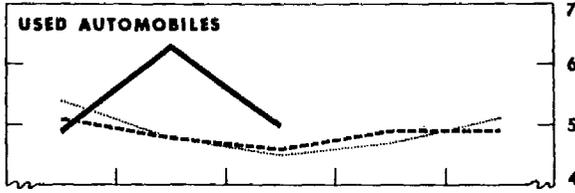
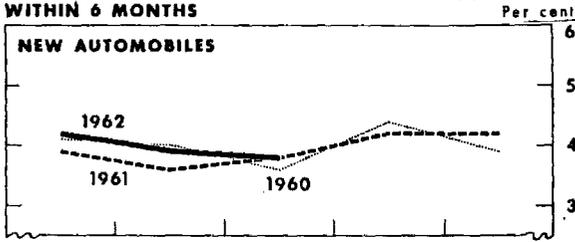
TABLE A.—Buying plans for houses, automobiles, and household durable goods

Item and time period	Level, July				Change, April-July <sup>1</sup>			
	1962	1961	1960	1959	1962	1961	1960	1959
Percentage of all families or of families in specified income group								
<b>New cars:</b>								
Plan to buy in 12 months.....	7.4	7.6	6.9	7.0	-0.3	+0.8	-0.1	+0.4
Plan to buy in 6 months.....	3.4	3.4	3.1	3.2	.....	+3	-2	+5
Income under \$7,500.....	2.1	2.2	2.0	2.2	.....	+1	-4	+4
Income \$7,500 and over.....	7.7	8.3	8.2	8.7	-1	+1.2	+7	+1.2
Definitely plan to buy.....	1.4	1.4	1.2	1.2	-1	+3	-3	+3
Plan to buy in 3 months.....	1.1	1.1	.9	.9	-2	+2	-3	+2
<b>Used cars: <sup>1</sup></b>								
Plan to buy in 12 months.....	8.1	7.9	7.2	7.8	-1	-4	-1.2	-7
Plan to buy in 6 months.....	4.5	4.2	3.8	4.2	+2	-3	-8	-5
Income under \$7,500.....	4.5	4.1	3.8	4.4	+1	-4	-8	-6
Income \$7,500 and over.....	5.1	5.0	4.8	4.7	+7	+2	-1.2	-1
Definitely plan to buy.....	1.7	1.5	1.4	1.4	+2	.....	-2	+1
Plan to buy in 3 months.....	1.7	1.6	1.4	1.5	+4	+3	+1	+3
<b>Houses (new and existing):</b>								
Plan to buy in 24 months.....	10.1	10.0	11.2	( <sup>2</sup> )	+1	.....	+1	( <sup>2</sup> )
Plan to buy in 12 months.....	5.2	5.0	5.4	( <sup>2</sup> )	.....	+1	+1	( <sup>2</sup> )
Income under \$7,500.....	4.4	4.4	4.8	( <sup>2</sup> )	.....	+2	+2	( <sup>2</sup> )
Income \$7,500 and over.....	8.4	7.8	8.8	( <sup>2</sup> )	+3	-2	-4	( <sup>2</sup> )
Definitely plan to buy.....	2.3	2.0	2.2	( <sup>2</sup> )	+3	-1	.....	( <sup>2</sup> )
Plan to buy in 6 months.....	2.3	1.9	2.4	( <sup>2</sup> )	.....	-4	-1	( <sup>2</sup> )
Plans per 100 families								
<b>Household durable goods: <sup>2</sup></b>								
Plan to buy in 6 months.....	19.3	18.4	20.1	( <sup>2</sup> )	-0.8	-1.8	-1.8	( <sup>2</sup> )
Income under \$7,500.....	18.0	15.1	17.6	( <sup>2</sup> )	-7	-6	-7	( <sup>2</sup> )
Income \$7,500 and over.....	29.6	31.0	34.3	( <sup>2</sup> )	-1.6	-2.9	-2.6	( <sup>2</sup> )
Definitely plan to buy.....	6.9	6.2	6.5	( <sup>2</sup> )	-2	-3	-1.2	( <sup>2</sup> )
Plan to buy in 3 months.....	6.8	5.8	5.9	( <sup>2</sup> )	-4	-9	-1.5	( <sup>2</sup> )
<b>Major household durable goods: <sup>3</sup></b>								
Plan to buy in 6 months.....	13.2	12.8	14.0	14.2	+2	-2	+1	+1.8
Income under \$7,500.....	12.2	11.4	13.1	13.6	+4	+2	+6	+1.8
Income \$7,500 and over.....	16.7	19.0	20.1	19.8	-3	+8	+1.0	+2.6
Definitely plan to buy.....	4.7	4.1	4.4	( <sup>2</sup> )	+3	.....	-3	( <sup>2</sup> )
Plan to buy in 3 months.....	4.5	3.9	3.8	3.8	+5	+2	.....	+4
<b>Growth items: <sup>3</sup></b>								
Plan to buy in 6 months.....	6.1	5.6	6.1	( <sup>2</sup> )	-1.0	-1.6	-1.8	( <sup>2</sup> )
Income under \$7,500.....	3.8	3.7	4.4	( <sup>2</sup> )	-1.1	-8	-1.3	( <sup>2</sup> )
Income \$7,500 and over.....	12.9	12.0	14.3	( <sup>2</sup> )	-1.3	-3.7	-3.7	( <sup>2</sup> )
Definitely plan to buy.....	2.2	2.1	2.1	( <sup>2</sup> )	-5	-3	-9	( <sup>2</sup> )
Plan to buy in 3 months.....	2.8	1.9	2.0	( <sup>2</sup> )	-9	-1.1	-1.6	( <sup>2</sup> )

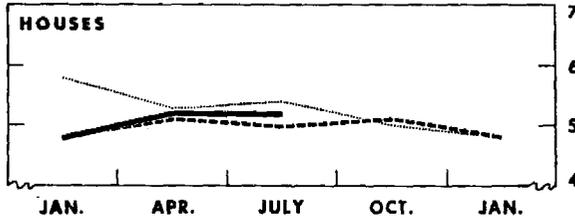
<sup>1</sup> Change for used cars shown for January-July rather than April-July period.<sup>2</sup> Not available.<sup>3</sup> Sum of plans to buy washing machines, refrigerators, television sets, air conditioners, clothes dryers, radio and phonographic equipment, and dishwashers.<sup>4</sup> Sum of plans to buy first 3 items listed in note 2.<sup>5</sup> Sum of plans to buy last 4 items listed in note 2.

NOTE.—Plans to buy include plans of families for which income was not ascertained.

**AUTOS AND HOUSES - PLANS TO BUY WITHIN 6 MONTHS**

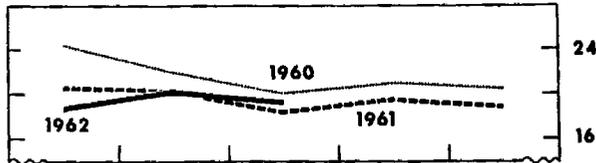


**WITHIN 12 MONTHS**

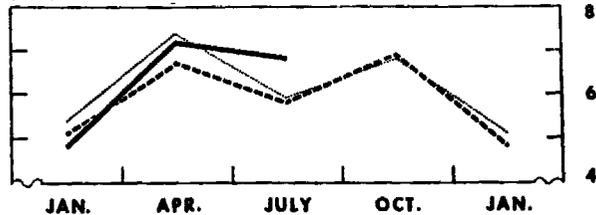


Note.--Plans to buy new autos and used autos include pro rata shares of planners undecided between new and used. They differ from proportions in Table 1 which include only specific plans to buy either new or used cars.

**HOUSEHOLD DURABLE GOODS - PLANS TO BUY WITHIN 6 MONTHS**



**WITHIN 3 MONTHS**



NOTE:--Plans to buy items listed in Table 2.

TABLE 1.—Plans to buy houses and durable goods, selected periods, 1960-62<sup>1</sup>

Buying plan	April 1960	July 1960	April 1961	July 1961	October 1961	January 1962	April 1962	July 1962
Percentage of all families								
Planning to buy new or used automobile: <sup>2</sup>								
Within 12 months.....	17.1	16.8	16.6	17.4	18.5	18.1	18.9	17.4
Within 6 months.....	8.8	8.1	8.4	8.4	9.1	9.1	10.2	8.8
Within 3 months.....	3.1	2.7	2.9	3.0	3.0	2.6	3.6	3.1
Planning to buy new automobile								
Within 12 months.....	7.0	6.9	6.8	7.6	8.1	7.8	7.7	7.4
Within 6 months.....	3.3	3.1	3.1	3.4	3.7	3.7	3.4	3.4
Within 3 months.....	1.2	.9	.9	1.1	1.4	1.1	1.3	1.1
Planning to buy used automobile								
Within 12 months.....	7.2	7.2	7.7	7.9	8.2	8.2	9.2	8.1
Within 6 months.....	3.9	3.8	4.1	4.2	4.4	4.3	5.6	4.5
Within 3 months.....	1.4	1.4	1.7	1.6	1.4	1.3	2.1	1.7
Planning to buy house (new or existing):								
Within 24 months.....	11.1	11.2	10.0	10.0	10.6	9.8	10.0	10.1
Within 12 months.....	5.3	5.4	5.1	5.0	5.1	4.8	5.2	5.2
Within 6 months.....	2.5	2.4	2.3	1.9	2.0	1.8	2.3	2.3
Plans per 100 families								
Planning to buy household durable goods: <sup>3</sup>								
Within 6 months.....	21.9	20.1	20.2	18.4	19.6	18.8	20.1	19.3
Within 3 months.....	7.4	5.9	6.7	5.8	6.9	4.8	7.2	6.8
Planning to buy major household durable goods: <sup>4</sup>								
Within 6 months.....	13.9	14.0	13.0	12.8	13.1	12.2	13.0	13.2
Within 3 months.....	3.8	3.8	3.7	3.9	4.5	3.2	4.0	4.5

<sup>1</sup> As reported in interviews in the 1st month of each calendar quarter. Interviews are taken in the week that includes the 19th of the month. Planning period begins on date of interview.

<sup>2</sup> Includes those undecided between new and used.

<sup>3</sup> Sum of plans to buy washing machines, refrigerators, television sets, air conditioners, clothes dryers, radio and phonographic equipment, and dishwashers.

<sup>4</sup> Sum of plans to buy 1st 3 items in note 3 above.

TABLE 2.—Plans to buy specified durable goods within 6 months, selected periods, 1960-62

[Percentage of all families]

Type of durable goods	April 1960	July 1960	April 1961	July 1961	October 1961	January 1962	April 1962	July 1962
Washing machine.....	6.0	5.9	5.3	5.1	5.4	5.2	5.4	5.3
Refrigerator.....	3.8	4.0	3.6	3.4	3.3	3.1	3.4	3.6
Television set.....	4.1	4.0	4.1	4.2	4.5	3.9	4.2	4.3
Air conditioner.....	3.4	1.4	2.6	1.1	1.2	1.9	2.6	1.3
Clothes dryer.....	1.8	2.0	1.8	1.7	1.9	1.8	1.8	2.1
Radio and phonographic equipment <sup>1</sup> .....	1.9	1.9	2.1	2.1	2.5	2.3	1.9	1.9
Dishwasher.....	.8	.8	.8	.7	.8	.6	.8	.8

<sup>1</sup> Radios or phonographs (or their component parts) costing together \$100 or more.

TABLE 3.—*Past and expected changes in income, selected periods, 1960-62*

[Percentage distribution of families]

Direction of change	April 1960	July 1960	April 1961	July 1961	October 1961	January 1962	April 1962	July 1962
Current income compared with a year earlier:								
Higher.....	22.2	21.5	20.7	20.6	22.6	22.2	23.1	21.1
Same.....	61.3	61.9	59.9	61.0	59.9	60.2	61.6	63.7
Lower.....	15.5	15.7	18.5	17.8	16.6	16.5	14.6	14.4
Doesn't know.....	1.0	.9	.8	.9	.9	1.0	.8	.8
All families.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expected income compared with current: <sup>1</sup>								
Higher.....	24.2	24.6	23.9	24.7	23.7	24.0	24.2	23.2
Same.....	60.2	59.6	59.4	58.5	59.3	60.0	60.3	61.2
Lower.....	5.6	5.9	5.4	5.8	5.7	5.0	5.1	5.1
Doesn't know.....	10.0	9.8	11.4	11.0	11.3	11.1	10.4	10.6
All families.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

<sup>1</sup> Expected a year hence.

NOTE.—Details may not add to totals because of rounding.

Chairman PATMAN. Thank you, Miss Dingle.

Before calling on Mr. Katona, I would just like to invite Miss Dingle's attention to the fact that she referred to the idea that the stock market might have something to do with consumer caution. In this connection, Mr. Greenwald said in his statement—this is a very significant statement—that business in general had not cut back or canceled plans for investment in new facilities in 1962 as a result of the sharp drop in stock prices in May and June or the so-called loss of business confidence.

Miss DINGLE. I wish we knew what the effect of the stock market decline was. Certainly I would not like to be in the position of saying exactly what it is. One of the questions frequently asked is what the stock market decline has done to consumer confidence, and if it had any effect directly, it would be more likely to be on the upper-income groups. I would not want any sign of weakness on their part to be overemphasized, and certainly it does not show up in their plans to buy houses or used cars.

I thought this was a matter that might be of interest in view of the questions that have been raised.

Chairman PATMAN. Thank you very much.

Mr. Katona you may proceed in your own way.

I believe you have a prepared statement.

**STATEMENT OF GEORGE KATONA, SURVEY RESEARCH CENTER,  
INSTITUTE FOR SOCIAL RESEARCH, UNIVERSITY OF MICHIGAN**

Mr. KATONA. Thank you.

I have been director of the economic behavior program of the Survey Research Center since its establishment in 1946 and professor of economics and of psychology at the university of Michigan. Originally, I have been a psychologist, but devoted the last 25 years to a study of consumer behavior and expectations.

Our research program stems from the conviction that the role of consumers in the American economy has undergone substantial changes. Before World War II it was justifiable to consider business

investment and Government deficits or surpluses as the sole autonomous factors influencing the business cycle and to assume that the consumer sector was an unimportant transmitter of income generated elsewhere. But during the past 25-odd years the number of middle-income families has increased greatly, and today a very substantial proportion of American families have discretionary income; many families also have some reserve funds; credit is available and buying on credit is widely accepted by consumers; finally, a sizable share of consumer spending is for postponable and discretionary expenditures. Today we must recognize three forms of investment: business investment, consumers' tangible investment expenditures for housing, automobiles, and appliances, and investment in human capital—primarily for education and health.

Consumer investment expenditures are not a function of money alone. Ability to buy is important, but changes in willingness to buy may occur independently of changes in income and may influence discretionary consumer demand. That optimism or pessimism, confidence or its absence matter has often been asserted in the past. What is new is that we are in a position to measure changes in consumer attitudes and expectations. The Survey Research Center began with such measurements 15 years ago. Even after 15 years of experience, shared over the last few years by other organizations, there remain many unsolved problems. Yet several crucial turning points in consumer expenditures for durable goods have been signaled in advance by Survey Research Center data on consumer expectations, and statistical analysis indicates that consumer expectations, as measured by the Survey Research Center, have substantial predictive value.

It is not possible to determine changes in attitudes and expectations through a few simple questions. The Survey Research Center conducts hour-long personal interviews at regular intervals, each time with a different nationwide sample of consumers, drawn by rigorous methods of probability sampling.

Senator DOUGLAS. May I ask how large your sample is?

Mr. KATONA. Our quarterly samples are about 1,350 families, and the first quarter of the year it is about double.

Senator BUSH. What is the geographical distribution?

Mr. KATONA. It is all over the Nation from Atlantic to Pacific.

Senator DOUGLAS. Is that about the same number of persons sampled in the Gallup poll?

Mr. KATONA. The Gallup poll unfortunately gives very little information about the size of its sample and the sampling composition. The number of cases is not the most important point. We assume from published data and information that Gallup still does not use rigorous probability methods.

Senator DOUGLAS. But on numbers, I have seen various statements that the probable number covered by the Gallup poll is somewhere around 1,500. Have you seen those?

Mr. KATONA. I have seen those, too. I don't know the facts. The number is not essential as is well known from the Literary Digest debacle. There were thousands and thousands of interviews.

Senator DOUGLAS. I understand.

Chairman PATMAN. There are 3,070 counties in the United States. That is about one for every two counties?

Mr. KATONA. No.

Senator DOUGLAS. There are about 1,500 of these counties which are insignificant in size. There are many counties—I will not mention in which State—which consist primarily of sagebrush.

Chairman PATMAN. You mean one to the county, then, instead of one to two counties?

Senator DOUGLAS. It would be very interesting to get the sampling figures. This figure of 3,100 counties is very deceptive, as anyone who runs for office in a large State knows.

Mr. KATONA. May I say that the sampling variations are important to assess the significance of certain small changes. But on the whole, modern statistical mathematical research has proved that sampling is substantially solved. If you have the money, you can draw reliable small samples. The real questions are reporting errors people not telling the truth, or not expressing themselves correctly; how to formulate the questions, since the answers depend on how the questions are formulated. Here are our great problems, and not in sampling any more.

Senator DOUGLAS. You have to have a minimum number, however.

Mr. KATONA. Of course.

Chairman PATMAN. You may proceed.

Mr. KATONA. The fixed question—free answer method of interviewing is used; respondents answer in their own words and are asked to explain why they think as they do. We do not ask multiple-choice questions which suggest the answers. We conduct such surveys now four times a year, in February, May, August, and November.

Our August survey, devoted especially to a study of consumer reactions to the stock market decline and the tax reduction proposals, is now in the field; the findings will be available in September. Therefore I am basing my discussion on our May survey, the major findings of which were given to survey sponsors early in June and released to the press on July 3. I brought along a few copies of the survey report for submission to the committee. With your permission, I shall summarize the major findings and conclusions and omit detailed documentation in my presentation.

The reason is I would like to concentrate my oral presentation here on new data and its interpretation. Statistical documentation of the data is available here in this supplementary material.

The Survey Research Center's measures of consumer attitudes and expectations advanced from the low point registered in February 1961 for about 12 months. Yet the improvement was not as extensive as following the 1958 or the 1953-54 recessions and did not continue in 1962. As table 1 of the survey report shows, there was even a small decline in the center's index of consumer attitudes from February to May 1962. The decline was so small, when sampling variations are taken into account, that it is appropriate to view the index as having stayed at a plateau during the first half of 1962.

The recovery was not as long and not as large as following previous recessions, and over the last few months, that is from February to May 1962, we had a sidewise movement.

While general consumer attitudes indicate the sluggishness of the recovery from the 1960-61 recession, in one important area our data have justified optimism since the spring of 1961. Attitudes toward

the automobile market and intentions to buy new cars showed an upsurge as early as May 1961 and remained on a high level during the following 12 months.

The original report given to the press over a month ago shows a table about intentions to buy cars. Let me summarize here three major figures. They showed that according to our surveys, 13.8 percent of families intended to buy cars during the next 12 months in February 1961; 16.4 percent in May 1961; and 17.4 percent in May 1962. The statistical data are presented in the report submitted to the committee. I may add that the upsurge of automobile intentions and, generally, of attitudes toward automobile buying was shown in our surveys, whereas it was not reflected or at least not strongly in the surveys conducted by the Bureau of the Census and reported by Miss Dingle.

In each of its surveys the Survey Research Center asks more than 50 questions about consumer attitudes and expectations. There have been times in the past when practically all these measures pointed uniformly upward or downward. Not so in the recent past. In addition to questions about automobiles, questions about personal financial prospects and market conditions have indicated satisfaction and optimism in 1962. In particular, the feeling that rising prices are reducing real income has become less frequent during the past 12 months.

On the other hand, there was a change for the worse in people's opinions about economic prospects, especially among upper income people. The consumer's mood is sober because of three persistent concerns: the recurrence of recessions, the relatively high level of unemployment, and the cold war. The great majority of Americans have drawn the conclusion from the experiences of 1958 and 1960-61 that Government and business are capable of forestalling a depression, but can do nothing to stop the recurrence of short and nevertheless painful recessions.

Our findings are, if you ask people whether a depression like in the thirties will recur, the overwhelming majority says, "No, it is impossible. Government and business know how to deal with it." If you ask how about recessions, how about some short peaks of unemployment, the overwhelming majority says, "No, we can't do anything. They will recur. They are in the cards." Given this frame of mind, people are sensitive to bad news.

We concluded, therefore, from an analysis of our data that up to May 1962 there was a sidewise movement which, although it did not signal a downturn, indicated that consumers would not contribute to a faster economic growth—unless new stimuli alter the prospects seen by them.

I turn now to an analysis of consumer reactions to two new developments, the stock market decline and the tax cut proposal. The dramatic break in the stock market occurred the end of May, when interviewing for our May survey was almost completed. Yet the market was already weak in the preceding weeks and even months. Nevertheless, we have reason not to attribute the findings reported up to now to stock market developments. It must be kept in mind that stockholdings are highly concentrated: Our surveys show that only about 18 percent of the 55 million American family units own stock, and

only about 7 percent of family units own stock worth \$5,000 or more. Thus the proportion of people who have suffered losses, even paper losses, is relatively small.

Yet the decline in the stock market has received wide publicity, and I expect to find in our August data that a very substantial proportion of consumers have heard of it. On the other hand, on the basis of past data, I expect to find that only a small proportion of the American people accept the notion that the stock market decline is a signal for an economic recession. Most Americans do not see a close connection between what happens in the stock market and what happens to the economy. This attitude is in line with the high demand for automobiles which continued in June and July. But there exists a minority with different views and therefore, overall, taking majority and minority together, the probability is that the August data will indicate more consumer caution and uncertainty than the May data.

Over the past few years the Survey Research Center has carried out extensive studies about consumer attitudes toward taxes. Since there has been some discussion about the results of a recent Gallup poll—it was criticized by President Kennedy at his press conference last week—permit me to submit some data.

In May and again in November 1961 we asked the following question of representative, nationwide samples:

There has been discussion about reducing taxes at the present time; do you think this would be a good idea or a bad idea?

The findings are reproduced in my table below. It appears that in 1961 the American people were about equally divided between those who thought tax reduction was a good idea and those who thought it was a bad idea. Naturally, many people might not have given any thought to the problem and might have made snap judgments. Of particular significance, therefore, is a question about the reasons people have for their opinions.

After they say that would be a good idea or a bad idea, we asked them, "Why do you think so?" In reply to this question, we found that only 13 percent of all people favored a tax cut because they thought it would increase purchasing power and stimulate recovery. So, if you wish to call it that, the sophisticated economic notion was shared last year by about 13 percent of American consumers.

Slightly over 20 percent favored a tax cut because, as they put it, "taxes are too high." On the other hand, 35 percent held that tax cuts would not be appropriate since the money was needed for national defense and other Government services. Another 8 percent were against tax cuts because they feared deficits or felt the budget should be balanced.

We shall have more data along these lines when our August survey is completed. Then we shall also know more about how people would use the money from a tax cut. Past data indicate that most low- and middle-income people would spend the money.

Recently people may have heard much more about the problem of a tax reduction than a year ago. Nevertheless, probably, the connection between tax reduction and increase in purchasing power is

not fully understood. During World War II when our group made extensive studies of war bonds for the Federal Government, we found that in the opinion of many people the Government could not buy the tanks and planes if the people did not buy war bonds.

In 1946 a substantial proportion of the American people said, "We buy war bonds to bring the boys back home," as if it would be impossible to ship the boys back home from the South Pacific if people would not buy war bonds.

Similar erroneous notions still prevail about taxes and defense expenditures. There are many people who believe that if taxes are not high enough, we can't do our duty in defending the country and in fighting the cold war. I conclude that should a tax cut be enacted, the Government would have an additional task of informing and educating the public about the reasons for its action.

Also, I may add, the Government should sponsor surveys about consumer attitudes toward a tax cut, both if the measure takes effect and if it does not, so as to understand better what is happening in our economy.

Should taxes be reduced now? As said before, people feel uncertain and cautious because they are not aware of any factor that might be capable of stimulating the economy and reducing unemployment. In a tax reduction, I believe, many people would see such a stimulus.

We are not in a recession today, even though the extent of the recovery is far from satisfactory. According to available indications there will be no recession in the consumer sector during the winter of 1962-63. Therefore the argument, let us wait with the tax reduction, is not without merit. But the last few weeks have brought forth a new consideration. Probably very many people have heard about the tax reduction proposals. There is a risk that they would view a decision by Congress not to reduce taxes now as a disappointment. A negative decision about the tax cut might then represent a new factor adding to pessimistic views and making the recurrence of a recession more probable than it has been. What Congress does is important; how the people interpret what Congress does or doesn't do is likewise important.

(The chart and report referred to are as follows:)

*Opinions on the advisability of a tax reduction, spring and fall, 1961*

[Percent]

Tax reduction	All families <sup>1</sup>	Family income				
		Under \$3,000	\$3,000 to \$4,999	\$5,000 to \$7,499	\$7,500 to \$9,999	\$10,000 and over
A good idea.....	42	53	43	39	32	33
Pro-con.....	6	4	7	6	6	4
A bad idea.....	43	29	44	47	57	55
Don't know, not ascertained...	9	14	6	8	5	8
Total.....	100	100	100	100	100	100
Number of cases.....	2,256	564	462	581	250	282

<sup>1</sup> Includes cases whose income was not ascertained.

*Reasons given for opinions (all families)*

	Percent
Good idea because:	
Demand needs to be increased; to stimulate recovery-----	13
Taxes are too high-----	22
Bad idea because:	
Government needs money; defense expenditures high-----	35
Tax cut would cause deficit; budget should be balanced-----	8

NOTE.—The questions were: "There has been discussion about reducing taxes at the present time. Do you think this would be a good idea or a bad idea?" "Why do you think so?"

Source: Survey Research Center, the University of Michigan.

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CONSUMER ATTITUDES AND INCLINATIONS TO BUY, MAY 1962

Survey Research Center, Institute for Social Research, University of Michigan,  
Ann Arbor, Mich.

The Survey Research Center conducted the latest of its quarterly Surveys of consumer attitudes and inclinations to buy between April 23 and May 29, 1962. A nationwide cross section of about 1,300 adults, selected by probability methods, was interviewed. Similar surveys have been conducted regularly since 1951.

This report summarizes the major findings of the May 1962 survey. In addition to measuring consumer expectations and intentions to buy, these surveys are particularly concerned with investigating the reasons for changes in attitudes. The surveys are directed by George Katona and Eva Mueller.

Consumer attitudes show stability over the past few months. The American people remain soberly optimistic and appear disposed to continue the high level of spending evident during the spring months of 1962. The outlook appears particularly favorable for the automobile market. These are the indications obtained from the latest Survey of Consumer Attitudes and Inclinations to Buy, conducted by the Survey Research Center of The University of Michigan from April 23 to May 29, 1962. The Center's Index of Consumer Attitudes is at the same level as in November 1961, but slightly below January 1962. The recent decline is so small (when sampling variations are taken into account) that it is appropriate to view the index as having stayed at a plateau during the past half year. As table 1 shows, this plateau is significantly below the peak levels attained in 1955-56, but does not compare unfavorably with more recent highs reached by the index.

The overall stability of the index is brought about by counterbalancing changes in two major areas of consumer sentiment. Consumers' satisfaction with their personal financial situation has improved since November. Favorable changes in personal finances seem to be reinforced by price stability, or more precisely, by absence of the feeling that rising prices are reducing real income. Fewer people indicate that they have worries of an economic kind. The recent accumulation of liquid assets by consumers has contributed to their feeling of financial well-being. Yet, as in past years, many people are far from content with their savings performance and strive to save more. The proportion of people who expect to be better off in another year has not been higher at any time in the past 10 years (table 2). And even longrun personal financial expectations which usually show great stability, have grown somewhat more optimistic in recent months.

At the same time, people's expectations regarding business conditions in the coming year, which improved decidedly between November 1961 and early 1962,

show some change for the worse since the beginning of the year. A very small deterioration also occurred in attitudes toward longer term economic prospects. Table 3 indicates that evaluations of the business outlook are considerably more favorable now than at the bottom of the 1960-61 recession, but (as in November 1961) are well below peak levels.

The weakening of optimism about business prospects since January is particularly pronounced among people with incomes of \$7,500 and over. Moreover, this is the only group which views business conditions less confidently than last November. It is likely that people in the upper income brackets are most sensitive to stock market news, and that stock market developments account in part for their change in attitudes. Yet, this group may also be most aware of public discussions about the somewhat unsatisfactory strength of the recovery.

Although stock prices declined throughout the interviewing period, the most dramatic break in the stock market occurred near the close of interviewing. This may explain the fact that only 3 percent of all people spoke spontaneously of the drop in stock prices when discussing economic news they heard recently. Direct questions on what people know about stock market developments and how they react to them were not included in the survey. Still, it is possible to compare interviews taken early during the interviewing period with those taken in late May when people might have been more concerned about the stock market decline. These comparisons reveal only a slight deterioration in evaluations of business conditions in late May as against late April and early May. Since late May the stock market has dropped further and has been repeatedly in the news. If the downward trend persists, it might well come to have a stronger impact on consumer confidence and expectations. The Survey Research Center's August survey will (among other things) be concerned with this question.

Answers to questions about the news people heard in the past few months show clearly that consumers are mindful of a number of unfavorable aspects of the business situation other than the stock market. Among the 51 percent of people who could recall some recent economic news, 28 percent referred to unfavorable news, and only 23 percent to favorable news. Even without the 3 percent who spoke about the stock market, references to adverse developments exceeded references to favorable developments by a small margin, while the reverse was true in November 1961. (At that time 21 percent referred to unfavorable news and 26 percent to favorable developments.)

The current mood of consumers is sober, perhaps even cautious, because of three persistent concerns: the recurrence of recessions, the relatively high level of unemployment, and the cold war. Given this frame of mind people are sensitive to bad news. Adverse developments in particular industries or localities, which may be of minor importance in the overall picture, are discussed and remembered. In May more people than last November said they had heard or read that business is declining; occasionally mention was made of specific industries, particularly steel. The steel price stabilization was rarely mentioned, and in these few cases opinions regarding it were divided. People also spoke about intense business competition, the impact of automation on employment opportunities, and labor problems.

Attitudes toward market conditions for major consumer goods were very favorable already last November. Evaluations of the automobile and housing market have improved slightly since then, while buying conditions for household goods are viewed in about the same way as in November (table 4). Satisfaction with recent price trends for durable goods and houses accounts to a large extent for the judgment that this is "a good time to buy."

Viewed as a whole, expressed buying intentions for major consumer goods exhibit no clear trend either up or down. Buying plans for new automobiles have been exceptionally frequent ever since May-June 1961. In January-February they dipped temporarily, but in May they were back at the high 1961 level or even slightly above.

*Percentage of families expressing intentions to buy a car<sup>1</sup>*

	All cars	New cars <sup>2</sup>	Used cars <sup>2</sup>
January to February 1961.....	13.8	6.3	7.5
May to June 1961.....	16.4	8.9	7.5
November 1961.....	18.3	9.5	8.8
January to February 1962.....	17.1	8.5	8.6
May 1962.....	17.4	9.7	7.7

<sup>1</sup> Families that reported they would or probably would buy, plus  $\frac{1}{2}$  of those who said they might buy during the next 12 months.

<sup>2</sup> Uncertain whether new or used apportioned equally between these categories.

Plans to buy used cars are the same as a year ago, but are somewhat lower than last fall and winter. Plans to buy a house for owner occupancy are less frequent than a year ago and less frequent than in most recent spring surveys. However, expressed buying intentions for the upper income group do not show a decline over the past year. Intentions to make major home improvements remain at peak levels. Plans to purchase home appliances are now slightly higher than a year ago for almost all major appliances, but in most cases comparisons with earlier years are not favorable.

Clearly there is an element of caution in consumer sentiment. Yet it should be emphasized again that people evaluate their own financial situation favorably and are satisfied with buying conditions. Hence, the sidewise movement of the index of consumer attitudes should not be viewed as a signal of an impending deterioration of consumer confidence. Unless the flow of unfavorable economic and political news increases, the state of consumer optimism in May points to a sustained high level of spending, particularly if personal incomes continue to rise gradually.

On the other hand, it is evident that the consumer is not in an exuberant frame of mind. There are no indications in the survey that people are disposed to upgrade their standard of living more rapidly in the period ahead than they did during the past few years. Thus, the impetus to faster economic growth, sought by government and business, is not likely to come from the consumer sector in the near future—unless new stimuli alter the prospects seen by consumers.

TABLE 1.—*Index of consumer attitudes and inclinations to buy*

[Fall 1956=100]

Date of study	Exclud- ing buy- ing in- tentions (6 ques- tions)	Includ- ing buy- ing in- tentions (8 ques- tions)	Date of study	Exclud- ing buy- ing in- tentions (6 ques- tions)	Includ- ing buy- ing in- tentions (8 ques- tions)
June 1955.....	104.2	102.2	May to June 1959.....	95.1	100.2
October 1955.....	102.6	102.7	October to November 1959.....	91.1	90.2
May 1956.....	99.3	99.1	January to February 1960.....	96.7	99.3
August 1956.....	99.8	97.6	May 1960.....	92.0	91.7
November to December 1956.....	100.3	102.4	October to November 1960.....	92.8	93.1
June 1957.....	94.4	95.1	January to February 1961.....	92.4	91.7
November to December 1957.....	86.0	86.7	May to June 1961.....	94.4	95.0
January to February 1958.....	82.2	83.0	November 1961.....	96.4	96.2
May to June 1958.....	86.5	86.6	January to February 1962.....	98.7	99.1
October 1958.....	92.7	91.5	May 1962.....	96.8	96.3

TABLE 2.—Consumers' expectations regarding their financial situation a year hence

[In percent]

Expected change in financial situation	November to December 1955	October 1958	May to June 1959	October to November 1959	January to February 1960	May 1960	October to November 1960	January to February 1961	May to June 1961	November 1961	May 1962
<b>A. All families:</b>											
Better off.....	32	31	34	33	40	35	31	37	38	33	37
Same.....	48	46	48	47	40	45	47	42	45	48	47
Uncertain.....	14	15	12	15	12	13	17	13	10	13	10
Worse off.....	6	7	5	5	7	6	5	7	6	5	5
Not ascertained.....	( <sup>1</sup> )	1	1	( <sup>1</sup> )	1	1	( <sup>1</sup> )	1	1	1	1
Total.....	100	100	100	100	100	100	100	100	100	100	100
<b>B. Families with incomes of \$7,500 and over:</b>											
Better off.....	43	44	49	43	50	43	41	44	47	44	49
Same.....	44	38	41	40	35	43	43	40	38	43	38
Uncertain.....	8	12	8	12	9	9	11	8	8	9	7
Worse off.....	4	5	2	5	5	5	5	7	7	3	4
Not ascertained.....	1	1	( <sup>1</sup> )	( <sup>1</sup> )	1	( <sup>1</sup> )	( <sup>1</sup> )	1	( <sup>1</sup> )	1	1
Total.....	100	100	100	100	100	100	100	100	100	100	100

<sup>1</sup> Less than 1/2 of 1 percent.

NOTE.—The question was: "Now looking ahead—do you think that a year from now you people will be better off financially, or worse off, or just about the same as now?"

TABLE 3.—Business conditions expected during the next 12 months

[In percent]

Expected business conditions	November to December 1956	May to June 1958	October 1958	May to June 1959	January to February 1960	May 1960	October to November 1960	January to February 1961	May to June 1961	November 1961	January to February 1962	May 1962
<b>A. All families:</b>												
Good times.....	74	45	60	66	75	64	52	54	61	63	72	65
Good in some ways, bad in others.....	5	8	6	6	5	7	9	9	8	6	6	5
Uncertain.....	15	22	22	16	11	17	27	18	14	20	13	12
Bad times.....	5	23	11	10	7	10	10	17	16	10	8	17
Not ascertained.....	1	2	1	2	2	2	2	2	1	1	1	1
Total.....	100	100	100	100	100	100	100	100	100	100	100	100
<b>B. Families with incomes of \$7,500 and over:</b>												
Good times.....	88	50	76	76	83	79	63	56	69	80	82	73
Good in some ways, bad in others.....	4	10	4	10	5	6	6	9	9	5	5	6
Uncertain.....	6	17	13	7	6	9	19	12	11	8	7	16
Bad times.....	1	21	6	4	6	5	9	21	10	6	5	10
Not ascertained.....	1	2	1	3	(1)	1	3	2	1	1	1	1
Total.....	100	100	100	100	100	100	100	100	100	100	100	100

<sup>1</sup> Less than ½ of 1 percent.

NOTE.—The question was: "Now turning to business conditions in the country as a whole—do you think that during the next 12 months we'll have good times financially or bad times, or what?"

TABLE 4.—Opinions about buying conditions for large household goods, cars, and houses

[In percent]

Opinion	June 1955	November to December 1957	June 1959	October to November 1959	May 1960	October to November 1960	May to June 1961	November 1961	May 1962
<b>Large household goods:</b>									
Good time to buy .....	55	39	48	43	44	42	45	48	49
Uncertain; depends .....	27	34	37	36	38	39	38	38	39
Bad time to buy .....	18	27	15	21	18	19	17	14	12
<b>Total .....</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Cars:</b>									
Good time to buy .....	50	26	38	82	41	40	44	42	47
Uncertain; depends .....	27	39	42	34	40	40	42	44	38
Bad time to buy .....	23	35	25	34	19	20	14	14	15
<b>Total .....</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Houses:</b>									
Good time to buy .....	( <sup>1</sup> )	26	42	38	37	35	42	41	45
Uncertain; depends .....		28	33	31	33	31	28	35	32
Bad time to buy .....		46	25	31	30	34	30	24	23
<b>Total .....</b>		<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

<sup>1</sup> Not available.

NOTE.—The questions were: "Now about things people buy for their house—I mean furniture, house furnishings, refrigerator, stove, TV, and things like that. Do you think now is a good time or a bad time to buy such large household items? Why do you say so?"

"Thinking of the automobile market—do you think the next 12 months or so will be a good time or a bad time to buy a car? Why do you say so?"

"Generally speaking, do you think now is a good time or a bad time to buy a house? Why do you say so?"

Chairman PATMAN. Thank you, sir.

Senator Douglas?

Senator DOUGLAS. First, I want to compliment all three of the panelists for these very informative and objective analyses.

Consumer expenditures take about 65 percent of the gross national product, gross private domestic investments about 14 percent, Government purchases somewhere around 21 or 22 percent. We have covered two of these fields today. I take it that all three of the witnesses agree that so far as objective measurements are concerned, there is not likely to be any decrease in personal consumption expenditures or private domestic investment. There may, indeed, be an increase.

In the concluding paragraphs of Mr. Katona's paper, he threw in a new argument which I never heard before: namely, since statesmen, politicians, economists, and journalists have been advocating a tax cut, the public is likely to be greatly aggrieved if it does not come. What you are saying is that, though there is no sound economic reason for these positions on the part of a statesman, politician, economist, or journalist, nevertheless, they will so affect public opinion that you have to conform with their faulty analyses.

This, indeed, is a strange argument which I find very difficult to accept.

Mr. KATONA. May I say, Senator, I did not say there is no sound economic argument. I think we all know one, that the 1962 recovery has been sluggish.

Senator DOUGLAS. That is true.

Mr. KATONA. Second, that the rate of growth of our economy since 1958 is nothing to be proud of. So I would say there are certain arguments. The third argument, that the recession is here or is threatening during the next few weeks, does not exist in my opinion according to our data.

Even then one may argue that preventive medicine is perhaps better than to operate when the appendix is about to burst. I leave that up to your judgment. As to the argument that people believe it, we have lots of evidence over the past few years that people's interpretation of what is going on influence their action.

Senator DOUGLAS. But if the interpretations are faulty, then must you conform to the faulty interpretations or try to change the interpretations and to have statesmen, politicians, economists, and journalists less trigger-happy and more restrained in their prescriptions?

Mr. KATONA. Again the word "faulty" is a value judgment which is hard to evaluate. It is not in line with objective indicators, but very often objective indicators don't prove good predictors because of people's notions and interpretations. So I think it is a real factor.

I am not radical regarding the analysis of psychological factors. I think both aspects are of importance. Ability to buy, which will probably continue to rise, is of tremendous importance. But the psychological notions and reactions to the ongoing discussions which emphasize recession and the need of tax cuts should not be forgotten.

Senator DOUGLAS. It is interesting that the argument for tax cuts now seems to be turning from the claim that it is necessary to prevent a recession, to the argument that it is necessary to speed up the rate

of economic growth. In other words, it is turning to a long-time factor.

As I see the situation, the benefit of a tax cut would be to create a deficit which would be met by increased borrowing and the creation of additional monetary purchasing power to buoy up consumers' income to the level of the prices charged by industry. I would like to ask if it would not be a better long-time remedy to try to bring prices down to the level of consumers' income rather than expanding consumers' income to the level of prices?

Mr. KATONA. I do not know of any way to bring prices down.

Senator DOUGLAS. You don't believe in the antitrust policy?

Mr. KATONA. I do.

Chairman PATMAN. Are you seriously insisting that we could roll back prices, Senator?

Senator DOUGLAS. I am saying we should try.

Chairman PATMAN. We tried that during the war.

Senator DOUGLAS. There you had a big expansion of the money supply. If you try to reduce price while expanding the money supply at a rate much faster than the growth in production, the effort is likely to be ineffective.

Mr. KATONA. We have made extensive studies on people's reaction to prices, and people thoroughly dislike inflation and are worried if prices rise out of understandable reason. They also distrust price reductions. What creates consumer confidence is price stability. People get accustomed to prices. After a while they think this is the right price just because it has been in existence for a year or longer. Price stability is perfectly satisfactory in the minds of most American consumers.

Senator DOUGLAS. You see what we are getting into. If you say that an increase in consumer purchasing power is necessary in order to speed up the rate of economic growth—and I agree with this—and then you say we cannot get it through a reduction in prices but only through an expansion in money income to be effected by tax cuts and governmental deficits, you are saying, in effect, that there must be a continuous injection of additional monetary purchasing power into the economy and continuing governmental deficits in order to maintain substantially full employment.

I think we ought to examine that very carefully before we come to that conclusion. This is really the difference between Keynes' 1936 book and his 1929 book on the theory of money. I have always thought the theory of money was basically sound. But the 1936 book, I think, disregarded the fact that the high unemployment in England, which continued ever since 1920, was, in my judgment, primarily due not only to a high interest rate policy of the Bank of England, which was part of it, but also due to the presence of an increasing degree of monopoly, quasi-monopoly, restriction of output, cartels, and so forth, which spread like a fever through British society and in which Keynes, himself, was one of the chief promoters.

If we abandon the effort to get a greater degree of competition in an industry and consequently a greater degree of price reduction, I think we are going to be driven to what you say. But we are going to pay a very heavy price for it. Before we turn to it, I would suggest most seriously that we try the other route.

Mr. KATONA. May I just say, Senator, on the question of continuous injection, I did not advocate a continuous injection. The people strongly believe that the Government can do something. People look to the Government for a new stimulus, for new trust.

Senator DOUGLAS. Is it possible that the Federal Reserve could do something?

Mr. KATONA. May I just say, first, about taxes, I do believe and there is every indication that millions and millions of Americans would consider a tax reduction as something rosy on the horizon and would get more optimistic and would spend more, not only spending the money they save in taxes, but still more, so that there would be an expansion in the next 12, even 24 months.

Whether later one needs further injections, that is beyond us. I argue for giving now a stimulus to the people, new hope and new thoughts that something is being done to improve the situation and to reduce not only unemployment but the threat of unemployment.

Senator DOUGLAS. I will just make two replies, because my time is almost up. The first is that your study of last year indicated that there were as many people opposed to a tax cut as were in favor of it, and you have not yet made your August study this year. So this is surmise on your part and not sound statistical material.

Second, the first lesson that any military commander must learn—he has two lessons—the first is so that his men do not fire prematurely on the enemy, to hold their fire, as Prescott said at Bunker Hill, until you see the whites of their eyes. The second, which even first sergeants have to learn, and lieutenants and generals have to learn, that you should not commit your reserves too quickly. You should have a reserve so that you don't mistake a diversionary attack for a main attack. I have been rereading Churchill's "Finest Hour." When the Nazis broke through the French line near Sedan and Churchill made his first visit to France and talked with General Gamelin he said, "Where is your strategic reserve?" Gamelin replied, "There is none. When the Germans came through, they went all the way."

So I have felt if you face the possibility of a recession, a tax cut is not the first thing you should do—a reduction in the interest rates is the first step. That has always been classic doctrine until the last 2 or 3 months. If that is not sufficient, and a recession is really on you, then the tax cut.

Senator BUSH. If you faced a recession or you were in a recession, the reduction in interest would come with it, would it not?

Senator DOUGLAS. Yes. I am speaking of a reduction of the interest rate as a preventive measure to stimulate housing. When you stimulate housing, you stimulate building materials, lumber, brick, cement, steel, electrical equipment, and so on. I have taken up more than my time, Mr. Chairman.

Chairman PATMAN. Thank you, Senator Douglas.

Senator Bush?

Senator BUSH. I am glad the Senator did take up more than his time. I think he developed a very interesting line of thought here.

Senator DOUGLAS. The Senator is always a gentleman.

Senator BUSH. I agree with what the Senator said about the tax cut, but I am very dubious about his feeling about interest rates.

Senator DOUGLAS. I have said you would be dubious about that.

Senator BUSH. It seems to me that interest rates are a reflection of the business situation and not a cause of it, you might say, one way or another. If business is good, interest rates are apt to go up. I think history would show that they do not inhibit the expansion of business. Many of our greatest periods of expansion in this country have come when high interest rates prevailed throughout the period. I think particularly of the 1920's, when for that whole decade we had relatively high interest rates. Certainly they did not inhibit a very broad and deep expansion of our economy at that time.

I would like to ask our friends from McGraw-Hill particularly this question: What effect do you think a tax cut at the present time, of the nature that is being discussed, something of the order of \$5 to \$6 billion, would have on business confidence generally? I am not talking about the consumer now as Mr. Katona was, but I am talking about the people that are responsible for the management of the great reservoirs of savings of our people and of the great funds that are at the disposal of the companies, large and small, upon which so much depends, especially the direction we are going to go with the national economy.

In other words, these people have the decisions to make, as you pointed out in your testimony. What is your judgment regarding the effect, Mr. Greenwald, of a tax cut now upon business confidence generally?

Mr. GREENWALD. I think it would act as a stimulant.

Senator BUSH. On confidence?

Mr. GREENWALD. Especially on confidence, sir. However, I would like to point out that at this time I don't see any necessity for a tax cut.

Senator BUSH. I gathered that from your testimony. You think while there is no necessity for it, still it would have an increasing effect upon business confidence?

Mr. GREENWALD. I think it would.

Senator BUSH. How do you reconcile those two points of view?

Mr. GREENWALD. I say that I don't think it is necessary at this time, because I think we have a very high level economy. I think our rate of growth, and we can get into the numbers game on the rate of growth in any direction, shape or form you would want to take it. However, if we go back to the end of the war and start from 1947, the rate of growth of the United States has been roughly 3.65 percent per year at a compounded rate. I think this is a good rate of growth. I don't believe that we should have to worry about 4, 5, or 6 percent rate of growth. If you consider where we are today, it seems to me that is a high-level economy.

I think if we were to talk about our strengths rather than our weaknesses, we would probably be better off. I think tax reform would help the confidence of business because this would mean there would be more incentive for them. Businessmen are looking for profits. Profits are important. I think there has been a profit squeeze despite the fact that profits are relatively high. I believe that if businessmen were told that the profit squeeze is going to be eased, that, profits will be better after taxes, then I think there is more incentive for the businessman. This develops confidence.

Senator BUSH. As the Senator from Illinois pointed out, if you have a tax cut of the order of \$5 or \$6 billion, this would be probably in addition to what other deficits we may face in fiscal 1963. Those estimates are now of the order of \$4 billion or maybe more than that, without any thought of a tax cut. So we are thinking in terms of a possible deficit of \$10 billion that might occur from a tax cut at a time when, as you point out, things are very good. The economy is high, gross national product is high, national income is high, and the various elements of the economy are strong and looking strong.

Wouldn't you be fearful, or would you be fearful that the financing of this kind of a deficit which, as the Senator pointed out, would largely have to be done by addition to the money supply through financing through the banking system, that this would have an inflationary effect which might injure the very object or retard the very object we are seeking to attain?

Mr. GREENWALD. I would say no in this respect. I think our economy does have excess capacity, as I pointed out. We have to close the excess capacity gap in unemployment and in facilities. The most important thing it seems to me would be to close this gap. The way I would think of tax changes would be along the type of tax reform where business would get some advantage and the consumer would get some advantage.

Senator BUSH. Mr. Ellis, the Du Pont economist, pointed out yesterday that we always have excess capacity in some areas. It is not unusual or undesirable that we have excess capacity. In some areas of the economy we don't have excess capacity. We are running close. We don't run to our full capacity for very long. I just wonder if this talk about excess capacity is not exaggerated from time to time. What is your comment about that?

Mr. GREENWALD. I would say no, sir; I don't think it is, especially when we deal with the manufacturing area. In other areas I can't say because I don't know enough about them. When I talk about capacity, I am talking about what the companies are telling us about capacity, not something that I estimated. This is a direct measure. If a company tells us it is working at 80 percent of capacity and it would like to operate at 95 percent of capacity, I know that that particular company has 15 points of what might be called excess capacity. This margin has to be reduced to the point where it can do its best job and produce its best profitmaking operation.

On the average for all manufacturing, we now arrive at an 84 percent operating rate and a 90 percent preferred rate. So you have a gap of only 6 points. But there are 6 points to eliminate before you would get the most efficient operating rate.

Senator BUSH. On that point, aren't we gradually closing it?

Mr. GREENWALD. We are. We have moved up from the low of the recession. However, you can say in a way that we have not moved up as fast as many of us thought we would. I don't know whether that is significant or not. But, if the businessman makes a plan and he thinks he is going to do so much in sales but doesn't, then you might say that this has some impact on his confidence. However, I don't think it has had much impact up to this time.

Senator BUSH. I think your estimate of the plans of businessmen is very reassuring, indeed. I certainly agree with your own opinion

that your whole appraisal of the situation does not warrant consideration of a tax cut at this time.

I have no further comment.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. First, I would like to say that I am very happy to see you again, Mr. Greenwald. You did a marvelous job before our Subcommittee on Statistics. I am happy to see in your statement you say you are considering seriously an exploration of the McGraw-Hill techniques as a public-private project because you are the pioneer of this technique and you have done excellent work in this area and your firm is considering this seriously.

I would also like to tell you how very grateful I am to you for making the statement you have just made this morning. Just yesterday one of the most distinguished Members of the Senate, Senator Javits, attacked President Kennedy's leadership and said there was a lack of confidence in the country, in the President of the United States and talked about the administration's alleged agonizing uncertainty and undecisiveness. Senator Javits was serious, and I challenged him on the floor of the Senate yesterday to document it, and in my judgment it was not there. You documented exactly the opposite case, and you have done it in spades here this morning.

You point out that the manufacturing industries overall plan to invest \$15.3 billion this year. It is down only \$110 million, which is not a significant drop. Then you point out that in most cases, when investment plans were lower than earlier, the reasons had nothing to do with the lack of business confidence or the drop in the stock market. You show there are a number of industries which have increased their investment plans.

Altogether I think this is solid documentation that there is no uncertainty that is provoking a lack of business confidence on the part of our business managers.

I think coming from McGraw-Hill, which is an objective organization, an organization which publishes Business Week, as I understand it, and is close to the business community, is an extremely significant assertion on your part.

I would like to ask you: You responded to Senator Bush that we needed a tax cut and that this would particularly be encouraging to the business community.

Mr. GREENWALD. Excuse me.

Senator PROXMIRE. I beg your pardon. You said that a tax cut would stimulate the economy. You did not say we needed one. You said the exact opposite, that it was unnecessary.

You reassert once again that the investment credit proposal of the administration would seem to have an insignificant effect on an increase in investment. You say \$300 million increase in investment although it will cost the Government \$1 billion to get it. That would be about the most expensive stimulation the Government handed out in a long time.

Then, you say that the comprehensive survey taken earlier this year shows that businessmen anticipated increasing their volume of cash flow composed of retained earnings and depreciation at a faster rate than investment in new plants and equipment. At that time they expected an increased cash flow of 14 percent and investment of only

10.5 percent. Why in the world do they need further tax cuts designed to increase cash flow? They certainly have plenty of cash available. The depreciation improvement which they have received only this year, only a few weeks ago, is going to add additional cash. So they have all the money in the world ready and available for investment. It certainly is not based on this apparently, is it?

Mr. GREENWALD. No, it is not. It is based on incentives and confidence. The incentive to the businessman. I think that is the only point that I would make about why we even should think about a tax cut now.

Senator PROXMIRE. You say an incentive to the businessman. You would agree that the profits were higher now than last year and the year before?

Mr. GREENWALD. In dollars but not in percentages of sales or return on equity.

Senator PROXMIRE. Yes, sir, Mr. Ellis showed that in percentage of investment they were the highest of any year since 1957 with the exception of 1959.

Mr. GREENWALD. If we look at ratios to sales, this is not the case. We did an editorial at McGraw-Hill not too long ago in which we talked about the squeeze on profits. If you take into consideration the long trend, I think we went back to 1946-50, the average profit on sales was 5 percent in 1951-55, 3.6 percent in 1956-60, 3.2 percent and in 1961 the profit percentage 3.1 percent. It came down substantially in those 5-year periods.

Senator PROXMIRE. Let us assume there is a relative squeeze on profits and you make a strong case that profits should be higher. Nevertheless, what would persuade business to invest when they have ample cash reserves to make the investment is an increase in consumer demand under these circumstances, isn't that correct? Even if the after-tax profit picture could be improved why in the world would a business invest if they don't have a specific reason in terms of satisfying a demand?

Mr. GREENWALD. I would agree with that, sir.

Senator PROXMIRE. So more important than a business tax cut under these circumstances with ample cash flow, the action already taken on the part of the administration with regard to depreciation, the investment credit which is likely to be passed this year—

Mr. GREENWALD. I would agree with that because this is the way to close the gap. This is the first step. I think you also have to make the other step, in combination, because in modernization terms industry is pretty far behind. I think we pointed that out in this testimony, too. A large percentage of our plant and equipment is obsolete. If we can improve that part of the economy, and this is what we are aiming at, with Revenue Procedure 62-21 and the tax credit, then I think we have a good chance of improving the situation. I would say this is the kind of thing that the businessman is waiting for. He wants to make a better profit margin. I think the level is not bad at this time, but improved margins are what he is aiming for. It is the profit margin that is being squeezed.

Senator PROXMIRE. Your position is that a tax cut is not necessary at the present time?

Mr. GREENWALD. Absolutely.

Senator PROXMIRE. If there is a tax cut it would be probably more stimulating for business if it were for consumers and individuals rather than corporations?

Mr. GREENWALD. I would like to see both. I think you have to have a combination.

Senator PROXMIRE. What you have said is not much of a case for a further tax cut.

Mr. GREENWALD. I agree. I see no case for a tax cut.

Senator PROXMIRE. I would like to ask Dr. Katona when you break down your statistics they are fascinating in what they tell about what people mean when they say they want a tax cut. On your final page you show that there is no group with incomes of over \$3,000 who favor a tax cut. The only group that favors a tax cut are those with incomes under \$3,000.

These are family incomes. I have computed the income taxes these people would pay and if there are four people in the family with a standard deduction they would pay about \$60 a year maximum. Therefore, I suggest these people are not talking about an income tax cut. When you say should we have a tax cut they're talking about a property tax cut.

These people pay about \$200 in property taxes. They pay close to \$75 or \$100 in sales taxes on the average. On the basis of my experience of talking with the people in my State they are very concerned about high taxes, but they are concerned about the local property and State taxes. The way your question is worded you say a tax cut, not an income tax cut. Therefore it is significant that those who are most conscious of the Federal income tax say no. Those who would be conscious of local taxes say, "Yes, we want a tax cut."

Mr. KATONA. You know, Senator, these are 1961 data and there was no income tax proposal at that time, so we formulated the question that way. It is easily possible that today the opinions are different. According to our knowledge, people mean both taxes. It is not correct to assume that they say no if they think of income taxes. According to the arguments made, mostly they think of income taxes. But any kind of tax cut would be a stimulus. I don't see any way to cut property taxes.

Senator PROXMIRE. I understand. But the question does not specify.

Mr. KATONA. That is right.

Senator PROXMIRE. It would seem a logical conclusion when you say you think taxes should be cut, without specifying an income tax and you get a response on the part of people whose taxes are concentrated in the nonincome tax area, they say, yes, a tax cut. Whereas, the people who pay the Federal income tax predominantly, and that is their principal tax, say no tax cut. Therefore, the action indicated for the Congress if we rely on public opinion would be not to cut Federal income taxes.

Mr. KATONA. I submitted this table primarily because of the lower part. I think the reasons people had in 1961 are still of interest. As to the division of opinion which says good idea or bad idea, the data are a year old and the data are of lesser value. In other words, I strongly emphasize the one point, that overwhelmingly those people who a year ago said a tax cut would be a bad idea had reasons which are erroneous, namely, the reasons that then we can't do what we

must do for national defense. That is why I said if a tax cut should be enacted this year, next year or whenever, it is necessary to inform and educate the people.

Senator PROXMIRE. I see. What you said at the very end I think is so important. If you are going to have a tax cut we have to do a far more extensive job of justifying that so that people understand the reason for it and are willing to accept it.

Miss DINGLE. May I add one purely technical point? In the under-\$3,000 income group you would have a large number of families that do not pay property taxes directly because you have a large proportion of renters. There are also, of course, a number of retired persons who own their own homes, but you do have a large portion of renters in this income group.

Senator PROXMIRE. That is right. There are also a large number of farmers, believe me, in this category—

Mr. KATONA. There are indeed.

Senator PROXMIRE. Whose taxes are overwhelmingly property taxes and many pay no income tax. In our State they are predominantly owners. Their incomes are less than \$2,000 per family. My time is up.

Chairman PATMAN. Congressman Curtis.

Representative CURTIS. I want to get to some specific questions because all of this has been placed in the context of what I regard as begging the question, that a tax cut actually will stimulate the economy in a period of deficit financing. I recognize that the bulk of the economic profession seems to have advanced that theory. However, I suggest that they have not established that as a correct theory. We have never tried it in the United States.

I know of no nation that ever has tried it. I think it is very important to drive that home right in the very beginning. We have had this theory advanced in the Ways and Means Committee hearings and I have asked each one of the witnesses why they thought that dealing, as we are, in economic aggregates, in a period of deficit financing—we are talking of balance between the Government sector and private sector—shifting \$5 billion from the Government sector in a tax cut to the private sector and then turning right around and taking \$5 billion from the private sector and transferring it back to the governmental sector by selling bonds to the private sector—why does that stimulate an economy? Although I do want to get into the details of this I think it is very proper to ask that question here. This is not a proven theory and I am very disturbed that without even debating it and getting into the reasons, all the witnesses seem—even you, Mr. Greenwald—

Mr. GREENWALD. I did not say that.

Representative CURTIS. To the extent that Mr. Katona, people like yourself, say it is a question of informing and educating the public on this new theory. In my view, I would say propagandizing the public.

Mr. KATONA. May I recapitulate, Mr. Curtis. The points are as follows: The strongest stimulus for the consumers to increase their spending, to improve their standard of living, to satisfy the innumerable wants the American people do have, the strongest stimulus is a rosy outlook—a hope that they get ahead, that there will not be unemployment. A tax cut contributes to the thought of more purchasing power.

Representative CURTIS. But does it? That is the whole point. That is the issue.

Mr. KATONA. By means of a few dollars to the low-income people.

Representative CURTIS. It doesn't go to the poorest. The poorest sectors of our economy are not taxpayers. We are talking about Federal income tax. We are not talking about the lowest income group.

Mr. KATONA. Quite a few people who are poor pay income taxes.

Representative CURTIS. There are a bulk of people who are not in the taxpaying brackets. I mean the income-tax paying brackets. I am happy that the American people have responded in this way and have not bought this "pig in a poke" that this automatically is going to do it. Maybe it does but I think it is about time for our economic professors and those in the profession to come forward and get into details and away from these aggregates. You transfer \$5 billion from one place to another. There may be something about the mix. Some of the economists were forthright in saying we won't have the public buy the bonds, not in the beginning, at any rate. We would have the Federal Reserve System or our banking system buy them. That is not tax cutting. We are simply talking about printing more money. Maybe that kind of inflationary pressure would help, but that, too, is an issue that needs to be discussed.

Mr. KATONA. In one respect you point to the most important factor in my opinion; namely, we need more information about the factors influencing consumer confidence. We do not know enough. Our group has done extensive studies over many years. There are great difficulties in a financing these studies. We have over the last few years received practically no Federal money in contrast to previous years, and I fully agree with you it is not established. We do not know enough.

Representative CURTIS. No, we have never tried it. When we are talking about it we need to refer to it as a theory. I respect those who advance the theory, although I honestly disagree with them, because I don't think they have done the homework necessary to back this theory up. One of our witnesses, I won't identify him, said we had an example in 1954. I pointed out in 1954 we cut Federal expenditures. I can begin to see a shifting from the public sector to the private sector. Incidentally, one thing that has not been brought out in these hearings to date is the fact that we have a tax increase that is going to hit all workers including the lower income groups who were not Federal taxpayers beginning in January 1, 1963. This tax increase is going to hit each one of them.

It is an average increase of \$24. I am referring to the increase in the social security taxes. It goes from \$150—and this is the rate paid by worker, matched by employer—to \$174.

Incidentally, in 1954 when we did cut the individual taxes I had thought we had done, incidentally, a politically astute thing and never could quite understand why the Republicans controlling that Congress got no political credit. It was then that I looked into the fact that at the same time we had increased social security taxes and just, by coincidence, almost the same amount we cut the individual income tax. A worker saw in his pay envelope the same take-home pay because the cut he got was almost eaten up by the increase in the social security

tax. So many people, as I campaigned in my area, didn't even know they had a tax cut because they were looking at take-home pay.

Mr. KATONA. We also had other tax increases. We had an increase in Federal income taxes over the last few years. If I had a \$10,000 income a few years ago and now have \$13,000 because of inflation, my real income was unchanged. Nevertheless, because nominally my income rose, I had to pay higher taxes. It is time to reverse this constant drain on incomes.

Representative CURTIS. I personally am very strongly in favor of a tax reform which is actually in the nature of tax cutting. But I do not relate it to any theory of increasing purchasing power. I relate it to what our tax is doing now in the way of dampening incentive in our private sector.

Getting back to incentive and business decision and investment, I think any tax cutting not unrelated to reform but following out this untried theory and unrelated to Federal expenditures cut is going to be discouraging to business. I may be in error, Mr. Greenwald, but that is what I would think the business reaction would be.

In answer to one of the questions by you, Mr. Katona, if Congress didn't do anything in light of all this talk about tax cutting, I think our business people would actually be encouraged that Congress had enough sense not to dabble around in untried theories.

Mr. GREENWALD. I am not talking about a "quickie" tax cut. I have only referred to tax reform.

Representative CURTIS. I think tax reform is always appropriate whatever the state of the economy is. I see my time is up.

Chairman PATMAN. Senator Pell.

Senator PELL. Thank you.

Dr. Katona, I notice in your testimony you refer to the fact that 18 percent of the 55 million American family units own stock. The other day, as I recall, the President of the New York Stock Exchange said that one out of six individual Americans owned a share of stock, which is considerably more. I was wondering how you equated those two figures.

Mr. KATONA. The two statistics are pretty much in agreement. The fact is that partly because of our tax laws in very many families there is joint ownership of stock or both husband and wife own stock. Therefore, I believe, as we have argued for years, that the New York Stock Exchange statistics, speaking of individual ownership, are somewhat misleading. It is not a question to count separately husbands and wives, and even many children of rich families have beneficial ownership of stock which is counted separately by the New York Stock Exchange. The question is to find out what proportion of American families own stock. Whether every member of the family or one owns stock is not important. The 18-percent figure is subject to error. It may be as high as 20 but it cannot be higher according to all data. That would be 1 out of 5.

Senator PELL. Are you including debentures in that or only equities?

Mr. KATONA. No. The fact is that of all kinds of bonds only U.S. Government savings bonds are widely distributed. All other debentures are owned by a very small proportion of people most of whom also own stock. But we include in equities mutual funds.

Senator PELL. Thank you. Mr. Greenwald, I noticed your point and was struck by it, that the economy has not gone down of late. I am struck too by an insertion in the Congressional Record by Senator Sparkman in which he put in a series of articles pointing out that never have profits been higher and the economy apparently more booming though we hear to the contrary. You point out that investment plans have not been particularly changed by the investment credit. You feel they are reasonably satisfactory in the United States. Nevertheless, in comparison with Europe apparently we invest about a third as much of GNP in new facilities as do they. This is true even now while Europe has recovered from the holocaust of the war and they are spending two or three times more of their GNP than we. How do you account for the difference?

Mr. GREENWALD. If you have a high ratio growth in investment relative to GNP countries generally you grow faster. I think this is fine in many areas of the world but I don't think this applies to the United States any more. I think we have a great record of growth in the past and we are the richest Nation in the world.

Senator PELL. My point may be stated better, why is it in Europe they are willing to put more profits into growth than here?

Mr. GREENWALD. I am not sure they are putting profits into growth. This raises another question, the comparability of statistics. Many industries for example in England or France are nationalized directly or indirectly. So these comparisons, often cover more than private industry.

Senator PELL. In general would you agree with the thought that a larger proportion of the product of a plant or business is spent on new equipment abroad than here?

Mr. GREENWALD. Yes, sir, that is true.

Senator PELL. What is the reason for that?

Mr. GREENWALD. This is something I am not certain about. I think you could argue that this is a question of the incentive that I raised earlier. In the United States you need the businessmen to invest, to feel that he has a reason for a larger amount of investment. I have said earlier before the Joint Economic Committee, that we should be investing somewhere around \$42 billion by the end of this year. However, we are only going to spend according to my estimate of plant investment in the fourth quarter, based on our surveys something like \$39 billion. Investment of \$42 billion would give us a larger ratio, although it might not be as high as in Europe. These countries are expanding from almost desolation, so it was necessary for them to have a high volume of capital investment to make up for the losses they had before. It probably also has to do with labor shortages overseas.

Senator PELL. Doctor, as both an economist and psychologist, is the reason for it psychological?

Mr. KATONA. I have just come back from a study trip of the Common Market countries. It is very true that in the first 10 years after World War II, which is roughly 1947 to 1957, because of the previous destruction, they have spent very much more on business investment than we have. Today the trend is downward. The new impetus in the Common Market countries comes from consumers, from an enormous increase in installment credit and automobiles, con-

sumer housing and consumer equipment. On the whole, the Common Market countries are Americanizing rapidly and that will show up in lesser business investments, more resembling our rates, and more consumer tangible investment expenditures as well. So if you look at the trend which foreshadows the future rather than on past facts, the differences will, I believe, diminish.

Mr. GREENWALD. May I add to that? At McGraw-Hill we have done surveys of oversea investments of U.S. companies. We will have a survey out some time in early September on plans for U.S. companies to invest overseas in 1962, 1963, 1964. My guess would be, as of this moment, that the results may show some decline which would confirm what you have just said. We do know from surveys of the IFO in Germany that increases in investment in Western Germany have gone downhill.

Senator BUSH. On a percentage basis?

Mr. GREENWALD. Yes, sir.

Senator BUSH. But they began from such a low percentage.

Mr. GREENWALD. One year it was plus 23, last year 14, this year it is expected to be 10. They have been building capacity up so fast that maybe they will not be increasing investment next year at all. Again we have to remember that the European Common Market has had a pretty good growth rate since the end of the war, relative to ours. They have built up a lot of capacity. When they get into a situation, and it may be that next year will be the year for them, where they have to go through a recession, then they won't need additional capacity. Business will start cutting back investment. It may be that American companies will be cutting back on their oversea investment next year. So European countries' ratio of investment to GNP in 1963, might be lower than ours. I believe that the trend in this ratio is down in the Common Market.

Senator PELL. Thank you, that is all.

Chairman PATMAN. I would like to ask you about these savings, Mr. Katona, and then I will yield to Mr. Reuss.

I believe you prepared a table for the Federal Reserve Bulletin a couple of years ago, did you not, about savings bonds and ownership of savings bonds? To the best of my recollection there was a figure that 73 percent of the people or families didn't own any savings bonds at all. Is that correct?

Mr. KATONA. Approximately. I don't remember the exact number. Ownership has declined since World War II.

Chairman PATMAN. Then isn't it a fact that according to those figures 7 percent of the remainder owned about 85 percent of the bonds? I am doing this from memory.

Mr. KATONA. I don't know whether it is as much as you say.

Chairman PATMAN. Does that sound unreasonable?

Mr. KATONA. If you ask me, according to my memory, I had the figure in mind that 10 percent owned 60 percent of the value.

Chairman PATMAN. Do you remember, Miss Dingle?

Miss DINGLE. I do not know. They are concentrated. A number of owners may own only one \$25 or \$50 bond. I think it is necessary to remember that particularly in the distribution of aggregates among groups in the economy there is a large sampling error involved. We

also know in consumer surveys in the past in dealing with items like savings bonds we have not picked up data that tie in directly with aggregates from other sources. We have generally underestimated ownership. I personally have felt that one has to interpret pretty broadly any data on distributions among groups collected in past surveys. I guess I would feel that given the problems with the data, we may not be able to distinguish whether it is 7 percent owning 70 percent or 7 percent owning 80 percent.

Chairman PATMAN. You do not remember the figures that I mentioned: 7 percent and 85 percent?

Miss DINGLE. I don't remember. We may have some computations which I would be delighted to look up.

Mr. KATONA. The point is well taken. All assets are highly concentrated.

Chairman PATMAN. Will you put that table in the record with your remarks when you correct your transcript, please?

Mr. KATONA. Yes, sir.

(The information follows:)

As shown in the accompanying table, only 27 percent of all spending units reported owning any savings bonds in the 1959 Survey of Consumer Finances, and the top 25 percent of the owners—about 7 percent of all spending units—accounted for almost 85 percent of the value of the savings bonds reported.

*Quartile ranking of savings bond holders, early 1959*

Quartiles	Percentage distribution of—		
	Spending units	Savings bond holders	Savings bond aggregate
All spending units.....	100 0		
No holdings.....	73 3		
Some holdings.....	26 7	100 0	100 0
Quartile ranking of holders:			
Highest quartile.....	6 7	25 0	85 5
Second.....	6 7	25 0	12 3
Third.....	6 7	25 0	3 3
Lowest.....	6 7	25 0	.9

NOTE.—Quartiles are obtained by ranking spending units according to size of holdings of savings bonds; one-quarter of all holders make up each quartile. The highest quartile in early 1959 included holders of savings bonds with face value of \$1,500 or more.

Source: 1959 Survey of Consumer Finances, Board of Governors, Federal Reserve System.

**SUPPLEMENTARY MATERIAL REGARDING MR. PATMAN'S INQUIRY ABOUT CONCENTRATION OF HOLDINGS IN U.S. GOVERNMENT SAVINGS BONDS**

Submitted by George Katona, Survey Research Center, University of Michigan

As stated during the hearings of August 8, 1962, survey data that indicate the proportion of aggregate amounts of savings bonds held by the largest holders (see the table for early 1959 submitted by the Board of Governors, Federal Reserve System, on August 14, 1962) are subject to substantial sampling and reporting errors. More reliable are data that show the changes over time in the proportion of families or spending units who hold no bonds, small amounts of bonds, and large amounts of bonds, respectively. The following table shows that a much smaller proportion of American spending units hold savings bonds at present than shortly after World War II. Yet the proportion of spending units having liquid assets has not declined during the last 15 years.

*Type and size of liquid asset holdings*

[Percentage distribution of spending units]

Type and size of holdings	1946	1951	1956	1960	1962
<b>U.S. savings bonds:</b>					
Zero.....	37	59	69	70	73
\$1 to \$499.....	37	24	18	16	15
\$500 to \$1,999.....	20	11	8	8	8
\$2,000 and over.....	6	6	5	6	4
Total.....	100	100	100	100	100
<b>Savings accounts:<sup>1</sup></b>					
Zero.....	61	55	52	47	49
\$1 to \$499.....	18	20	20	19	19
\$500 to \$1,999.....	16	14	15	16	15
\$2,000 and over.....	7	11	13	18	17
Total.....	100	100	100	100	100
<b>Checking accounts:</b>					
Zero.....	66	59	51	43	43
\$1 to \$499.....	18	27	31	39	41
\$500 to \$1,999.....	14	10	14	14	12
\$2,000 and over.....	2	4	4	4	4
Total.....	100	100	100	100	100
<b>All these liquid assets:</b>					
Zero.....	24	28	28	24	27
\$1 to \$499.....	29	30	27	27	29
\$500 to \$1,999.....	28	23	23	24	21
\$2,000 and over.....	19	19	22	25	23
Total.....	100	100	100	100	100

<sup>1</sup> Includes savings accounts in banks, savings and loan associations, and credit unions.

Source: Pp. 77 and 78 of 1960 Survey of Consumer Finances, published by Survey Research Center, Ann Arbor, Mich., in 1961. The 1962 data are from the 1962 Survey of Consumer Finances conducted by the Survey Research Center.

Chairman **PATMAN**. Congressman **Reuss**.

Representative **REUSS**. Would the members of the panel comment on my impression that there is not in sight today in this country the same kind of stimulant to consumer demand that was offered by the automobile in the 1920's or by homebuilding and consumer durables in the late 1940's and early 1950's. Does anybody disagree with that observation?

Mr. **KATONA**. I think I disagree with the conclusion you seem to imply, sir. It has often been stated that we are a wealthy, fat, saturated economy, who have all we need, and there are no needs, no wants.

Representative **REUSS**. Let me hasten to add I was not implying that. I know that 20 or 25 percent of our people with very low incomes are not really in our market economy at all and that the great mass of the rest of our people could, if given the financial means to do so, consume at a higher level. My question was whether there seemed to be specific commodities now on the horizon of the kind which were at the center of the great buying booms in the two periods previously mentioned.

Mr. **KATONA**. There is no single commodity, you are right. None of us have all the things we may want. What kind of things would you like to have? If you asked that shortly after World War II people mentioned a few things like homes, automobiles, washing machines. Today people mention a long list of things and matters such as vacation trips or summer homes and innumerable other wants.

Representative REUSS. Don't you find that the list of wants that you get nowadays, as opposed to the list of wants which you got in some earlier period, stresses in a much greater degree, services and intangibles—medical care, recreation, vacations, leisure time activities, nongoods items.

Mr. KATONA. And also education and cultural things.

Representative REUSS. Exactly.

Mr. KATONA. You are right. These are also expensive things.

Representatives REUSS. That is right. I am wondering what effects increased expenditures on services have on the economy which may be different from those we would get from the same amount of spending on goods.

Mr. KATONA. Travel leads to an enormous investment by the private sector, say for motels, and by the public sector for roads.

Representative REUSS. I am not suggesting that a greater demand for medical care is not accompanied by a certain additional demand for hospitals and medical schools. My question is whether a dollar spent on services is likely to produce just as much economic activity as a dollar spent on goods?

Mr. KATONA. We don't know the answer to this question. There is structural change in connection with the correctly stated facts in our economy.

Mr. GREENWALD. We don't really know what new products are coming along. There may be some magic things on the drawing boards of many companies in the United States. We do know that research and development expenditures have gone up tremendously. We know that new products are a key to all of these programs. We know, for example, from our surveys that 14 percent of manufacturers' sales in 1965 are going to be in new products that are not now in existence—14 percent of manufacturers' sales. That is a very significant number.

Representative REUSS. I welcome and recognize what you say. My question, however, was whether there now are in being and ascertained things which look today as exciting as the automobile looked in the 1920's and as the consumer durable goods looked in the early 1950's.

Mr. GREENWALD. We may not have any one good but we may have a combination of 5 or 10 which could give sizable stimulus to the economy. In 1961 the economics department of McGraw-Hill did a long-range forecast through 1975. The Russians criticized this report. They called McGraw-Hill, and myself, since I was responsible for the preparation of the report, the Knight of the Electric Blanket and of the Helicopter. I want to point out that we have many new products coming along because of R. & D. Some day we will have wall-sized television screens and many of us will be driving around in our own helicopters. This might be a significant market of the future.

Miss DINGLE. May I make one comment?

I think there are really two aspects here. I think you have been emphasizing the real investment that is involved in connection with production of goods versus services, which is a complex issue. I think there is another question here and that is the question of what you do to consumer purchasing power and consumer saving versus dis-saving, as represented by debt. I think some economists have been

surprised in recent years how greatly there has been an increase in debt in connection with services.

Representative CURRIS. Percentagewise to the value of the consumer durables.

Miss DINGLE. If you look at the expansion in consumer debt over recent years, you will find the so-called personal loans have accounted for a larger proportion of the increase and durable goods credit for a smaller proportion as compared with earlier periods. It is a complex question. Personal loans do include some loans that are incurred for purchasing small durable goods, the purpose of which is not specified by the consumer to the lender. But it does also include all of these new areas. It includes the travel credit that many lenders are actively promoting now. It includes educational loans and a number of others. So I would say again it is very difficult to judge how important this is, but the statistics on consumer credit certainly show that we have some new or expanding credit areas in connection with services.

Representative REUSS. Now let me get on to a very interesting point raised by Dr. Katona.

I am struck at the tremendous desire on the part of housewives in the European countries for our whole range of consumer durable goods—dishwashers, dryers, refrigerators, washers, and so on. I wonder if you don't feel that there is a coming boom in Europe in consumer goods, Professor Katona.

Mr. KATONA. You are 100 percent right. Not only a coming boom, but the boom in the last 3 years is largely due to consumers. It has the consequence that the consumers say that they need more income because they want to have all these attractive things. Over the last year wages rose enormously in the Common Market countries because of consumer needs.

You see, traditionally economists have always thought that consumption is a function of income. There is truth in it. There is truth also in the reverse. Income is a function of consumer wants and needs. If people desire many things they work for higher income and wage increases.

Representative REUSS. This brings me to a central question. Couldn't European employers grant most of the new wage demands without inflationary consequences, if the United States furnished a large volume of the desired consumer goods? This would require that the Common Market and the other European countries reduce their present very high tariffs. The export sales we could make as a result would help us to combat unemployment, increase the level of economic activity, and reduce our payments deficit. It would also bring American and European wage patterns close together and so contribute to long-term international payments equilibrium.

Did you follow this rather complex question?

Mr. KATONA. I did, sir. It is a wonderful thought. I don't believe it is very practicable from the European point of view.

Representative REUSS. Isn't it only practicable, but quite necessary from the free world point of view? Must we not look at the elements of our problem—surplus European payments, a U.S. payments deficit, overfull employment in Europe, underemployment here, an ebullient growth rate in Europe, and a lagging growth rate here.

Mr. KATONA. I fully agree with you and all our efforts should be directed toward greater cooperation and mutual tariff reductions between Common Market countries and the United States.

Representative REUSS. I am glad to have your answer. My time is up.

Chairman PATMAN. We have another meeting here at 2 o'clock with Dr. Heller and the other members of the Council of Economic Advisers. Shall we go further?

Representative CURTIS. I personally would like to.

Senator PROXMIRE. I have a couple of questions.

Chairman PATMAN. You may go ahead, Mr. Curtis.

Representative CURTIS. Thank you very much, because I want to get into some of the details and I spent my previous time on the general overall picture. Have any series of statistics been developed on new products and services on the market? I have heard a figure that something like 25 percent of the goods and services on the market today were unknown 5 years ago.

Mr. GREENWALD. It is an estimate that we may have made at McGraw-Hill.

Representative CURTIS. I think there was an estimate.

Mr. GREENWALD. What we do in our surveys is ask the question about expectations for new products and what percentage of sales they account for in a period of 4 years ahead.

Representative CURTIS. That is a sort of ad hoc thing.

Mr. GREENWALD. We check back every year.

Representative CURTIS. Is 25 percent accurate?

Mr. GREENWALD. That is close but not exact. The time period is wrong. When we asked this question the very first time in 1956, the result was that about 10 percent of manufacturers' sales would be in new products 4 years ahead. When we asked it the last two times we got an answer of 14 percent. This would be for a 4-year period. So if you add these two together you come fairly close to 25 percent but for an 8-year period.

Representative CURTIS. I think Monsanto Chemical made the observation (though I may be quoting them wrong) 90 percent of their dollar sales reflected items that were not even manufactured in 1950.

Mr. GREENWALD. May I provide you with a few figures, sir?

Representative CURTIS. Yes, please.

Mr. GREENWALD. I will quote them to you from our survey of business plants for new plant and equipment, 1962-65. These data are on an industry basis. These are the percents that new products will account for of sales in 1965. For iron and steel, 5 percent; nonferrous metals, 9 percent; machinery, 23 percent; electrical machinery, 22 percent; autos, trucks, and parts, 10 percent; transportation equipment, 34 percent; fabricated metals and instruments, 18 percent; the chemical industry, 16 percent; paper and pulp, 10; rubber, 6; stone, clay, and glass, 13; petroleum and coal products, 6; food and beverages, 12; textiles, 13; miscellaneous manufacturing, 9; and all manufacturing, 14 percent.

Representative CURTIS. To me it is in this new product area but we will find the answer whether we are going to have a growing and dynamic economy. I was very pleased to listen to Congressman Reuss develop a theme that I have been trying to develop for some time. It

is my belief that our economy is not tired and sluggish. Quite the contrary, we have "growing pains." What we are seeing, among other things, is a shift from manufacturing to distribution and services and, indeed, to new products. When we have this kind of obsolescence it does relate to capacity and it relates to unemployment because our skills become obsolete. The lessening of and need for unskilled and semiskilled labor as we move forward is very marked. These are the areas I think we have to get into in order to determine whether we have a growing economy rather than GNP. I don't mean by that that GNP is not a valuable indicator. It certainly is, and very important. But it is not a very good one to measure whether our economy is dynamic and growing.

Mr. GREENWALD. This is the point I was trying to make before. As a matter of fact, research and development are still expanding rapidly. This is why we are going to get new products. There is quite a bit of this going on. When I cite industry figures, I don't know which products the iron and steel industry has on its drawing board or which product the transportation industry has in mind. Yet there are many new products coming along which industry expects to be in existence and for sale by 1965.

Representative CURTIS. Let me go to another area that is collateral and that very few economists have taken note of. I am reading from the HEW indicators in July—on page 27 of the chart 25, "School bond sales." We started in 1957 in the school bonds voted on, in one column, and then the next column is the bond issues passed and the percentage passed; \$1.4 billion of total voted in 1957, \$1.8 in 1958, \$2.26 in 1959, \$2.25 in 1960. And here is the figure, 1.2 in 1961. The drop in percentage of passing was even more dramatic. In 1960, it was \$1.8 billion and in 1961, \$0.8; a drop of \$1 billion in school bonds that were voted. I can well understand why we are seeing a tapering off in school construction which doesn't show up on the chart on page 27, educational construction. But it is going to. That might be something that Senator Javits could use to back up his point of what indecisiveness does. I lay a good bit of that to all of this talk of Federal aid to school construction and the indecisiveness of action. This is a very important economic indicator in an area where our economy needs to move forward even more so, in this area of training and education. I have one question I would like to direct to all of you, another indicator that worries me. I made some comments before on it, but I see no one picks this up very much. I am talking now about employment figures. This is from page 9 from our Economic Indicators of July. We have continued to have an increased civilian labor force on this chart since 1955 even during recessions. Civilian labor force constitutes those employed, plus unemployed. This has been growing now at a rate of around a million a year. This is where the question comes to you samplers.

We know that our unemployment statistics are based on sampling and on questioning people. The other is a pretty real figure, I guess, the employment figure. What is there about the fact that the employment continued to increase right on up through 1961, but then looking at the monthly indicators, employment or rather civilian labor force decreased from June 1962, 74 million and June of 1961, 74,286,000. Is this an economic phenomenon? And if so, it is a very serious one.

Or could it be that in the sampling of who are unemployed there is a different standard being set in the questions asked of a person: "Are you looking for work?" Would anyone comment on this? To me this is a very, very serious situation.

Mr. GREENWALD. There is one part of this I know something about. There has been a change in the coverage in April of this year, due to the 1960 Census of Population. The figures for the overlap period are roughly 200,000 different. So if you were to assume that you could now make June 1962 comparable with June 1961. I would assume that it would be 200,000 higher and thus roughly the same and not down. I am only pointing this out.

Representative CURTIS. I appreciate that. I think we need some comment on this. I would issue here a challenge to the administration to tell us whether there is a new economic phenomenon hidden in this or has somebody changed the rules of the game in the Bureau of Labor Statistics in the method of sampling as to who are the unemployed? Because either the unemployed should be a million more than they are, or there is something happening to us in not increasing our civilian labor force.

Mr. GREENWALD. If you also look at the employment figures rather than the unemployment figures, these have been going up.

Representative CURTIS. They have been going up. But in trying to compute whether there is a recession, or about to be, or anything like that, we relate it to unemployment and all of these people are talking about this gap between potential based upon the unemployed and unused capacity. If somebody is trying to "rig" these figures—and I think that term deserves to be used until we get an explanation of this thing—then it would show more of a gap and it certainly would should a lesser use situation. The one area of great concern to me has always been employment and unemployment—I know the Senator from Illinois knows this—under the last administration as well as this. I kept my finger on this employment and unemployment thing because I think there is one area where we need to do something. I would say, incidentally, it is in the field of training and retraining and dealing with obsolete skills more than anything else where attention should be paid.

Mr. GREENWALD. As you know, I have talked about unemployment at these hearings before. I worry about what this unemployment statistic means. I personally do not believe there is any "rigging" in these figures. I also worked for the Bureau of Labor Statistics many years.

Representative CURTIS. I defended, I might say, this group in the Bureau of Labor Statistics against the charges in the article in Reader's Digest. But when I see no one coming forward pointing out what has happened to a traditional trend of increasing the civilian labor force by around a million a year, and the one area that has not been moving up is in the unemployment area, I think it requires some examination. I said as far as rigging figures is concerned, it needs to be explained what phenomenon has changed this thing other than rigging the figures. I hope they are not rigged.

Mr. KATONA. May I say as an independent observer that the entire statistical profession is convinced that Census Bureau and BLS do an outstanding sampling and statistical job in their unemployment

studies. There are questions of definition which have widely been discussed in the literature about who are really unemployed, and so on. But as to sampling and interviewing they do an outstanding job.

Senator PROXMIRE. I would like to suggest the Congressman has been a very good friend of the Bureau of Statistics and has always supported them and has been a champion of their integrity and honesty. I do think that this is so serious and such an excellent point is made that before this afternoon we ought to get an explanation from the Department of any changes that are involved in these figures and a justification to the extent they can make one of why we have this stark and dramatic change. I think the Congressman has made a very legitimate and proper point.

Representative CURTIS. I want to thank the Senator. I am trying to be helpful. I, too, would presume we could rely on the figures. If this is so, we have seen a dramatic change in the development of the civilian labor force.

Senator DOUGLAS. If the Congressman would yield, I also have always had great respect for the BLS and the Census. They are not perfect, of course, but I think they have been kept free from political influence. I think this failure of the civilian labor force to grow is one of the most disconcerting developments. Yes, sir; we had some possible explanations of it which happen to agree with my own ideas and which I, therefore thought, were very fine; namely, that it translates into particularly young people and particularly unskilled people and minority groups who cannot get a job because industry or the economic system does not grow. And who because they do not have a job sort of drift around in a hopeless fashion. I live in a great city, as you do. I see these groups in my own city. My daughter has an apartment just off Central Park in New York on the West Side, just four blocks from her a few days ago they had an outright war between the Puerto Ricans and the Negroes. These young people are largely those who dropped out of school, can't get a job. They are neither at school or at work. They are milling around the streets. They are young and unskilled and members of minority groups. When all three of these disadvantages hit them at once it creates a terrible situation. I think it is much worse this year than last year. I felt for over a year that this was the greatest internal problem in the United States.

Mr. GREENWALD. What you are really saying is that they are not in the labor force.

Senator DOUGLAS. Yes. This is disconcerting. There may be some change in the method of measurement of BLS. And I agree with both my colleagues that it should be explored. I want to suggest it is not merely changes in measurement.

Mr. GREENWALD. If they were in the labor force then they would probably be all unemployed on this basis.

Senator PROXMIRE. Yes. We would have as heavy unemployment now as a year ago which was 7 percent.

Mr. GREENWALD. This is a function of the idea that we are a highly technological economy. We have gone so far ahead technically that we are not going to find jobs for these people unless they are well trained in the future.

Senator DOUGLAS. Unless there is enough demand.

Mr. GREENWALD. Not even then, because unskilled workers cannot take a job in technical fields.

Senator PROXMIER. I want to apologize for keeping you longer but I would like to take a few more minutes.

Mr. KATONA, in your response, and Miss Dingle suggested this, you said that a lot of these people who have incomes of less than \$3,000 are not taxpayers, property taxpayers, they are renters. I would like to suggest on the business of the statistics I have just gotten over the phone most of these people are not Federal income-tax payers at all. As a matter of fact, of the returns filed for people with incomes of less than \$3,000, there are some 21-million-plus, and more than half of those returns are not taxable. These are for individuals.

If we recognize the fact that there are families involved here, that is more than one individual in each unit with total income of less than \$3,000 I would say that probably two out of three of the people in this lowest category pay no Federal income taxes. These are the people who bring out your total answer that there appears to be a fair balance between tax cut as a good idea and a bad idea. If we recognize this factor, and most people are subjective enough in talking about their own taxes, you would have a very substantial advantage on the side of those people who in 1961 felt a tax cut was a bad idea.

Mr. KATONA. I am very grateful to you, Senator. I plead guilty. I have not thought of breaking down our data by taxpayers and non-taxpayers. I learned better and I shall do so in future surveys. I again would like to emphasize that this balance, whatever those data on the top part show, whether there are 40 or 50 percent who say good or bad idea, is not too important. We asked the question in 1961 when it was more an academic question mainly to get some baselines for the 1962 or 1963 inquiries and to ask the question about reasons.

In other words, to find out something, why do people think as they do, or how do they think about deficits and about taxes, and so on. I have submitted this table primarily for the sake of the second part of the table and to counteract notions which appeared in the press that 72 percent of all people, including the low-income people, are against the tax cut, which appeared in newspapers last week from a public poll.

Senator PROXMIER. Their question was not as good as yours. Their question was if this would increase the debt or the deficit. It was suggestive and it was loaded. I say this although the result supported my own bias.

Mr. KATONA. I would not put great stress on these figures and your point is well taken.

Miss DINGLE. I would say that this makes very clear, as I have been convinced in the past, that it is desirable to put out data insofar as possible with relevant breakdowns of which the income breakdown is probably the most important. I think the age breakdown is also important. I think it makes it possible for people like you and other intelligent users to be able to pick out the groups which may be most important for a given question.

Senator PROXMIER. I think Dr. Katona's breakdown was really the crucial thing. Briefly, I would like to suggest that there is a price the European countries are paying, too, in addition to all the factors which you emphasized of their enormous unfilled needs and their Americanization attitudes because of the movies and other things from

this country developing Americanized demand. They are adopting our standard of desire. This is an explanation, a big explanation or part of the explanation, for the growth of their economy. They have suffered a much greater degree of inflation in those countries than in this country without exception.

In some cases it is worse than others. Isn't that correct?

Mr. KATONA. Very true.

Senator PROXMIRE. Mr. Greenwald, would you agree that higher interest rates now would tend to block some of this rosy picture that you painted in construction and municipal bonds? I should say school construction and hospital construction as well as home and business construction?

Mr. GREENWALD. If you mean we are going to have additional changes—

Senator PROXMIRE. Yes. If the Federal Reserve Board adopts the policy of continued increased interest rates.

Mr. GREENWALD. Yes, sir. I did point out that housing is practically at an alltime peak. Even if you lowered the interest rates I don't believe it would help too much.

Senator PROXMIRE. What do these alltime peaks mean? In terms of family formation we ought to be at an alltime peak every year because we have more people involved.

Mr. GREENWALD. I am not arguing this. I would say in the area of construction you are operating pretty close to capacity relative to some other industries.

Senator PROXMIRE. We had such a long construction recession. We have not yet achieved in a single year as large a number of housing starts as we did in 1950.

Mr. GREENWALD. This is another one of those statistical series for which we have a break in comparability. So we have only the 1959 figure of private housing starts which just fell short of 1.5 million units.

Mr. KATONA. May I say one word about interest rates?

According to our studies of consumer decisionmaking, what they take into account when they decide, there is no doubt that in housing, interest rate matters. In other words, a sizable drop in interest rates would stimulate many people to go ahead with house buying and building plans. In consumer durables, automobiles, et cetera, it does not matter, as Senator Douglas knows best, because interest rates are so high that even a one or two percentage point drop is not significant.

Senator DOUGLAS. In the case of automobile costs it does not matter because they do not know what they are.

Mr. KATONA. It would not matter. Regarding business investment probably it would not matter because risk factors play a greater role. So the impact of reduction in interest rates is restricted to housing, I believe.

Senator PROXMIRE. Which is tremendously important in terms of employment. The other point was that perhaps a new industry along the line that Congressman Reuss is pursuing, Fortune magazine said might have the kind of impact automobiles had in the 1900's, is the space industry. This year we will have a \$2 billion increase in spending for man-to-the-moon. They expect to be spending at the rate of \$10 to \$15 billion a year by 1970. Because so much of this is con-

centrated in research and development the byproducts of possible industrial expansion could be perfectly enormous for our society.

Mr. KATONA. No doubt that is a necessary observation.

Senator PROXMIRE. Thank you very much, Mr. Chairman.

Senator DOUGLAS. We will meet at 2 o'clock.

(Whereupon, at 12:30 p.m. the committee was recessed, to be reconvened at 2 p.m. the same day.)

#### AFTER RECESS

(The committee reconvened at 2 p.m., Hon. Wright Patman, chairman of the committee, presiding.)

Chairman PATMAN. The committee will be in order, please.

This afternoon the committee continues hearings on the state of the economy and the question of what changes might be made in Federal policies to achieve maximum employment, production, and purchasing power. We are privileged this afternoon to have the Council of Economic Advisers. The program of the President is, of course, the outcome of a decision process in which advice, recommendations, and considerations of many kinds from many sources, inside and outside the economy, play a part. The professional economic advice of the Council is one element. It is not and should not be the sole consideration in the formulation of Presidential economic policy or of congressional policy. In congressional testimony and in other public statements the Council must protect its advisory relationship to the President. We assume that the committee does not expect the Council to indicate in what respect its advice has or has not been taken by the President nor to what extent particular proposals or omissions of proposals reflect the advice of the Council.

Dr. Heller, this morning we had a witness from McGraw-Hill Publishing Co., Dr. Greenwald, and he testified on one point that would interest you. He said that the survey that McGraw-Hill made in late June indicated that business planned to spend \$37.9 million on new plant equipment this year, more than 10 percent over 1961. He also said that McGraw-Hill's checkup survey made in late June indicated, and I quote:

Our checkup pointed up the fact that business in general had not cut back or canceled plans for investment in new facilities in 1962 as a result of the sharp drop in stock prices in May and June, or the so-called loss of business confidence.

Among the companies indicating investment cutbacks only a few cited economic conditions as the reason. In most cases where investment plans were lower than they were earlier, the reasons given had absolutely nothing to do with a lack of business confidence or the drop in the stock market. Instead technological delays and construction delays were the reasons given.

Dr. Ackley, we want particularly to welcome you back to Washington and to congratulate you and the Council on your membership. We regret Dr. Tobin's leaving, but we are delighted to have you and are looking forward to a long and fruitful association. After hearing from Dr. Heller and other members of the Council, if they have statements, members of the committee will ask questions under the 10-minute rule.

Dr. Heller, I understand that you have a prepared statement, and I understand that you would like to proceed with your prepared statement. That will certainly be all right. You may proceed as you desire.

**STATEMENT OF WALTER W. HELLER, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; ACCOMPANIED BY GARDNER ACKLEY AND KERMIT GORDON, MEMBERS**

Dr. HELLER. Thank you.

Chairman PATMAN. You are recognized, Dr. Heller.

Dr. HELLER. Thank you. We are pleased to appear once again before the Joint Economic Committee. I might say that in accordance with your request we have prepared a statement on economic outlook and policy today. In developing this statement we have tried to be responsive to the questions put by the committee, and I think we have in effect also prepared, at least on a small scale, the kind of midyear economic review that some members of the committee have at times thought desirable for presentation to the committee. As the chairman has indicated, I should like to read this statement on the performance of the economy, the outlook and policy problems.

We are examining the economic outlook today because the current expansion has not been as vigorous as all of us hoped and most of us expected. The expansion has slowed down in 1962 and we must be alert to the danger that the current recovery, like its immediate predecessor, will not carry us to full employment.

Nevertheless, we should recognize the important economic gains that have been scored during the past year and a half. From the first quarter of 1961 to the second quarter of 1962—

Gross national product rose from \$501 to \$552 billion, a rise of 10.2 percent (or a rise of 8.5 percent after price correction).

Consumption in constant prices increased by more than \$250 per family (annual rate).

Corporate profits before taxes have increased by roughly one-fourth.

Labor income increased by nearly 9 percent.

Unemployment (seasonally adjusted) declined by about 1 million persons, with the rate falling from 6.8 to 5.5 percent (and to 5.3 percent in July).

In order to conserve time we have put many of the statistics into a separate statement called "Summary of 1961-62 Economic Expansion and Policies."

Chairman PATMAN. Without objection, you may insert them as a part of your remarks in the record.

(The statement referred to follows:)

EXECUTIVE OFFICE OF THE PRESIDENT,  
COUNCIL OF ECONOMIC ADVISERS,  
*Washington, August 6, 1962.*

**SUMMARY OF 1961-62 ECONOMIC EXPANSION AND POLICIES**

**A. THE RECORD OF GAINS**

Since the beginning of the current expansion taken as of February or the first quarter of 1961:

1. The U.S. gross national product rose from an annual rate of \$500.8 billion in the first quarter of 1961 to \$552 billion (second quarter, 1962) or 10.2 percent in five quarters. In constant prices, the gain was 8.5 percent.

2. Personal income increased from an annual rate of \$401.2 to \$440.4 billion (June 1962)—a rise of 9 percent.

3. Corporate profits before taxes increased by a fourth from \$39.8 billion (annual rate) to \$50.1 billion (first quarter 1962). The level for the first quarter of 1962 was slightly below that of the fourth quarter of 1961.

4. Industrial production expanded by more than 15 percent (June).

5. Labor income increased from \$282 billion (annual rate) to \$309 billion (June)—or almost 10 percent.

6. Payroll employment in nonagricultural establishments rose by 1.9 million jobs (June).

7. The number of persons unemployed declined by 23 percent (seasonally adjusted) from 5 to 3.8 million persons (July). The unemployment rate dropped from 6.9 to 5.3 percent of the civilian labor force.

8. Prices remained virtually stable. The industrial, as well as total, wholesale price index declined. The total index fell from 101 to 100.1 (June) on a base of 1957-59=100. Consumer prices rose by only 1.3 percent from 103.9 to 105.3 (June)—with most of the increase in the service sector.

#### B. ELEMENTS IN THE RECOVERY

##### 1. Consumption:

(a) Personal consumption expenditures have risen \$24 billion (annual rate in five quarters—\$10 billion in services, \$8 billion in nondurable goods, and \$6 billion in durable goods).

(b) In constant (1961) prices, per capita consumption increased by nearly \$75 (or more than \$250 per family) as Americans advanced their living standards.

(c) Durable goods purchases in the last two quarters were 5 percent above 1959 and 1960 levels, while disposable personal income was about 10 percent higher.

(d) Auto sales have accounted for most of the gains in consumer durable purchases since the first quarter of 1961. Although June sales were somewhat lower than the preceding 3 months, July sales rebounded on a seasonally adjusted basis. The total number of cars sold in the first 7 months of this year is 25 percent greater than in the same period of 1961.

(e) The savings rate has stayed near 7 percent during the recovery. It is not high as compared to most postwar years, but it has not shown the decline that marked the first year of previous recoveries.

(f) The expansion in consumption occurred at the same time that the consumer was strengthening his liquidity position. During 1961 holdings of liquid assets (cash, bank deposits, savings, loan shares, and government bonds) rose by over \$20 billion and consumer debt by only \$1½ billion.

##### 2. Investment:

(a) Business fixed investment (total of producers' durable equipment and nonresidential construction) rose by \$5.4 billion or 12 percent in five quarters.

(b) Investment has lagged behind corporate cash flow (consisting of after-tax profits and capital consumption allowances). Cash flow rose by \$7½ billion from an annual rate of \$47 billion in the first quarter of 1961 to nearly \$54½ billion in the first quarter of 1962 (preliminary estimates indicate it was about the same in the second quarter).

(c) Improved operating rates have stimulated investment, but excess capacity remains a drag on capital spending. Operating rates have risen about two-thirds of the way back to preferred operating rates, from the low levels that existed in early 1961.

(d) Total manufacturing and trade inventories at the end of June 1962 were \$4.4 billion, or 4.8 percent, above their level in February 1961. But sales increased faster—by 10.3 percent over the same period. The inventory-sales ratio declined from 1.58 to 1.47 in April and May, but rose to 1.50 in June.

(e) Housing has increased sharply over last year. Residential construction expenditures in July were \$25.7 billion (annual rate) or 29 percent higher than in February 1961. Housing starts in June were 1.4 million units (annual rate) compared to 1.2 million units in February 1961.

##### 3. Government:

(a) Federal receipts (on a national income account basis) rose \$13 billion (annual rate) from the first quarter of 1961 to the first quarter of 1962, reflecting higher profits and incomes. Federal receipts are expected to show further rises in the second quarter.

(b) Federal purchases of goods and services rose by \$6.5 billion, of which \$5.3 billion was for national defense. (The rise in five quarters was \$7.1 billion of which \$5.6 billion was for national defense). *Other Federal expenditures* rose by \$2.8 billion.

(c) The income-and-product deficit declined from an annual rate of \$6.3 billion in the first quarter of 1961 to \$2.4 billion in the first quarter of 1962.

(d) State and local purchases increased \$4.6 billion (annual rate) from the first quarter of 1961 to the second quarter of 1962.

#### 4. Money and credit:

(a) The money supply (excluding time deposits) rose by \$4.1 billion or 2.9 percent from February 1961 to June 1962. Including time deposits, the increase was \$20 billion or nearly 9.4 percent.

(b) Bank loans increased \$12.2 billion or 10.7 percent from February 1961 to June 1962.

(c) Long-term interest rates have been unusually stable for a period of economic expansion. However, in the past month, the average yield on Government bonds has risen somewhat, reaching a level of 4.02 in July compared to 3.81 in February 1961.

#### 5. International:

(a) The overall balance-of-payments deficit, as measured by U.S. gold sales and increases in foreign dollar holdings, showed improvement in 1961 and further gains in the first half of 1962. The payments deficit was \$1.9 billion (annual rate) during the first quarter compared to \$2.5 billion for the entire year 1961 and \$3.9 billion for 1960. Latest indications are that the deficit has decreased further and is now running at an annual rate of \$1.0 to \$1.5 billion.

### C. STRONG AND WEAK SPOTS IN THE CURRENT OUTLOOK

1. The economy expanded vigorously during 1961; the pace of advance in 1962 has been considerably slower. There are a number of weak spots in the economic data for May and June. Only a few preliminary figures are available so far for July.

(a) Personal income advanced only \$2.1 billion from April to June compared to \$6.4 billion from February to April.

(b) Retail sales declined in both May and June. (Judging by department store sales, sales rose in July.)

(c) Unemployment as a percentage of the labor force rose slightly in June over May levels and then declined to 5.3 percent in July; however, this is still considerably higher than at our full employment goal.

(d) Inventory accumulation has tapered off markedly. Accumulation of manufacturing and trade inventories in the second quarter of 1962 was less than half the amount in the first quarter (\$0.8 billion compared to \$1.6 billion). Due to the drop in sales, overall inventory sales ratios rose in June.

2. The prices of common stock have fallen 18 percent from March 15 to August 3, reducing the estimated price-earnings ratio from 19.7 to 16.6 (based on estimated second quarter earnings). Stock prices on August 3 were 58.12 (Standard & Poor's price index) compared to 55.11 on the day before the 1960 elections. The realization that inflation has been brought under control is an important factor in the decline of the stock market. The decline in stock prices is a source of concern in economic policy because of its possible adverse effects on consumer and business expectations. Margin requirements were reduced from 70 to 50 percent July 9.

3. Private long-term interest rates are still generally below those at the trough of the economic cycle in February 1961 and borrowing ease continues.

4. The outlook for continued price stability is favorable.

5. Federal purchases are headed upward, though at a slower rate. State and local spending is expected to continue its upward trend.

6. The Commerce-SEC survey taken in April and May shows investment plans for 1962 at a level 8 percent above 1961. This result was the same as the February survey, and it points to continued moderate increases in plant and equipment outlays for the rest of this year.

### D. ADMINISTRATION'S PROGRAM FOR STRENGTHENING THE ECONOMY

1. An 8-percent tax credit, totaling \$1¼ billion, on new investment in machinery and equipment has been proposed to the Congress. The administration's

proposal would increase the rate of profit on a typical new 10-year asset to the same extent as a 20-point reduction in the corporate income tax.

2. A comprehensive tax reform bill, involving a net reduction in individual and corporate income taxes, will be outlined later this year for consideration by the next Congress in 1963. The President has recommended that the reduction in the tax rate be made effective as of January 1, 1963. He has also said that, if economic conditions warrant, he will request a tax cut in 1962.

3. Standby authority for temporary income tax reduction has been requested of Congress. This tool could be used quickly and effectively to combat economic recessions.

4. Depreciation guidelines for business have been revised, reducing tax bills on 1962 profits by an estimated \$1.5 billion and releasing these investable funds for business use.

5. Taxes have been removed on surface transportation effective November 16, 1962, and have been reduced by 50 percent on air transportation.

6. Extension of temporary unemployment compensation and improvement of our welfare programs have also been requested.

7. The Manpower Development and Training Act was enacted in March 1962, launching a \$400 million program. In addition, a bill to aid in employment of our youth is pending before Congress. Money invested in training or retraining of our unemployed can benefit society by a multiple of that investment, quite apart from the immeasurable return to the worker in regaining a sense of purpose and hope.

8. Area Redevelopment Administration was established in 1961 to aid areas of chronic unemployment. The act provides funds to aid commercial and industrial development, technical assistance in community planning, and retraining of unemployed workers. To date 700 communities have participated and over 10,000 people are in training programs.

9. A bill has passed the Senate authorizing \$750 million immediately for additional Federal, State, and local public works in areas of heavy unemployment and \$750 million of stand-by authority for the future. A bill now in the Rules Committee of the House provides \$900 million immediately for additional public works but does not provide standby authority as requested by the administration.

10. Pending before Congress is a bill to provide \$500 million in aid to urban areas for the development of mass transportation.

11. The President's trade expansion program (passed the House) will stimulate the foreign market for American production and improve the competitive position of the United States in relation to the European Common Market. The bill allows the President to reduce tariffs 50 percent generally and to abolish them on certain goods. Government aid is to be provided for U.S. workers and industries affected by the change in tariff regulations.

12. A Consumers' Advisory Council has been established to advise the Government on issues of broad economic policy, governmental programs protecting consumer needs, and the flow of consumer research.

13. Many other measures such as aid to education now pending before Congress would provide additional stimulus to the economy.

**NOTE.**—All figures are seasonally adjusted or based on seasonally adjusted data except prices and interest rates.

Dr. HELLER. If advances could be maintained at this pace, on the average, we would achieve full employment—full utilization of our resources consistent with our interim goal of 4 percent unemployment—sometime late in 1963. But obviously we are still all concerned by evidence that the next 5 quarters are not likely to yield equally strong advances. Gross national product (in constant prices), after rising at a rate of 9 percent per year from the first to fourth quarter of 1961, has been rising at a rate of only about  $3\frac{1}{4}$  percent per year in the first half of 1962. Personal income increases averaged \$2.6 billion (annual rate) per month during the 10 months of recovery in 1961, but have been averaging only \$1.6 billion since December. After rapid gains during 1961, corporate profits seem to have changed little in the past 2 quarters. On the other hand, the first half of 1962 has witnessed a more rapid improvement in employment and a

more rapid decline in unemployment than we experienced last year.

In early 1961 we were in the position of having to recover not from one but from two recessions—for the recession of 1960 came on top of the incomplete recovery from the recession of 1957–58. There can be no doubt that impressive gains in employment and output have been made in the past year and a half. But the economy has not yet regained the reasonably full utilization of its labor and capital which it last experienced in early 1957. It is in this context that we must reexamine the means for achieving the goals of the Employment Act of 1946: “maximum employment, production, and purchasing power.”

The postwar era taken as a whole has, to be sure, witnessed remarkable progress in the achievement of these goals. The worst rates of unemployment in the postwar era were about 7½ percent of the labor force, much better than the best performance of the economy in the 1931–40 decade, when the unemployment rate remained consistently above 14 percent, about twice as much as the highest postwar figure. But the record of the past 5 years—while a great improvement over the prewar era—has not matched that of the first postwar decade. From 1946 until mid-1957, full utilization of resources was the normal state of the American economy. Unemployment significantly exceeded 4 percent of the civilian labor force only about one-third of the time, principally during and immediately after the two brief recessions of 1948–49 and 1953–54. Since late 1957, unemployment has fallen below 5 percent of the labor force only briefly. It reached a peak of 7 percent in the recession of 1960–61, and has averaged 6 percent for the 5-year period. Nor has the plant and equipment capacity of American industry been fully utilized. According to one widely used measure—and I might say we are aware of the limitations of measures of capacity, particularly after reading the excellent report of this committee on the subject—manufacturing operating rates in the past 5 years have averaged 6 percentage points lower in relation to capacity than in the previous decade and have consistently remained well below the peak efficiency rates preferred by businessmen. After dropping to 77 percent at the beginning of 1961, the average operating rate rose to an estimated 87 percent in the second quarter of 1962, still several points short of preferred levels.

Our capacity to produce has continued to expand since mid-1955 by roughly 3½ percent per year, reflecting (1) a growing labor force, and (2) higher productivity stemming from improved and expanded equipment and plant, greater skill of workers and management, and technological innovations. But our actual production has grown less rapidly; at an annual rate of 2.7 percent from mid-1955 to date. Actual gross national product has not kept pace with the economy's potential: beginning with 1958, unused potential output has amounted annually to an estimated \$25 to \$50 billion (1961 prices). The gap between potential and actual output has narrowed from over \$50 billion early in 1961 to roughly \$30 billion today. But idle resources have continued to be the Nation's outstanding extravagance and inefficiency.

It is important to improve this record of recent years. Our leadership of the free world, the opportunities for our youth, the security of our aged, the mobility of our surplus farm population, the pros-

pects for meeting growing public needs, the rejuvenation of our chronically depressed regions, the capacity of our economy to adapt smoothly to the expansion of our international trade, all of these are linked to the goal of maximum employment. As President Kennedy said in his Economic Report for 1962:

A full employment economy provides opportunities for useful and satisfying work. It rewards enterprise with profit. It generates saving for the future and transforms it into productive investment. It opens doors for the unskilled and underprivileged and closes them against want and frustration. The conquest of unemployment is not the sole end of economic policy, but it is surely an indispensable beginning.

#### DEVELOPMENTS IN THE FIRST HALF OF 1962

At the end of 1961, the rise of GNP in three quarters of recovery had exceeded the upswing from the low point of GNP in the comparable periods of the preceding two recoveries. While certain factors were weaker than in 1954-55 and 1958-59, others were stronger, leading to an expectation that the economy would continue upward at a relatively strong pace in 1962.

Nevertheless, on the basis of past experience, the growth during 1962 was projected to be more modest than in the recovery quarters of 1961. What I am saying is that the \$570 billion estimate of GNP that was used as the underpinning to the budget projections actually represented a slower rate of recovery in 1962 than in 1961. The shift from inventory liquidation to restocking that follows a recession normally yields large gains in the early stages of recovery. Some slowdown in the rate of advance must be expected as the expansion continues. But the change of pace was sharper than anticipated—in the three quarters of recovery in 1961 GNP advanced at an annual rate of nearly \$13 billion per quarter; its increases in 1962 were only \$6.4 billion in the first quarter and \$7.0 billion in the second. Apart from statistical adjustments resulting from the revision of 1961 date, actual GNP in the second quarter, at \$552 billion, ran at least \$10 billion below projections.

This disappointing outcome is virtually all traceable to investment in plant and equipment and inventories. In relation to income, consumer buying has held up relatively well; housing is now close to its predicted flight path after an erratic dip in the first quarter; exports are slightly above expectations; and Government purchases have behaved about as expected.

Although business fixed investment began to rise more promptly in this expansion than in earlier recoveries, its performance since the turn of the year has been disappointing. As against an expected increase of roughly 14 percent in 1962 over 1961, it now appears that the gain for the year will be closer to 3 percent. That figure of 8 percent is roughly consonant with the 10-percent figure you mentioned, Mr. Chairman.

I am sorry that we do not have a revised estimate at the present time.

This weakness of investment has sometimes been attributed to a "profits squeeze." In fact, corporate profits have increased, as already noted, by one-fourth over the period since the first quarter of 1961, although in the aggregate further profit gains do not appear to

have occurred so far in 1962. In the logic of our private enterprise system an adequate level of profits is essential to economic progress. Profits should be higher than they are today, and they will be higher when our productive capacity is more fully utilized. It can be estimated that if the economy were operating at a 4-percent unemployment level, corporate profits after taxes would be a healthy \$30 billion—compared to a \$25.6 billion annual rate in the first quarter of 1962.

Corporate profits after taxes reached a peak of \$22.8 billion in the inflationary year of 1950, a peak which they did not surpass until 1955, and which even today they surpass by only a modest margin despite the considerable growth in corporate sales and in the total investment in corporate assets since 1950.

Still, we cannot look at corporate profits in isolation. Since 1950, corporate depreciation and other capital consumption allowances have risen from \$9.4 billion in 1950 to \$28.7 billion (annual rate) in the first quarter of 1962. Together, corporate profits after taxes plus corporate capital consumption allowances—often called “corporate cash flow”—have risen from \$32.2 billion in 1950 to \$54.3 billion in the first quarter of 1962.

A comparison of business fixed investment with corporate cash flow can only be approximate since noncorporate investment is included in the investment figures, but it gives some indication of business attitudes toward investment in relation to the flow of depreciation and after-tax profits. Most of the time from 1951 to 1957, business fixed investment exceeded corporate cash flow; since mid-1958, the reverse has been true continuously, and the distance has widened in the current expansion; cash flow has grown about \$7 billion (annual rate) above the \$47 billion level of the first quarter of 1961; business fixed investment has meanwhile advanced \$5.4 billion from its \$44.7 billion rate in the trough quarter. Although investment for modernization and cost-cutting is rising moderately—and surveys suggest that about 70 percent of plant and equipment investment is for these purposes—the gains in profits during 1961 did not generate enthusiasm for a major expansion of plant and equipment. The overall willingness of business firms to invest has not kept pace with their overall ability to invest out of internal funds.

Inventory investment in the second quarter is estimated at the relatively low annual rate of \$3.4 billion. The working down of steel inventories was a factor in recent months, but even apart from steel, the general pattern of inventories reflects a cautious policy by business firms. Inventories were growing less rapidly than sales through most of 1961 and into the spring of 1962. Inventory-sales ratios which were declining from levels already relatively low by past standards would typically have heralded a speedup in inventory accumulation, but this has not occurred in 1962.

Business conservatism toward capital goods and inventories appears to be grounded in the experience of the past 5 years. The American economy since 1957 has had continuously slack labor markets, buyers' markets for materials, and persistent excess capacity. It has proved difficult for businessmen to work up much enthusiasm for buying or building ahead of minimal needs with that history still fresh in their memories. The Nation's businessmen have had their

share of disappointments in the past 5 years. They saw markets contract in 1957 just as they were adding new plant capacity and new labor to meet expected growth in demand. Much of the expanded capacity had to remain on the sidelines when the 1958-60 expansion fell short of full use of the Nation's great productive strength. To be caught long on capital and labor and short on markets tends to breed caution the next time around.

We do not have the stimulus of large backlogs of demand that marked the early postwar years. We do not have—and do not want—the stimulus to buying that inflationary expectations can provide. Against this background, it is difficult for private demand to carry the economy to full employment under existing tax rates.

During a period of recovery, an appreciable share of the growth in business and personal incomes is drained off into Federal taxes. I might say that this was a concern which we, as you may recall, expressed in our initial testimony before this committee in March of 1961. The fact is that the automatic stabilizers do cushion a downward movement, but at the same time exert a very considerable drag on a recovery. This tends to hamper the growth in both consumer and producer demand upon which continued expansion depends. During the five quarters of the current expansion, Federal taxes (net of transfers) have taken \$12 billion of the \$51 billion increase in total incomes, but Federal purchases have taken only \$7 billion of the \$51 billion increase in total output. The difference between the \$12 billion of added taxes (net of transfers) and the \$7 billion of added purchases is a measure of the drag on the recovery exercised by the Federal budget. If tax receipts had grown less rapidly, or expenditures more rapidly, total demand would have grown faster, and the expansion of output and income would have been greater. The automatic stabilizing effects to the Federal budget, which help to cushion a recession, also tend to retard a recovery.

If the economy were at full employment today, we estimate that total income and total output would be about \$30 billion higher than at present. But Federal tax receipts would be about \$9 billion above present levels, and private saving would be \$5 or \$6 billion higher than today. Thus, taxes and savings would be drawing \$14 or \$15 billion from the economy, which would have to be offset by additional investment and Government expenditures for full employment to be maintained. This means that, at present levels of Government expenditure, our present tax system bars the way to full employment unless we are able to raise private investment about \$14 or \$15 billion above present levels. I will come back to this point later.

#### PROSPECTS FOR THE MONTHS AHEAD

The most recent evidence on economic activity, though mixed, offers cause for concern. After a slow start in January-February, and then a brisk pickup in March and April, the 1962 economic expansion slackened in May and June. Those measures of overall activity which primarily reflect the results of the execution of past decisions to hire, buy, and produce—for example, the overall measures of income, employment, production, and construction—kept setting new records almost every month.

However, as previously indicated, the pace of advance was not satisfactory. And any appraisal of the outlook must also recognize the recent softness of many indicators which record current decisions and which point toward future economic decisions. For example, the movements of orders and contracts are likely to foreshadow changes in production and shipments. New orders for durable goods have been moving downward since January and in June were 7 percent below their January peak. Machinery and equipment orders are lower than in January, although they recovered some lost ground in May and held almost even in June. Housing starts and building permits have shown considerable strength in recent months, even though the latest figures are considerably below the high points of the present expansion. Commercial and industrial construction contracts are another area of recent strength on which the latest returns point downward. The factory workweek frequently indicates the needs of manufacturing firms for additional labor. It has declined during both May and June. The stock market is one of the many factors which help mold and reflect economic expectations and attitudes toward spending, but the full implications of the slide in the market from March to June will not be clear for many months.

As we look ahead, we see mixed evidence on the various components of expenditure.

#### CONSUMPTION

Consumers have raised their spending in pace with gains in their incomes during the current expansion, and there is little evidence to suggest a marked departure from that pattern in the months ahead. A rather sharp and widespread decline in retail sales during June was worrisome, but preliminary data for July indicate a strengthening in department store sales, new auto sales, and total retail sales, after allowing for seasonal changes. Past experience and current surveys indicate only a limited possibility that consumers will spark a renewed advance in the economy. (I believe you reviewed some of those current surveys this morning.) Such a spark would probably have to arise from the volatile area of durable goods purchases. In the current expansion, autos have supplied most of the strength in that sector, and it would be surprising if demand for 1963 autos were to top the brisk activity in 1962 models.

#### HOUSING

With the aid of rising incomes, readily available mortgage credit, and lower interest rates, homebuilding has done very well. The sharp rise in starts this spring carried housing activity to high levels. But, following a sharp decline in starts for June, total housing outlays fell in July. Permits come first in the chronological sequence of permit-start-construction activity. The recent data on permits point neither to a continued slide in starts below the June level nor to a resurgence to the high levels of April and May.

#### PLANT AND EQUIPMENT

Surveys of business intentions point to continued modest increases in fixed investment during the remainder of 1962. The recent Mo-

Graw-Hill survey found no evidence of cutbacks in late June after the stock market decline. Recent softness in orders for equipment raises some doubts about the outlook for plant and equipment investment but the evidence is not conclusive. At the same time, the recently announced reform of depreciation guidelines and the pending tax credit for investment serve as sources of future buoyancy in this sector.

#### INVENTORIES

In the postwar period, every recession has been dominated by inventory cutbacks. But today, given the conservative inventory-sales ratios already prevailing, it would be surprising if large-scale inventory liquidation were initiated. Reduction in stocks of steel has been an important factor holding down inventory investment in recent months. With that adjustment apparently nearing completion, inventory investment might revive this fall or winter. On the other hand, new orders and unfilled orders are important determinants of inventory policy, and strong incentives to build stocks probably would arise only in response to a reversal in recent trends in such orders.

#### GOVERNMENT

Purchase of goods and services by the Federal Government are expected to increase at a moderate rate in the next few quarters, giving some support to the private economy. The upward trend of State and local outlays will surely continue.

These prospects for various components are difficult to add up. They do not sum up to a crisis in the economy, nor do they offer any assurance of spontaneous resumption of brisk advances in the private economy. A continued period of modest upward movements or leveling off is one reasonable possibility. We experienced this in 1956-57, with gains in output just large enough to prevent a significant rise in unemployment. But we cannot rule out the alternative possibility that the recent slowdown in the expansion represents advance warning of an economic decline. A more explicit verdict would not do justice to the perplexing and inconclusive crosscurrents in the evidence before us—nor to the obvious limitations of the science of economic forecasting.

But even in the face of much greater uncertainty than usual about the pace of further advance and the possibility and timing of an economic downturn, this much is clear: The U.S. economy is still operating considerably short of its potential and action on the important economic measures recommended by the President is needed to strengthen its performance.

#### POLICY ACTIONS

Pending proposals: The slowdown in the rate of expansion in 1962, combined with the current uncertainties in the economic outlook, underscore again the importance of action on the President's recommendations in the Economic Report last January for—

**a defense-in-depth against future recessions \* \* \* a three-part program for sustained prosperity which will (1) provide standby power, subject to congressional veto, for temporary income tax reductions, (2) set up a standby program**

of public capital improvements, and (3) strengthen the unemployment insurance system.

These three measures, or reasonable alternatives—providing up to \$10 billion of temporary income tax reduction (at annual rates), \$2 billion of public works acceleration, and stronger unemployment compensation—would, as the President said in January—

enable Federal fiscal policy to respond firmly, flexibly, and swiftly to oncoming recessions.

By enacting the foregoing proposals or the related measures that now lie before it, the Congress could provide a significant economic stimulus at the present time.

As the President noted in his statement on June 7:

\* \* \* I have asked the Congress to provide standby tax reduction authority to make certain, as recommended by the eminent Commission on Money and Credit, that this tool could be used instantly and effectively should a new recession threaten to engulf us. The House Ways and Means Committee has been busy with other important measures, but there is surely more cause now than ever before for making such authority available.

The public works acceleration legislation which has passed the Senate and is pending in the House will provide for additional Federal, State, and local public works in areas of heavy unemployment. (The Senate bill also includes provision for additional standby authority permitting the extension of the program should conditions warrant.)

The temporary extension of the period of unemployment compensation benefits earlier authorized by the Congress has now lapsed, and its renewal has been requested. Such a program alleviates in some measure the hardship of those most directly and immediately affected by continued excessive unemployment. Moreover, the resulting addition to consumer purchasing power strengthens consumer buying.

Other measures now pending before the Congress can also provide immediate as well as sustained support for further economic expansion:

The investment tax credit, part of the 1962 revenue bill, promises further significant incentive to business investment, in addition to the encouragement already provided by the new depreciation guidelines.

The proposed Trade Expansion Act of 1962 will contribute to the administration's program to expand our exports—a potential source of increased demand for the output of our farms and factories, important for this reason as well as for its contribution to improving our balance-of-payments situation.

The proposed Youth Employment Opportunities Act, aimed especially at the severe unemployment and underemployment of our young people out of school, would make inroads on a particularly unfortunate byproduct of slack in our economy.

#### TAX REDUCTION

Beyond these important and timely measures now pending before the Congress, a program to improve the rate of utilization of our resources and the rate of growth of our economy must include the

even more fundamental measures of tax reduction and tax reform. On June 7, President Kennedy stated :

\*\*\* our tax structure, as presently weighted, exerts too heavy a drain on a prospering economy \*\*\*. A comprehensive tax reform bill \*\*\* will be offered for action by the next Congress, making effective as of January 1 of next year an across-the-board reduction in personal and corporate income tax rates which will not be wholly offset by other reforms. In other words, it is a net tax reduction.

The President has also indicated the possibility of asking for earlier action on tax reduction if economic developments should require it.

Apart from the announced intention to recommend both individual and corporate income tax reduction effective January 1, 1963, unless adverse economic developments require earlier action, no decision has been made on the size, composition, and timing of a recommended tax reduction. But the basic case for easing the net tax drain on the economy, as well as the broad principles which should guide tax reduction, are reasonably clear in the light of our unsatisfactory economic experience of the past 5 years.

A reduction in net tax liabilities of both consumers and business spurs the economy's advance toward full resource utilization in three important ways:

First, it increases the disposable income of consumers. The statistical record indicates that consumers consistently spend from 92 to 94 percent of their total disposable income. And past experience also confirms that increases in such incomes are very largely and very quickly translated into higher consumer spending. As the private income released by tax reduction is spent, markets strengthen, production rises, new jobs are created, and incomes and profits rise accordingly. This generates added cycles of private spending and leads to further increases in output and employment. This process alone—the so-called “multiplier effect”—translates the original personal tax reduction into an increase in gross national product considerably larger than the reduction itself.

Second, by bolstering sales and pushing production closer to capacity, tax reduction stimulates investment in inventories and in plant and equipment, the so-called accelerator effect. This further expands gross national product, raises profits, and reduces the deterrent effect of excess capacity that since 1957 has plagued the economy and curbed expansionary investment.

Third, by reducing the Government's share of business earnings, tax reduction improves profit margins and increases the supply of internal funds available for investment. This strengthens both the incentives and the financial ability of businessmen to undertake the risks involved in new investment.

Decisions on size, composition, and timing of tax cuts will need to give appropriate weight to the following economic considerations:

1. The longer-term need for reducing the excess of Federal revenues over Federal expenditures that would be realized at full employment, a need that depends on:

- (a) The current size of the full employment surplus, estimated at \$7 to \$8 billion on a national-income-accounts basis;

- (b) Its prospective size in light of projected growth in Federal expenditures and Federal revenues as the economy expands;

(c) The amount of surplus at full employment that is needed to curb inflationary pressures while maintaining a high level of investment.

2. Any short-term need that may exist for overcoming temporary deficiencies in consumer and investment demand.

3. The necessity of combining individual and corporate income tax reduction in the manner best suited to stimulating both consumption and investment, to support both markets and incentives.

4. The appropriate relationship to the projected reform of the tax structure, a reform designed to improve equity and remove the artificial tax barriers or concessions that divert resources from their most efficient uses and thus impair our rate of economic growth.

5. The invigorating effect of tax reduction on the economy and the resulting "feedback" of revenues to the Federal Treasury which limits the net budgetary cost of the reduction and, over time, may even wipe out its initial addition to a budget deficit.

6. The monetary policy being pursued—for example, if monetary policy becomes more restrictive for balance-of-payments reasons, a larger tax reduction would be needed to yield a given economic stimulus.

#### MONETARY POLICY

As the last point indicates, fiscal policy and monetary policy are tightly interwoven, indeed are in part substitutes for one another. A given stimulus to the economy can be achieved by a relatively easier fiscal policy coupled with a relatively tighter monetary policy, or vice versa, but the effects on the balance of payments and on the investment-consumption balance in the economy may be rather different in the two cases.

During this economic recovery, the task of monetary policy has been especially difficult. There has been a compelling need for general monetary ease, as part of expansionary economic policy for full employment and adequate utilization of our resources. It has been especially vital to maintain reasonably low long-term interest rates and a plentiful supply of investment funds in order to stimulate private investment and quicken the tempo of growth in potential output. Yet, concurrent with these objectives, it has been necessary to discourage large flows of capital out of this country that could complicate the task of restoring a healthy balance of payments and confidence in the dollar.

The problem of capital outflow is tied primarily to our level of short-term interest rates relative to those of other countries, and it has therefore been necessary to prevent short-term rates from falling too low. At the same time, the monetary and debt authorities have tried to shield long-term rates, so critical to economic expansion, from the restrictive impact at the short end of the maturity spectrum.

Since February 20, 1961, the Federal Reserve has conducted its open-market operations in all maturity sectors of the U.S. Government securities market. On balance, the Federal Reserve has actually sold short-term U.S. Government securities in the open market since that date, but it has bought longer term securities, primarily 1 to 5 years, in amounts much larger than the sale of short-term securities. Most of the purchases of long-term securities took place in 1961,

Since then, such purchases have been more limited. The Treasury Department has also adapted debt management policies in part to these same objectives, primarily through concentrating new cash offerings of securities in the short-term area, but also by buying long-term securities for the Treasury investment accounts to the extent that such purchases were consistent with the objectives of these funds.

The action that the Federal Reserve took, effective January 1 this year, in raising the maximum interest rate payable on commercial bank time deposits to as high as 4 percent, has increased the total flow of funds through financial institutions. This has put pressure upon these institutions to find investment outlets and has helped to reduce yields on both mortgages and municipal bonds. Actually at this point of time, 17 months after the beginning of economic recovery, long-term private interest rates are generally below their levels at the cyclical trough in February 1961. This does not say they are low enough.

What it says is that as far as the statistical record is concerned, they are below the trough levels in February 1961. They are also below the levels at the corresponding stage of the 1958-59 recovery, despite the postwar peak in interest rates that intervened. The reduction in long-term rates has had to overcome two psychological barriers, rather stubborn ones—first, some persistence of inflationary psychology in the financial community despite the lack of tangible inflation; and, second, vivid memories of the experience of 1958-59, when economic recovery was accompanied by sharp increases in long-term rates (as I recall, the sharpest in a hundred years in comparable phases of the business cycle).

The total of demand and time deposits and currency has been increasing since February 1961, by more than 7 percent per year, and the availability of bank reserves has been generally favorable to the expansion of bank credit. Banks have been going more heavily into municipal bonds and mortgages. Very little of the expansion of bank loans and investments over the past year has been in U.S. Government securities. In relation to economic activity, liquidity in the economy is not much changed from its postwar low.

A special word is in order on the relation of monetary policy to the balance-of-payments situation. We have, from the beginning, taken a number of determined and effective measures to improve our balance of payments and maintain confidence in the dollar. In dealing with the balance of payments, however, it would be self-defeating to adopt policies that would undermine the vigor of the economy; for example, through restrictive monetary-fiscal policies. Confidence in the dollar is dependent upon a strong, growing American economy.

Further, a revival of vigorous growth here will make the United States a more attractive outlet for long-term investment funds, both domestic and foreign. As a result, monetary and debt-management policy must continue to aim at providing ample credit and liquidity to support needed recovery and growth, consistent with the requirements of balance-of-payments policy.

Finally, as monetary and fiscal policies are brought into coordinated focus, these points stand out:

1. At a time when the Federal budget was becoming progressively less expansionary in its net impact on the economy during the 1961-62

recovery, monetary policy remained easy, partly through conscious effort of the monetary authorities, partly because expansionary forces have not been as strong as expected, and partly because 1961-62 may mark the end of a rising trend—related to inflationary expectations—in interest rates.

2. Balance of payments and gold outflow considerations currently demand a more restrictive monetary policy than would be desirable from the standpoint of the domestic economy. To this extent, fiscal policy must be more expansionary than would otherwise be necessary in order to promote domestic economic expansion and narrow the excessive gap between our economic performance and our economic potential. Indeed, closing this gap can play an important role in building longrun confidence in the dollar. As the steps currently being taken to eliminate the balance-of-payments deficit and strengthen our international monetary position achieve their objective, the curbs on our freedom to use monetary policy to meet the needs of the domestic economy will be progressively reduced.

3. Any move toward sizable tax reductions must, of course, be accompanied by a willingness to move toward higher interest rates if this should prove to be necessary (a) to discourage any adverse capital flows that might develop, or (b) to offset any inflationary pressures that might ensue if the rebound toward full employment should prove to be unexpectedly rapid. With a gap of approximately \$30 billion between actual and potential output, the prospect of inflation from excess demand is surely remote.

4. If budget deficits are incurred, the method of financing them must be carefully adapted to the prevailing economic circumstances. A careful balance must be struck between bank and nonbank financing, a balance which will not thwart or nullify the expansionary effect of budget measures in an economy with excessive unemployment and excess capacity, but will prudently shift Federal debts into nonbank hands as the economy comes close to or reaches full employment.

Summing up, let me say that relative monetary ease has facilitated economic expansion in the recovery of 1961-62; that even greater ease would have been possible in the absence of international payments pressures; that those pressures throw an additional burden on fiscal measures as part of a coordinated economic policy for full employment and faster growth; and that care must be exercised not to overcompensate for such international monetary pressures by premature or excessive tightening of credit and interest rate.

#### CONCLUSION

We would be dangerously complacent if we focused only on such impressive advances in our economic well-being in recent years as:

The rise of over \$50 billion in gross national product since the first quarter of 1961, and the accompanying rise in employment, personal income, and profits.

The shrinkage of our balance-of-payments deficit from \$3.9 billion in 1960 to \$2.5 billion in 1961, and the prospect of further shrinkage to \$1.5 billion or less this year.

The 4 years of stability in our wholesale price level since 1958.

The continued growth in our economic potential at rates exceeding prewar averages.

But when we look ahead, instead of backward, it is the size of the job yet to be done that demands attention and commands action: the continued hardship, inequity, and waste of unemployment; the excessive amounts of unused industrial capacity; the unsatisfactory pace of economic expansion in 1962; and the remaining gap in our balance of payments. My statement today has put its emphasis on this unfinished business of economic policy. The uncertainties of current economic developments and prospects underscore the urgency of that unfinished business. They also intensify the need for action on those economic measures that the President has already put before Congress, and the need for forethought on the tax adjustments which are needed to remove barriers to the expansion and full utilization of the great potential of the American economy.

Chairman PATMAN. Thank you very much, Dr. Heller. I assume you are speaking for the Council?

Dr. HELLER. I am, Mr. Chairman.

Chairman PATMAN. Dr. Heller, when you were before the committee in January presenting the President's economic report for 1962, I believe you then projected a GNP for the year of \$570 billion. You mentioned that in your statement, I know. Is that correct?

Dr. HELLER. That is correct.

Chairman PATMAN. What amount of investment in plant and equipment did you project for 1962 at that time, do you recall, Dr. Heller?

Dr. HELLER. We projected a 14-percent increase in the investment in plant and equipment over 1961; that is, a total of about \$39 billion for 1962.

Chairman PATMAN. Do you recall your projection of Federal expenditures?

Dr. HELLER. May I put those in terms of the rise that we expected from 1 year to the next?

Chairman PATMAN. Yes, sir. Also construction expenditures and consumer durables. Rather than delaying the hearing, Dr. Heller, I will ask you if you have the question to put the answer in the record if you will, please.

Dr. HELLER. Thank you, Mr. Chairman.

(The figures referred to follow:)

An increase of \$8 billion from 1961 to 1962 was expected in Federal expenditures on an income-and-product basis with about \$5½ billion of the increase occurring in purchases of goods and services. Data in the first half of 1962 are consistent with those projections.

It was anticipated that residential construction in 1962 would run \$3 billion above the 1961 average—or \$1 billion above the fourth quarter of 1961. Despite the weak first quarter results, the average for 1962 is likely to be within \$1 billion of the projected level.

No explicit projections of public construction or nonresidential building were made.

A \$5 billion rise in 1962 over 1961 was expected in consumer durable expenditures—slightly more than half in autos and the rest in other durables. The second quarter of 1962 showed a level of \$3½ billion above 1961, with nearly all of the gains coming from autos.

Chairman PATMAN. What figure did you project for money supply on the average for the year 1962?

Dr. HELLER. I do not believe we made an explicit projection for the money supply.

Chairman PATMAN. What is the money supply now for the latest date for which you have any data?

Dr. HELLER. The total money supply is \$145 billion, consisting of \$30 billion of currency outside of banks, \$115 of private demand deposits.

Chairman PATMAN. Is the GNP figure of \$552 billion correct for the second quarter of 1962?

Dr. HELLER. That is the preliminary estimate of the Department of Commerce; yes, sir.

Chairman PATMAN. May I point out that between the fourth quarter of the last year and the second quarter of this year GNP increased by 2½ percent, but your money supply grew in the same period on a seasonally adjusted basis by only 0.9 percent. Is that correct the way you understand it?

Dr. HELLER. From the trough of the recession until the middle of this year GNP rose to the second quarter by about 8½ percent on a price corrected basis and the money supply grew about 9 percent.

Senator PROXMIRE. I think Chairman Patman is talking about time deposits.

Dr. HELLER. Thank you, Senator. I am including time deposits in this 9-percent figure.

Chairman PATMAN. I might point out also in the second quarter of 1961 the money supply amounted to 27.8 percent of GNP. In the second quarter of this year it equals only 26.4 percent of GNP. This volume of money relative to the size of the economy requiring money is now the lowest since 1929. In trying to find out why the predictions you gave us last January were wrong, have you considered whether or not your projections were sabotaged by the monetary authorities?

Dr. HELLER. We try to look at all of the factors in the situation.

Chairman PATMAN. That is one of them, I believe you will admit.

Dr. HELLER. I think it is fair to say that the level of interest rates is one of the important factors influencing construction activity and plant and equipment investment. If the level of interest rates could have been lower and the money supply greater, the conditions for investment would have been more favorable.

Chairman PATMAN. Dr. Heller, I might also point out from the fourth quarter of 1960, just before President Kennedy took office, to the second quarter of the present year the gross national product increased 9.6 percent. Within the same period the money supply increased at only about one-third of that rate or a total of 3.3 percent. This brings up a question. When I first came to Congress, Dr. Heller, about 34 years ago, I was one of the group advocating the payment of the adjusted compensation certificates to three and a half million veterans of World War I, commonly known as the bonus. We finally secured its passage under Mr. Hoover and overrode his veto to get half of it paid by loans with interest, but that was not satisfactory to us. Then we commenced a campaign to pay it off in cash, and we succeeded after passing it several times in the House and Senate, and almost over the President's veto in 1935, only lacking eight votes, but in 1936 we passed it over the President's veto, with provision for pay-

ment to veterans of over \$2 billion. We expected that to add a lot of purchasing power and help the country because it would go into every nook and corner of America, as you know. Each veteran had an average certificate of \$1,015. And yet, when payment was made it did not seem to have much of an effect and we were puzzled about it. But I soon discovered that when the money was paid, the monetary authorities for the first time in history doubled the reserve requirements of banks, which absolutely nullified the payment of that money and retarded the country.

The reason I bring that up now is that it occurs to me that we have a comparable situation. We have a situation where we want to do something to increase purchasing power among our people and the monetary authorities are, in effect, threatening to veto it through monetary policy; and they can do it. I can certify to that because I was a witness to it in 1936. They did it then. And they have the power to do it now. Have you thought about that prospective trouble?

Dr. HELLER. Mr. Chairman, as I tried to indicate in my statement, I think you are 100 percent correct in saying that the interrelationship of fiscal policy and monetary policy has to be kept in the forefront of our policy thinking. It is perfectly true that it is possible to nullify expansionary monetary policy by restrictive fiscal policy or vice versa.

It is a source of concern to us that in response to balance-of-payments pressures monetary policy has not been as easy—particularly in the last few months—as would be required by the domestic economic situation alone. I think that we must be extremely vigilant to make sure that any tightening on the monetary front is really a necessary response to the balance of payments and the gold outflow situation.

Chairman PATMAN. I think you will have to assess carefully what the monetary policy may do. You cannot guard against it because you do not have the power to guard against it. In effect, the Federal Reserve Board members have 14-year terms. I do not think President Kennedy has selected even one.

Dr. HELLER. One.

Chairman PATMAN. He has selected one. One out of six. Of course, the Open Market Committee is the most powerful group on earth. By law, it is composed of 12 members. Seven members of the Federal Reserve Board and five presidents of Federal Reserve banks. But in effect and in practice the 12 presidents of Federal Reserve banks come into this Open Market Committee, and they advise with them. Their views are sought and obtained at the meetings of the Open Market Committee and for all practical purposes they are full participants. So these 12 presidents of Federal Reserve banks are selected by representatives of the banks and the banks want higher and higher interest rates all the time.

I feel that we are in a little danger trying to bring this country back to full employment with a situation like that, where the monetary authorities have the power to veto what you do. I hope Congress gives some consideration to this question in the interest of full recovery and employment.

Senator Bush?

Senator BUSH. Mr. Chairman, during the previous 8 years I heard a great deal about the tight-money policy of the previous adminis-

tration. I always contended in discussing that it was not a tight-money policy, but rather a sound-money policy. I am rather sympathetic with the attitude of this administration in respect to monetary policy so far. You would not define it as a tight-money policy, would you, Dr. Heller?

Dr. HELLER. I would not. But a sound-money policy sometimes is a tight-money policy and at other times is an easy-money policy.

Senator BUSH. If you look at the statistics that are being piled up here in this hearing, it seems as though housing was going ahead apace this year, and that is influenced by the rates of money, I suppose, to some degree. But certainly the interest rates have not seemed to inhibit the increase in housing construction which is going ahead at a very good rate. A million and a half starts this year, I believe. Also consumers' credit has been expanding considerably. That does not seem to have been inhibited by interest rates. Is that not so?

Dr. HELLER. These things are relative in the sense that if interest rates were still lower I presume that housing starts would be still higher. But a rate of 1.4 or 1.5 million starts, which it looks like at the present time, is a very substantial advance over the trough of 1961, and indeed a very respectable showing in terms of the history of the 1950's. That does not say we would not want more.

Senator BUSH. I would like to say that I congratulate the administration for its attitude on this question of monetary policy. I think it has been very satisfactory so far, and I hope it would not be dislodged by any of the loud requests for lower interest rates artificially produced by the Government. Have we ever had a temporary tax cut of the type that is being discussed now for the purposes that are being discussed now?

Dr. HELLER. No, we have not.

Senator BUSH. I have not been able to recall that has ever been tried before.

Dr. HELLER. No.

Senator BUSH. So this would be an experiment, then? We are not able to forecast in the light of what may have happened before, but it would be a new adventure if we were to embark upon a temporary tax cut for the purpose of spurring the economy, especially in the face of expected deficits, is that true?

Dr. HELLER. That is correct, Senator. There have been extensive discussions of this possibility in the whole postwar period, but it has never been undertaken, even though we seemed at one time in 1958 to be close to it. But there was a certain Easter recess after which people in Congress seemed to back a way from it.

Senator BUSH. Thought better.

Dr. HELLER. Anyway they reconsidered it.

Senator BUSH. Dr. Heller, a few years ago I read a book by Professor Galbraith which is a very interesting book on the economy, "The Affluent Society." In that book he advocated a different approach to the tax situation. He said he thought if we were going to go ahead and expand that we were going to have to very greatly broaden our base of taxation. He advocated an addition to the tax, that we should not be entirely dependent upon the income tax to the extent that we are, which is probably heavier than any other country today, I understand.

He talked about some sort of a tax, I think he called it a production tax. It was a tax upon the production of goods, generally speaking. Is that correct? Do you recall?

Dr. HELLER. Essentially the Galbraith position was to change somewhat the balance between private and public goods and make public goods less expensive and private goods more expensive. But I believe that he was directing this particular comment on consumption taxes primarily to the State and local level. He was suggesting that State and local governments should not be quite as bashful about using taxes that would be a direct burden on private consumption.

Senator BUSH. You did not gather he was directing that toward the Federal Government tax system?

Dr. HELLER. That was not my impression though I stand subject to correction.

Senator BUSH. It was my impression, but I have not read that book for about 3 years, so I would not want to argue that point with you.

Dr. HELLER. I have not read it for 19 months.

Senator BUSH. You have not had much time in that period.

Mr. Chairman, I have no further comments.

Chairman PATMAN. Senator Douglas?

Senator DOUGLAS. Dr. Heller, you know I have a very high opinion of you.

Dr. HELLER. That is an ominous opening statement.

Senator DOUGLAS. It is very sincere, I assure you. When you estimated last January when you appeared before us that the gross national product would be \$570 billion for calendar 1962, I asked you if you were not a little optimistic and you replied no, you thought this estimate was well taken. Then I asked you this question which appears at the top of page 11 of the hearings:

Suppose you do not reach these goals—one must always have plans ready in case the program of attack does not succeed.

Dr. HELLER. That is right.

Senator DOUGLAS. Do you have any plans that you want to reveal or do you think it is wise not to discuss them?

Dr. HELLER. I do not want to suggest, Senator, that we have some hidden weapons or secret weapons that are in reserve for this purpose. Weapons are available that I think are familiar to this committee and to all of us. For example, monetary ease. If the recovery is not as vigorous throughout 1962 and 1963, as anticipated, one of the weapons would be monetary ease.

Senator DOUGLAS. The first part of this question is this: Is it not apparent that we are going to fall very far short of \$570 billion as GNP for calendar 1962? The average for the first half is a little less than 549. To reach 570 you would have to have an average of 590 for the second half. An average of 590, which would mean you would have to go well over 600 in the final quarter. Are not we going to fall very far short of 570 and should not we frankly admit that now?

Dr. HELLER. We are certainly going to fall substantially short of \$570 billion for the year. When I said earlier in response to your question that we have not formulated a new estimate, it is not to deny that we are going to fall substantially short of the \$570 billion projection.

Senator DOUGLAS. You said if we do fall short the weapon should be monetary ease. Have we in practice had this monetary ease?

Dr. HELLER. Senator, we have in part, although, as I noted in my statement, we have been inhibited with respect to short-term interest rates by balance-of-payments considerations. Most of our present long-term interest rates, however, are below those at the time of the trough in 1961, and in case after case—

Senator DOUGLAS. You expect them to be that just through the normal cyclical process, interest rates fall in a period of recession and rise during a period of advance.

Dr. HELLER. If I may interrupt, that is what makes the comparison with 1959-60 relevant. Every one of the major interest rates today is below its level at the corresponding point in the recovery of 1959-60. The reason for that in part is that the recovery this time has not been as strong as expected and the monetary ease that has been continued is, therefore, greater than it would have been if the recovery had been more vigorous. In a sense we have used continued monetary ease.

Senator DOUGLAS. I want to concentrate our attention upon the developments in May, June, and July of this year when, as you said, economic conditions began to turn down, and when according to all the classical principles, monetary ease should have been observed. On page 29 of your very excellent Economic Indicators, the first column gives the rate on 3-month Treasury bills on what is known as the short-time rate. In May that was 2.694. At the end of June it was 2.719. On July 21, it was 2.983.

I have a release just issued by the Federal Reserve Board a few hours ago. It shows a slight fall, but it is still 2.874 as of August 4. This is an increase since the average in May of 28 points, or over 10 percent. So the short-term rate has gone up 10 percent. It is notorious that this has been done by the Federal Reserve selling short-time Government bonds in the market which has depressed the price and raised the yield and consequently raised the short-time rate upon which the Reserve in the past has always placed such great emphasis. My figures are correct, are they not?

Dr. HELLER. Yes, indeed, they are. I was just going to add the very latest figure which is 2.802.

Senator DOUGLAS. When was that?

Dr. HELLER. That is the figure for the week of August 11.

Senator DOUGLAS. Have we reached August 11 yet?

Dr. HELLER. No.

Senator DOUGLAS. Is not this forecasting on a large scale?

Dr. HELLER. These figures are reported as of the beginning of the week of the new issue, but they are reported as of the date at the end of the week, so we have it already.

Senator DOUGLAS. Even so that is an increase of 21 points, or around 8 percent!

Dr. HELLER. No, I believe that is an increase of 11 points, or 4 percent.

Senator DOUGLAS. Has not the policy of the Federal Reserve in the last 3 months been to violate the historic principle that when recession threatens—and I agree with you that it is not here, and the testimony this morning was pretty clear that there was no clear evidence that it was coming—Has not the action of the Federal Reserve in raising interest rates flown in the face of the doctrine that the first

thing you should do when storm signals begin to go up is to reduce interest rates?

Dr. HELLER. Let me make a few comments on that. In January the 3-month Treasury bills was 2.746; now it is 2.802.

Senator DOUGLAS. That is when you were prophesying we would have a GNP of \$570 billion. Everything was fine at that time.

Dr. HELLER. There had been a fall in the interim period and then a rise. Of much greater concern than the short-term rate—which is the essential one for stemming outflows of funds to foreign countries, funds that further aggravate our balance-of-payments and gold situation—of much greater concern for economic expansion is the long-term rate. There I would certainly share your concern about the rise.

Senator DOUGLAS. Let us get that into the record. In May that was 3.09, was it not? No, pardon me. It was 3.88, was it not?

Dr. HELLER. Yes, that is the figure.

Senator DOUGLAS. July 14, it was 4.03, which is an increase of 15 points and approximately under 4 percent.

Dr. HELLER. Yes, and the latest figure was 4.04 for the week of August 4.

Senator DOUGLAS. So that is slightly higher. You have had an increase both in the short-time rate and long-time rate. You yourself argued, and I thought very cogently, that the first thing you should do if it actually fell short of the prediction was to get a decrease in the interest rate.

I know you do not have control over the interest rate, but we are trying to find out whether the monetary policy has really been correct.

Dr. HELLER. As I indicated a moment ago, we have been concerned by the fact that the short-term rate increase has been matched by a rise of a similar number of basis points in the long-term rate, because it is the long-term rate that is most important for economic expansion.

Senator DOUGLAS. I have always held with that in the past. The excuse is the one that you gave, namely, it is necessary in order to prevent the outward flow of gold. I want to read the comparative short-time rates for the European countries.

Switzerland is supposed to be the rater and I think it is. The Swiss short-time rate is 2 percent. The Dutch, who are very thrifty have a short-time rate as of June of 2.32, or 2½ percent. Germany, which has been held up to us as an example, has a short-time rate of 2.38. The only countries with higher short-time rates are France, which I do not think is a great deal of an international investor; Canada, which has just gotten into difficulties, and, therefore, is raising its rate to protect itself; and Great Britain which is the other gold exchange country. I want to suggest that these comparative rates indicate that the Federal Reserve has taken fright too quickly and is using an excuse which is really not tenable.

My time is up and with that I will stop.

Chairman PATMAN. Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

Following your statement, Dr. Heller, you are basing the basic theory on what has been referred to as the gap theory that you advanced, I think it was a year ago.

Dr. HELLER. March 6, 1961.

Representative CURTIS. Let me ask this in reference to that. Incidentally, I might state that this is a theory with which many disagree and it is important to know there is this disagreement. Accepting the "gap theory" just for the sake of discussion here, it strikes me that really things are much worse off than you indicate because one of the two bases of the gap theory is unemployment figures, is that right?

Dr. HELLER. Yes.

Representative CURTIS. The unused labor force?

Dr. HELLER. Unused labor force and unused industrial capacity.

Representative CURTIS. I want to direct attention to the unused labor force because it really should not be the unemployment figure as much as it should be the percentage of the population from 14 to 65 or 14 up, which goes to make up the potential civilian labor force, am I not correct?

Dr. HELLER. Yes.

Representative CURTIS. The thing that disturbs me is that in our indicators—the ones I have here are from July, 1962—beginning in 1955, that our civilian labor force has continued to rise since World War II and it has risen during recessions along with the upturns, averaging almost around a million a year.

We see that the civilian employment has been rising, but in June—and this is the last month that I have a comparison—in June of 1962, the civilian labor force was less than June 1961. Sixty-four million in June 1962, 74.286 million in June 1961, which is not only not an increase but is a decline. If you threw that into your gap theory, I suspect your gap is widening because you would really be adding a million more people on to the unemployed rolls.

Dr. HELLER. May I comment on that comparison, Congressman Curtis?

Representative CURTIS. Yes.

Dr. HELLER. There is so much month-to-month variability in the size of the labor force that it is safest to use quarterly averages when making comparisons. During the second quarter of this year, the civilian labor force was 60,000 higher than a year earlier. Over this same period, the Armed Forces were increased by some 350,000 persons. In order to take account of this, our comparisons should be based on the total labor force, which includes the Armed Forces. The over-the-year increase is thus 410,000. Next, since April of this year, labor force estimates have been constructed using information from the 1960 Census of Population. Previously, estimating weights from the 1950 census were utilized. This change has reduced estimates of the labor force by about 210,000. Correcting for this, we find an over-the-year increase of 620,000.

This is a sizable increase, but it is still smaller than was expected on the basis of population growth and trends in labor force participation. I think there are two reasons for this shortfall. First, the retirement rate has increased, partly in response to liberalized social security benefits. Second, and more important, has been the continued slackness in the labor market. Total employment has increased by over 1¼ million in the past year, but about half of this increase has been due to recovery in manufacturing and to the rehiring of previously laid-off workers. The expansion in new job opportunities has been rather modest. In particular, employment gains in services and

trade, while substantial, have been much smaller than in earlier expansion periods. This has a particular relevance for labor force growth, since these industries absorb a high proportion of the women who enter the labor market. We would expect that at full employment, when more new job opportunities were being created, workers would enter the labor force to fill these jobs.

Representative CURTIS. We have had that in previous recessions, and we do not have a similar decline. In fact, reading the figures from 1955, which I have in front of me, each year there has been a net increase. I was trying to see which is the smallest. Probably about from 1956 to 1957 where the increase was a little less than 400,000. It seems to me that is the figure, if you are going to use the gap theory.

Just to restate it, I think you have misconstrued what is going on here in our economy through dealing in economic aggregates. When we identify who the unemployed are, they are centered in the unskilled, semiskilled, who through the rapid technological growth and through meaningful growth in our society cannot find jobs unless they get trained for the skills that are in demand. This is something that is inherent in a growing economy and should not be looked upon as a gap. It should be looked upon rather as something that must be met.

The same thing, I would say, applies to industrial capacity. Again, when we grow rapidly we create more obsolescence; of what was capacity in 1960, though physically still in existence, it is not economic capacity in 1962.

At any rate, I wanted to go on to another thing because this one base of your syllogism is the gap theory. The other is the theory of deficit financing. I am talking about your recommendations that in a period of already deficit financing we have a tax cut to stimulate the economy which would create further deficits, and also at the same time increase rather than decrease Federal expenditures. Your second suggestion was a \$900 million public works superimposed on the present expenditures in the budget. Am I not correct in describing that as a theory of deficit financing?

Dr. HELLER. I want to make one small correction. The President's proposal in the public works area was a \$600 million proposal.

Representative CURTIS. I thought it was \$900 million.

Dr. HELLER. That was the figure that came out of the House Public Works Committee.

Representative CURTIS. At least it is the theory of deficit financing. Throughout your paper and your discussion here of the status of our economy, you are one of the few witnesses that has not referred to the important factor of business confidence. You recommend two new and untried theories, the gap theory and the theory of deficit financing, which certainly are not held to be sound by the business leaders in the private sector.

Certainly a recommendation and pursuit of theories such as these, even if they were true, is not going to help business confidence, is it?

Dr. HELLER. Mr. Curtis, we thought that in testifying as to the importance of profits and investment stimulants and stronger markets that we were in effect testifying on the factors which above all others create business confidence.

Representative CURTIS. Do not you feel that Government policy is a very important factor in business confidence?

Dr. HELLER. Indeed it is.

Representative CURTIS. And that is what we are talking about here, Government policy. These are your policy recommendations. In fact, you worded them as such in your prepared statement.

Dr. HELLER. The policies for increasing markets, for stimulating investment through depreciation guideline revision and investment credits.

Representative CURTIS. Those are the collaterals. But you advanced three basic recommendations, two of which are the ones I have mentioned. One was tax cutting, the second was increased public works, and the third was what?

Dr. HELLER. The unemployment compensation provisions.

Representative CURTIS. Yes.

Incidentally, all three of those, or at least two of the three, are almost academic in August of 1962 in the tail end of this session of this Congress.

Dr. HELLER. I think we should distinguish between the short-run stimulants for inadequate cyclical recovery, on the one hand, and the longer run bolstering of markets, and profits, and investment incentives, on the other. Perhaps in our testimony we did not make clear enough the distinction between these two in our thinking. The President's three-ply program for sustained prosperity was designed to meet the problem of dips in economic activity, temporary inadequacies in the level of economic activity. But coupled with that there has to be a longer term program for removing the tax overburden, for stimulating consumer spending, and for stimulating business incentives.

Representative CURTIS. Under this when would you ever balance the budget, or better still, when, looking backward in our history, would you have ever balanced the budget since World War II? Following your gap theory?

Dr. HELLER. The budget has been balanced. There was essentially no gap except in very short periods from 1946 to about 1955.

Representative CURTIS. We had the Korean war in there.

Dr. HELLER. During that period we had a substantial number of budget surpluses both on the conventional administrative budget and even a larger number on the cash budget.

Representative CURTIS. In retrospect, you would approve of those balanced budgets?

Dr. HELLER. Those surpluses were extremely important and necessary and a desirable factor in moderating inflation and in stimulating investment.

Representative CURTIS. Then the key question is this: 1962, which is predicated to beat all records in gross national product, which is the way you have been measuring your gap, in spite of the fact that it is that way, and 1961 broke all records in gross national product, you do not feel that is a year when you need to have a balanced budget?

Dr. HELLER. Because of the fact that the economy is still operating very substantially below its tremendous potential, a fact which would, I am sure, be recognized by a very great majority of private, business, and labor economists, as well as the great majority of Government economists.

Representative CURTIS. I have been listening to them and interrogating them to find why they felt that way. They do not all look at it that way, fortunately. Those who hold your view, I honestly think, are not looking at the indicators that really measure economic growth.

Chairman PATMAN. Congressman Reuss?

Representative REUSS. Mr. Chairman, Chairman Heller and members of the Council, I want to commend you for responding once again to the mandate of the 1946 Employment Act, directing the Council to send up not only an annual report but supplementary reports at such times as they may be advisable. You did so last year, and I thought your decision most appropriate. I thoroughly agree that a new report is advisable at this time, and I am delighted you have given us this very comprehensive document.

I want to discuss with you the monetary policy which appears to be in effect today. In the last 8 weeks, at a time when there has been justifiable concern about the economy, the Federal Reserve Board has markedly decreased the free reserves in the banking system, and this has resulted in an increase in both short-term and long-term interest rates, has it not?

Dr. HELLER. Yes, it has.

Representative REUSS. The Treasury has also within the last few days issued a long-term bond with a maximum legal permissible coupon of  $4\frac{1}{4}$  percent. That is also a fact, is it not?

Dr. HELLER. Yes.

Representative REUSS. If it were not for so-called balance of payments considerations, it would be indefensible, would it not, to tighten the supply and increase the cost of money at this time?

Dr. HELLER. In the light of economic conditions today and economic prospects, yes.

Representative REUSS. So let us look at the validity of the balance of payments argument for doing this. You would agree, would you not, that one, speculation, and two, the needs of trade, are a very important cause of the movement between countries of short-term capital funds?

Dr. HELLER. Yes.

Representative REUSS. Would you say that these causes are more important than, or at least equally important as, differentials in interest rates?

Dr. HELLER. The answer to that question varies from period to period. At one time, as in late 1960, when there was a speculative run, no feasible amount of change in interest rates could have stemmed the flow. At other times, however, a very substantial part of the short-run flow is responsive to interest rates.

Representative REUSS. In the last 8 weeks were interest rate differentials between the major trading nations such as to have justified an apparent attempt to raise U.S. interest rates?

Dr. HELLER. As Senator Douglas pointed out, in some countries, yes, and in some countries, no.

Representative REUSS. Weren't Canada and the United Kingdom the only major countries with interest rates higher than ours?

Dr. HELLER. Canada raised its short-term rate to about 5 percent, and the U.K. had come down to just under 4 percent. Neverthe-

less there was still an incentive even with the differential for funds to move out in response to these interest rates.

Representative REUSS. Were the interest rate differentials, after adjusting for exchange risks and forward cover, such in the last 8 weeks as to require a different policy on the part of this country?

Dr. HELLER. I lack an intimate detailed knowledge of these movements, but I am under the impression that there were some pressures on the dollar to which this was at least in part a response. While I am not qualified to give you a very detailed answer on the movements of forward cover and interest rates, I do know that there was an incentive to move funds overseas, particularly to the United Kingdom.

Representative REUSS. Does the Council of Economic Advisers make an independent judgment as to whether a given interest rate differential is a major risk for our balance of payments, or do you accept the judgment of the Federal Reserve System? If your answer is that you make an independent judgment, have you made one in the last 8 weeks, and does it accord with that of the Federal Reserve? And if it does not, have you let them know?

Dr. HELLER. I would put our situation this way: We make a judgment based on information that is supplied by the Treasury and by the Federal Reserve. But as far as the policy implications are concerned, we, of course, form our own counsel, and discuss these matters with the Treasury, with the Federal Reserve Board, and with the President in periodic meetings.

Representative REUSS. Of course, if frail man should err in this, the consequences could be most serious, could they not? If we raised our interest rate structure when it was not necessary for balance-of-payments reasons, we would have injured our domestic growth prospects, needlessly.

And if domestic stagnation results in a large involuntary deficit, perhaps made even larger by a tax designed to undo the effects of tight money, we might in fact increase our balance-of-payments problems. Foreign central banks could become more alarmed with such a large budget deficit than from seeing modest quantities of short-term capital move around.

Dr. HELLER. I think that any tightening that goes beyond what is required for progress and stabilization on the balance-of-payments and gold front is a heavy price to pay, and an unnecessary price to pay, particularly when it hits long-term rates. We are concerned, and have been concerned, with the recent tightening to which both you and Senator Douglas have referred, with the question whether it meets felt and actual needs, with the question of whether it might not be nullified by rising interest rates in some of the other countries, and with the question of whether it would not be possible to differentiate a little bit more between the rise in short-term rates and that in long-term rates. These concerns of ours have been expressed in our discussions within the administration and with the Federal Reserve Board.

Representative REUSS. Putting to one side the question of whether we have in fact gone astray in the last 8 weeks in raising interest rates, would you agree that interest rates higher than those we have today are likely to harm our domestic situation and are of doubtful value for our balance-of-payments situation?

Dr. HELLER. I feel that, given the present economic outlook, this is a time to be very careful that interest rates not be raised one basis point more, or credit tightened one dollar more, than is absolutely required by the international payment situation. I think that this requires continued vigilance in the current economic situation.

Representative REUSS. Thank you.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Mr. Chairman, would you turn to your statement. I call your attention to the sentence which reads:

The most recent evidence on economic activity, though mixed, offers cause for concern.

I ask you, concern about what?

Dr. HELLER. Concern about the full utilization of resources in the economy and about the pace of further expansion.

Senator JAVITS. Does it offer concern that we may be heading into another recession?

Dr. HELLER. When we tried to sum up our view on the outlook we said that we cannot rule out the alternative possibility that the recent slowdown in the expansion represents advanced warning of an economic decline. That is one alternative that has to be taken into account in the formulation of policy and in the watching of the indicators.

Senator JAVITS. When you use the word "decline," is that the same meaning as my word "recession" or is it a different meaning?

Dr. HELLER. In a sense, "recession" means a receding from the previous levels achieved in the economy; and I suppose in this case "decline" is a euphemism for "recession."

Senator JAVITS. It is a fact, is it not, that you have omitted one factor which is a sign of danger, and that is the diminution of inventory accumulation in the second quarter of 1962. Is not that correct?

Dr. HELLER. We specifically covered the \$3.4 million rate of inventory accumulation in our statement.

Senator JAVITS. Except it is not at that particular point, is that correct? That is an additional factor.

Dr. HELLER. That is an additional factor and we pointed to it.

Senator JAVITS. Now, may I ask you this question? Is there a connection between your statement that a program to improve the rate of utilization of our resources and the rate of growth of our economy must include the even more fundamental measures of tax reduction and tax reform—is there a connection between that statement and the statement that we have just been discussing that there is cause for concern? In other words, is tax reduction a measure which is designed to relieve us, if we can be relieved, of this cause for concern?

Dr. HELLER. If further developments in the economy, Senator, confirm the rather more pessimistic possibilities, the two are very much related. But our statement to which you refer has both a short- and long-run orientation. I think we are confronting, as the 5 years of unsatisfactory economic performance indicate, a longer term problem of inadequate expansion and continued underutilization of our resources which calls for tax reduction and tax reform, in any event. As we noted in the list of considerations concerning the size, timing, and composition of tax reduction there is also a shorter term ques-

tion of the need that may exist for overcoming temporary deficiencies in consumer demand.

Senator JAVITS. As a matter of fact, you say no decision has been made on the size, composition, and timing of a recommended tax reduction. I call that an agonizing indecisiveness on the part of the President. One of my colleagues took a special exception to that—Senator Proxmire of Wisconsin. What do you call it?

Dr. HELLER. Senator, I am not as good a phrasemaker; but I would like to point out that the President has, after all, taken a decision which I believe represents a decisiveness with respect to tax reduction that has not been seen for many many years. He has said that he will propose a tax reduction effective January 1, 1963. In other words, there is a decision not only to cut taxes, but explicitly to cut corporate and individual income taxes by an across-the-board reduction—and, indeed, a net reduction in the sense that the reduction in rates would not be offset by restoring the base.

Senator JAVITS. Then, are not you giving us the very narrow choice as to whether we shall give the President the power to reduce or whether we shall reduce ourselves. Is not that the choice you are giving us? What you want is the power for the President to reduce. I say we should reduce ourselves. So the choice is do we give the President the power to reduce or do we reduce ourselves?

Dr. HELLER. I think that observation directs itself to a somewhat different problem; namely, the standby tax-cutting authority. The President's request was for authority to cut up to 5 points from the individual income tax rates for a period of 6 months. There, I think, your comment is more directly applicable than to the other point of a more permanent tax cut to take effect on January 1, 1963, which the President is going to propose.

Senator JAVITS. It is fair to say, is it not, that the decision to cut taxes has already been made in the sense that either we will cut them now, or the President is going to recommend some other scheme for cutting them as of January 1.

Dr. HELLER. In that sense, yes, it is.

Senator JAVITS. The decision is made in that regard, is it not, really?

Dr. HELLER. Yes, it is.

Senator JAVITS. Mr. Chairman, may I reserve the balance of my time so I can vote?

Chairman PATMAN. Dr. Heller, I would like to know about the basic premise on which you are proceeding. Is our problem that the rate of savings is too low or the rate of consumption too low?

Dr. HELLER. I think we have to look at two aspects of that. One is the aspect of the question that relates to an underemployed economy where there is a fair amount of slack, in which the primary problem is that the level of total demand is too low.

Chairman PATMAN. How is that related to the present situation?

Dr. HELLER. The level both of consumer demand and investment demand are too low to make full use of the labor, machinery, plant, and equipment that are available in the economy. Our problem at the present time is not an inadequate level of savings.

Chairman PATMAN. But isn't the fundamental problem the fact that consumption is too low?

Dr. HELLER. Consumption and investment demand are too low.

Chairman PATMAN. The personal income tax cut which the President has mentioned has been described as "across the board." Does that mean you reduce each tax rate by the same number of percentage points?

Dr. HELLER. In saying that he would recommend an across-the-board reduction in rates, Mr. Chairman, it leaves the question open whether it simply means a reduction in every bracket or a percentage point bracket in every bracket or a percentage reduction in liabilities.

I would say that statement of the President does not rule out any of several alternative ways of accomplishing the objective. I believe what he is saying, in effect, is that he wants to see reductions from top to bottom.

Chairman PATMAN. If we increase the exemption, say, from \$600 to about \$900, or \$1,000, income tax payers in each category would get the benefit of it, would they not?

Dr. HELLER. That would apply a tax reduction to all taxpayers.

Chairman PATMAN. Even the 91-percent bracket would be benefited to the same extent.

Dr. HELLER. Taxpayers in the 91-percent bracket would get 91 percent of \$300, if the exemption were raised to \$900.

Chairman PATMAN. So that would have an across-the-board effect, too, wouldn't it?

Dr. HELLER. I believe the President spoke of across-the-board reductions in rates.

Chairman PATMAN. I believe he did. If we had an across-the-board tax cut, that would increase disposable income of families in the high income brackets a great deal more than those at the low level of the scale; if you felt that our basic problem is one of an inadequate rate of savings, I could understand that kind of proposal. But if you think that the problem is underconsumption, as you have stated, then I should think you would want to make the largest cuts in the low-income group to keep things even. In other words, an across-the-board cut would tilt the income distribution in favor of the high income families.

Do you have any estimates of the different income classes as to how much of the family income goes into consumption and how much goes into savings, Dr. Heller?

Dr. HELLER. I do not believe we have those at hand. Those are difficult to come by. We will try to find what there is available and present it for the record.

Chairman PATMAN. Will you please insert the information in connection with the revision of your remarks when you get your transcript?

Dr. HELLER. I would be happy to.

(The information is as follows:)

Data on consumption expenditure or saving by income bracket are not available for any year subsequent to 1955. The following data for 1950 are based upon a BLS-Wharton School study and show current saving as a percentage of after-tax money income. The unit is the urban family.

Annual after-tax money income	Saving as percent of after-tax income	Annual after-tax money income	Saving as percent of after-tax income
Under \$1,000.....	-81.7	\$5,000 to \$5,999.....	6.5
\$1,000 to \$1,999.....	-6.2	\$6,000 to \$7,499.....	10.0
\$2,000 to \$2,999.....	-1.7	\$7,500 to \$9,999.....	16.3
\$3,000 to \$3,999.....	2.4	\$10,000 and over.....	30.7
\$4,000 to \$4,999.....	4.5		

Source: Friend and Schor, "Who Saves," Review of Economics and Statistics, May 1959, p. 232.

Data on consumption expenditure by income bracket for 1955 are available from a study by Life magazine, but the income concept is before taxes, and consumption expenditure does not include gifts and contributions, educational expenditures, or expenditures away from home on vacation. Since average income by bracket is not known, percentages could not be calculated. The unit in this case is the household, not the family.

Annual household income before taxes	Average consumption of goods and services	Annual household income before taxes	Average consumption of goods and services
Under \$2,000.....	\$1,933	\$5,000 to \$6,999.....	\$5,016
\$2,000 to \$2,999.....	2,924	\$7,000 to \$9,999.....	6,063
\$3,000 to \$3,999.....	3,839	\$10,000 or more.....	7,946
\$4,000 to \$4,999.....	4,363		

Source: Life Study of Consumer Expenditures, conducted for Life by Alfred Politz Research, Inc., New York, 1957, vol. 1, p. 17.

Chairman PATMAN. Have you had any estimates made to show a given amount of stimulus, how much reduction of taxes would be involved and how it would be distributed under each of the alternative methods: raising the exemption, making the cut in the first income tax bracket, and making the cut across the board?

Dr. HELLER. We have made some comparisons to see what kinds of reductions would be involved for any given loss of revenue. For that purpose we have prepared a table of five different tax proposals all of which would reduce total tax liability by approximately \$6 billion. It is not intended as anything more than an example. It does not suggest that \$6 billion is the figure we are talking about. This table could be used to construct comparison for any other level of tax reduction.

[This table is inserted into the record below.]

Chairman PATMAN. If we had an across-the-board cut in taxes, which would change the income distribution in favor of the top bracket income receivers, wouldn't we have a worse fiscal structure after the period of deficit is over? In other words, wouldn't you, in the long run, increase the troubles which the tax cut is intended to cure?

Dr. HELLER. It is extremely hard to answer a question like that, Mr. Chairman, without having a more or less explicit proposal concerning the relationship of proposed rates in the high brackets and the low brackets.

Chairman PATMAN. I will ask you about one other issue that was raised in your testimony. You stated that during this economic recovery, there has been a compelling need for general monetary ease.

I repeat that. You say there has been a compelling need for general monetary ease as part of an expansionary economic program for full employment and adequate utilization of our resources.

What can the President and the present administration do about monetary ease at this time under present laws and practices?

Dr. HELLER. As several members of the committee have pointed out, the administration's possibilities for creating ease are limited since the primary instrument of monetary management and policy is the Federal Reserve Board.

Chairman PATMAN. Over which you have no control.

Dr. HELLER. Over which there is no legal control, as such. There is an informal administrative coordination and cooperation in which the administration tries to develop, in concert with the chairman of the Federal Reserve Board, an approach to our economic policy problems.

This is a matter of persuasion and cooperation rather than a matter of dictation.

Senator PROXMIRE. I would like at this time to read a letter which Chairman Patman has just received from Ewan Clague on the business of the interrogation by Congressman Curtis and myself this morning, and our concern over the statistic "Open Employment" on page 9 of the Economic Indicators, showing that the total labor force, including Armed Forces, between June 1961 and June 1962 remained almost stationary. You have already been questioned on this, I believe, Dr. Heller.

Dr. HELLER. Yes, sir.

Senator PROXMIRE. And responded to it. But the fact that this was the first time in many years, and some concern was expressed that there may be a statistical error or some statistical mistake, I would like to read this letter.

(The letter referred to follows:)

U.S. DEPARTMENT OF LABOR,  
BUREAU OF LABOR STATISTICS,  
Washington, D.C., August 8, 1962.

The Honorable WRIGHT PATMAN,  
Chairman, Joint Economic Committee,  
U.S. Congress, Washington, D.C.

DEAR CHAIRMAN PATMAN: Since mid-1961, the over-the-year growth in the labor force has appeared to be slowing down. Evidence of this is provided by the monthly survey of the labor force, conducted by the Bureau of the Census for the Bureau of Labor Statistics. On the average during the first half of 1962, the proportion of the population in the labor force in almost every age group was slightly below that for the comparable period of the year 1961. The only significant exceptions were men and women 18 to 19 years of age and women 45 to 64 years of age. Somewhat the same picture is seen in comparing the second half of 1961 with the same period in 1960.

There is no reason to believe that these declines are due to the operation of the survey. There was no change in the sample areas included in the monthly survey, in the methods of interviewing, or in the quality-control methods used by the supervisory staff. No revisions in the concepts and definitions of the labor force, employment, and unemployment have been made.

The only new element in the statistics is the introduction of data from the 1960 Census of Population into the estimation procedure to replace those from the 1950 census. This change was made in April 1962 when the census material became available. The effect was to reduce employment and the civilian labor force by about 200,000; no changes occurred in the percent distributions within age groups or in labor force or unemployment rates by age. The revision and its effects were fully described in the monthly report on the labor force for April 1962. In each subsequent month, our statements about year-over-year labor force growth always make allowance for this revision.

I am enclosing a copy of the monthly report on the labor force for April 1962 which contains a statement on the revision in the estimation procedure due to the 1960 census figures.

Sincerely yours,

EWAN CLAGUE,  
Commissioner of Labor Statistics.

**NEWS****U. S. DEPARTMENT OF LABOR**

Arthur J. Goldberg, Secretary

USDL - 5210

FOR RELEASE: 12 Noon, Tuesday  
May 15, 1962U. S. DEPARTMENT OF LABOR  
BES, Tel. 961 - 2916  
BLS, Tel. 961 - 2634**THE EMPLOYMENT SITUATION: APRIL 1962**

NOTE: Beginning with the figures for April 1962 information from the 1960 Census of Population replaces that from the 1950 Census in the estimation procedures for the labor force survey. The monthly and annual changes in the labor force data quoted in this release are based on the old April figures, which are comparable with previously published data. The differences between the old and new data are small (see page S-1 in attached Monthly Report on the Labor Force).

Factory employment and hours of work showed continued strong improvement in April, Secretary of Labor Arthur J. Goldberg announced today.

With most manufacturing industries reporting better-than-seasonal developments during the month, jobs in this sector rose by 80,000 instead of showing the small decline usual at this time of year. Construction employment expanded sharply during the month after the usual spring pickup had been delayed by bad weather in March. Trade employment continued to show better-than-seasonal improvement for the fourth consecutive month. Altogether, nonfarm payroll employment at 54.7 million was up 675,000 from March to April, or a quarter of a million more than seasonally.

With the gains of the past few months, manufacturing employment has returned to within 200,000 of the level in May 1960, the prerecession peak in general business activity, while trade is now significantly above that level.

## THE EMPLOYMENT SITUATION

May 15, 1962

Page 2

The factory workweek continued to improve in April, and at 40.4 hours was at a level which has not been exceeded for this month since 1953. Overtime hours in manufacturing edged up to 2.7 hours, the highest level for April since data became available in 1956.

As announced on May 9, unemployment declined seasonally by 400,000 in April, and at 3.9 million was 1.0 million lower than a year earlier. The seasonally adjusted rate of unemployment of 5.5 percent was virtually unchanged from the preceding 2 months but was well below the 6.9 percent of a year earlier. State insured unemployment declined by 400,000 in mid-April to 1.9 million.

Total employment moved seasonally higher by 700,000 to 66.8 million in April. Nonagricultural employment (including the self-employed, unpaid family workers, and domestics) rose by 450,000 to a record for April of 61.9 million, an increase over the year of 1.2 million.

Agricultural employment increased by 250,000 from March and was virtually the same as a year earlier in April at 5.0 million.

The number of workers on part time for economic reasons declined by 100,000, somewhat more than seasonal, to 2.2 million in April, some 800,000 less than at the same time in 1961.

The total labor force, including the Armed Forces, rose about seasonally again in April to 73.7 million, and was 650,000 higher than a year earlier.

Characteristics of the Unemployed

Age and Sex. Nearly all of the April decline in unemployment was among adult men, reflecting the spring pickup in outdoor activity. While the unemployment rate for this group has shown mainly seasonal improvement since January, both their number and rate of unemployment were substantially under April 1961 levels. Joblessness among women and teenagers was unchanged over the month.

**THE EMPLOYMENT SITUATION**

May 15, 1962

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Duration of Unemployment. The reduction in unemployment in April was primarily among those who had been out of work from 1 to 3 months (5 to 14 weeks) about in line with seasonal expectations, as was the lack of change in the number of long-term unemployed (of 15 or more weeks duration). Workers who had been seeking work for 27 weeks or more numbered 700,000 in April, unchanged from March, but 300,000 less than the recession high in July 1961. However, the number in this group was still 300,000 higher than before the recession.

New Workers. Among the unemployed in April were 450,000 persons seeking their first jobs, some 80 percent of whom were teenagers. Inexperienced workers have found it increasingly difficult to find jobs in recent years. This April, they accounted for 12 percent of total unemployment compared with 7 percent at the trough of the 1958 recession.





April 1962

monthly  
report on

# THE LABOR FORCE

employment • unemployment • hours and earnings

UNITED STATES DEPARTMENT OF LABOR

Arthur J. Goldberg, *Secretary*

Issued May 1962



U.S. DEPARTMENT OF LABOR  
Arthur J. Goldberg, Secretary

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Bureau of Labor Statistics

Ewan Clague, Commissioner

with the cooperation of the

Bureau of Employment Security

Robert C. Goodwin, Administrator

This report combines The Monthly Report on the Labor Force previously issued by the Bureau of the Census and the Employment, Hours, and Earnings release previously issued by the Bureau of Labor Statistics. In addition, statistics and analysis relating to insured unemployment have been provided by the Bureau of Employment Security.

The Bureau of the Census collects and tabulates for the Bureau of Labor Statistics the labor force data based on household interviews, shown in this report. A description of the manner in which the various statistics are collected and what they represent is provided in the Explanatory Notes.

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The Monthly Report on the Labor Force is prepared in the Bureau of Labor Statistics, Division of Manpower and Employment Statistics, Harold Goldstein, Chief.

THE MONTHLY REPORT ON THE LABOR FORCE; APRIL 1962

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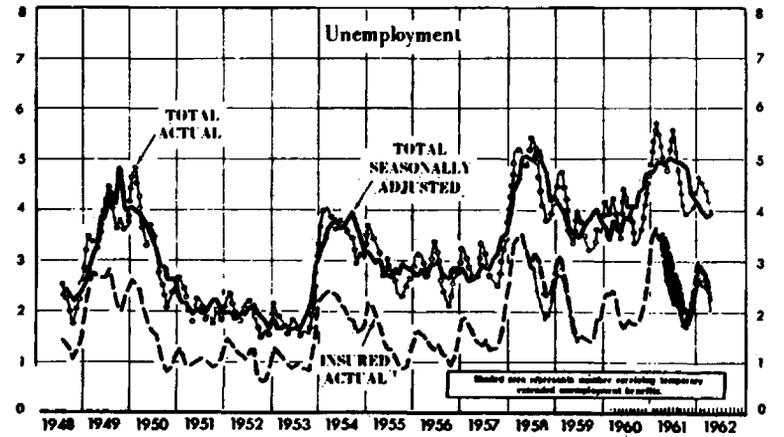
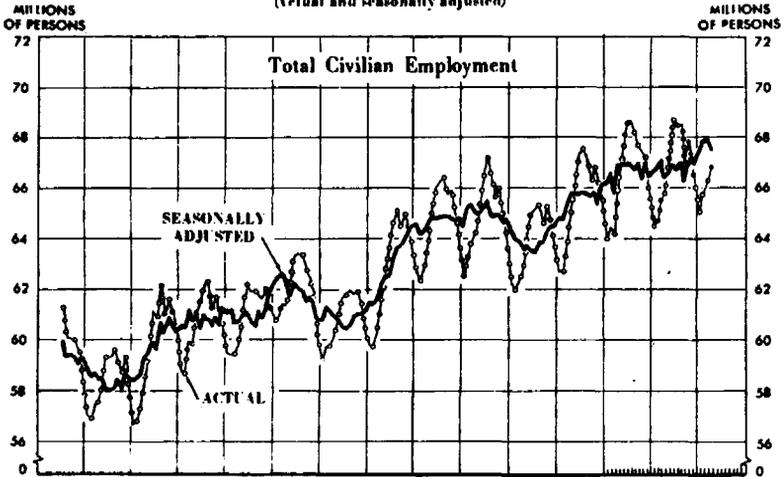
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TRENDS IN EMPLOYMENT AND UNEMPLOYMENT  
July 1948 to date  
(Actual and seasonally adjusted)



Included under following programs: State unemployment insurance, unemployment compensation for Federal employees, veterans, ex-servicemen, railroad workers (RRA) and temporary program.

Beginning in January 1960, data include Alaska and Hawaii

### Nonfarm Payroll Employment

Nonfarm payroll employment rose sharply by 675,000 to an April record of 54.7 million. The total was 1.5 million higher than the depressed level of a year ago and 530,000 higher (seasonally adjusted) than before the beginning of the business downturn in May 1960. Better-than-seasonal gains were widespread in manufacturing industries, while construction employment regained its previous month's loss. Smaller increases which were also better than seasonal, occurred in trade, transportation and public utilities, and State and local government.

Employment in manufacturing rose by 80,000 to 16.6 million; it usually declines in April. The gains were spread among virtually every manufacturing industry, in both consumer and producer goods. Employment in transportation equipment, which usually shows a seasonal decline in April, held its employment level as automobile sales reached their highest point since September 1955. The fabricated metals, electrical equipment, and machinery industries increased significantly on a seasonally adjusted basis, as did primary metals and the stone, clay, and glass industries. In the soft-goods manufacturing industries, the greatest strength was shown in apparel where jobs in April were cut substantially less than in the same month in previous years.

The largest part of the April job increase was seasonal and occurred in other than manufacturing industries. The increase of 240,000 in construction brought seasonally adjusted employment up to the level of February 1962 and December 1961 after weather affected declines in January and March 1962. The job pickup in transportation and public utilities is the third consecutive monthly increase whereas there had been virtually no improvement during the last half of 1961 and a decline at the turn of the year. Trade has picked up 100,000 workers (seasonally adjusted) since January, and has now risen significantly beyond its May 1960 level for the first time.

Half of the 1.6 million jobs gained during the recovery period from February 1961 have been in manufacturing, concentrated in the five durable goods industries which accounted for the major part of the recession loss. These industries (primary metals, fabricated metals, electrical equipment, transportation equipment, and machinery) have increased an average of 10 percent over their recession lows, although machinery has shown much less of a gain than the others. In nondurable goods employment, the increases averaged only 2-1/2 percent during the upswing, but these industries suffered far less loss during the recession. Electrical equipment alone among the major manufacturing industries has risen substantially beyond prerecession levels after allowance for seasonal change. (See Table A.)

The other half of the 1.6 million job increase since February 1961 was in trade, service, government, and finance. Among these, only trade shows any decline during the recession, and this decline was small. On the other hand, employment in service and government continued steadily upward without interruption during the recession, as it had in these industries throughout the postwar period.

In other nonmanufacturing industries, mining and construction are the only ones showing losses (totaling 75,000) since the latest recession low.

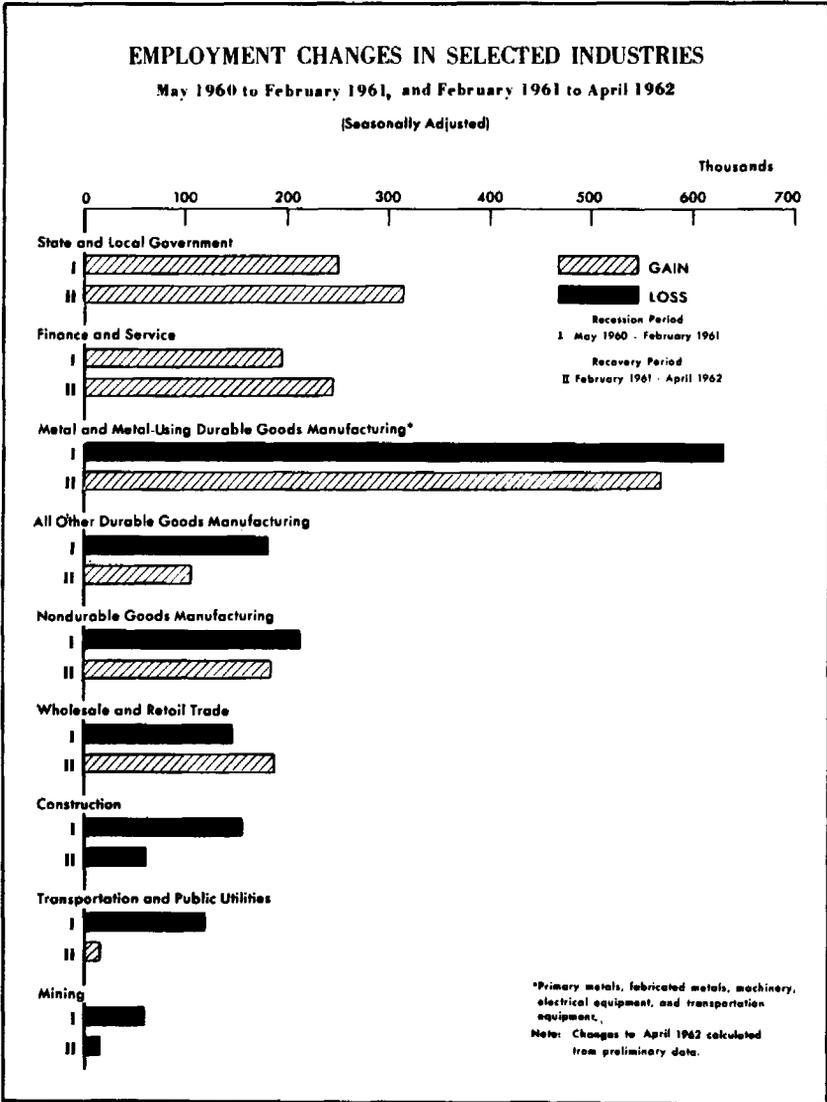
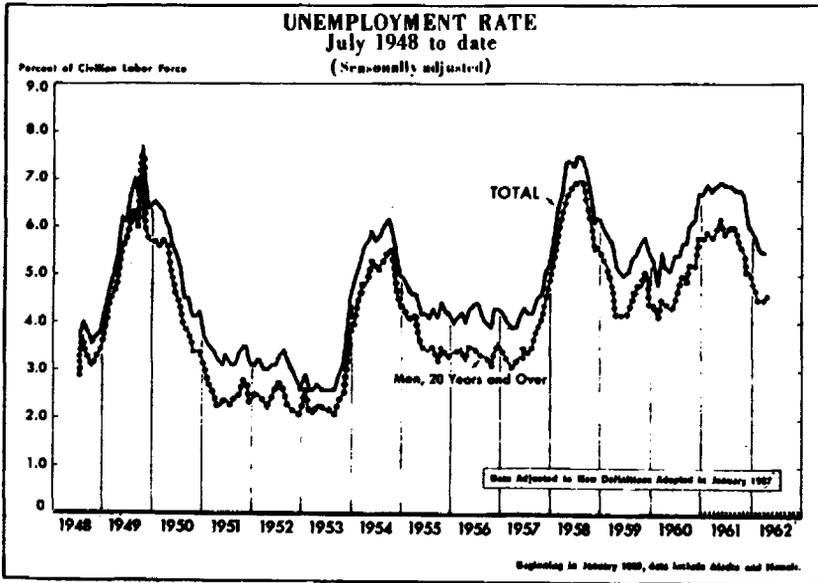
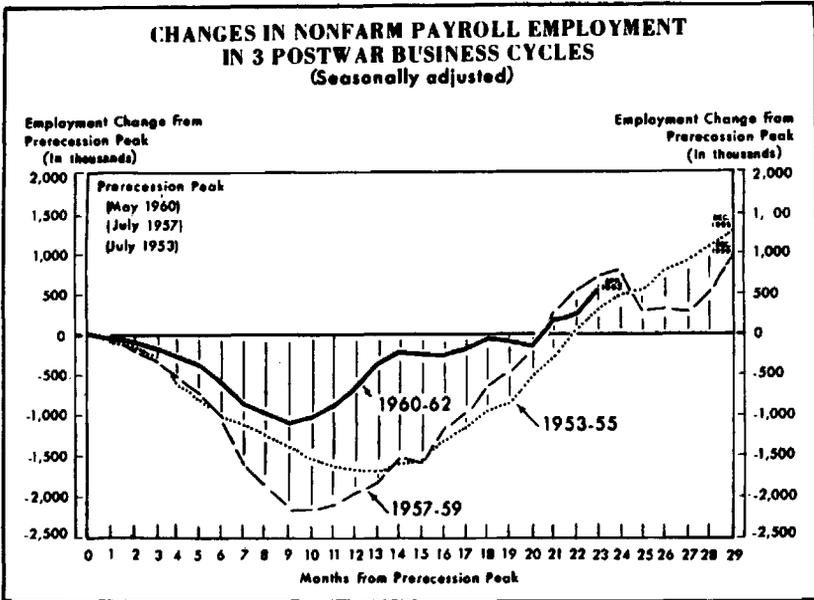


Table A. Employment Changes in Nonfarm Industries in Post-World War II Business Cycles (Seasonally adjusted, in thousands)

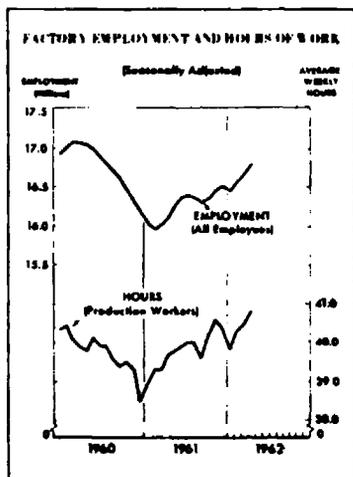
	Pre-recession level	Change to trough	Change from trough After 14 months
<b>1960-62</b>	<b>Mar. 1960</b>	<b>Feb. 1961</b>	<b>April 1962 1/</b>
Total nonfarm industries.....	54,584	-1,099	+1,627
Manufacturing.....	16,985	-1,023	+852
Durable goods.....	9,608	-811	+669
Nondurable goods.....	7,377	-212	+183
Manufacturing workweek (hours)...	40.1	-0.8	+1.5
Construction, transportation, and mining.....	7,686	-332	-55
Trade.....	11,442	-146	+186
Finance and service.....	9,996	+195	+245
Government.....	8,475	+207	+399
<b>1957-59</b>	<b>July 1957</b>	<b>April 1958</b>	<b>June 1959</b>
Total nonfarm industries.....	53,077	-2,176	+2,878
Manufacturing.....	17,240	-1,478	+1,234
Durable goods.....	9,902	-1,197	+962
Nondurable goods.....	7,338	-281	+272
Manufacturing workweek (hours)...	39.9	-1.3	+1.9
Construction, transportation, and mining.....	8,008	-555	+330
Trade.....	10,922	-318	+548
Finance and service.....	9,255	+17	+425
Government.....	7,652	+158	+341
<b>1953-55</b>	<b>July 1953</b>	<b>Aug. 1954</b>	<b>Oct. 1955</b>
Total nonfarm industries.....	50,449	-1,711	+2,617
Manufacturing.....	17,782	-1,764	+1,098
Durable goods.....	10,275	-1,391	+832
Nondurable goods.....	7,507	-373	+266
Manufacturing workweek (hours)...	40.7	-1.0	+1.2
Construction, transportation, and mining.....	7,764	-332	+371
Trade.....	10,265	-53	+454
Finance and service.....	8,037	+244	+487
Government.....	6,601	+194	+207
<b>1948-50 2/</b>	<b>Nov. 1948</b>	<b>Oct. 1949</b>	<b>Dec. 1950</b>
Total nonfarm industries.....	45,138	-2,289	+3,961
Manufacturing.....	15,534	-1,587	+2,157
Durable goods.....	8,311	-1,374	+1,850
Nondurable goods.....	7,223	-213	+307
Manufacturing workweek (hours)...	39.8	-0.3	+1.4
Construction, transportation, and mining.....	7,408	-778	+937
Trade.....	9,339	-104	+299
Finance and service.....	7,088	+81	+244
Government.....	5,769	+99	+324

1/ Preliminary

2/ Both job losses and gains during the 1948-50 cycle were exaggerated by nationwide strikes in coal and steel and the subsequent return of the workers on strike.



Increases in the number of nonproduction workers have contributed to the gains in manufacturing employment in recent months. The employment of these workers, who perform the clerical, administrative, sales, and professional work in manufacturing, tended to remain fairly steady at 4.2 million during the period of recession (when hundreds of thousands of production workers were being laid off) and during the early period of recovery. Since the fall of 1961, however, there has been a resumption of growth in their employment; since September nonproduction workers have contributed about one-sixth of the gain in manufacturing employment on a seasonally adjusted basis.



#### Hours and Earnings

The factory workweek, at 40.4 hours, has not been exceeded in any April since 1953. Better-than-seasonal workweek developments were registered by every major industry except lumber, which reported no change after reaching a very high level in March. Notable gains in the durables sector were registered in fabricated metals, electrical equipment, transportation equipment, and furniture. In the soft-goods sector, apparel and textiles shows the most significant improvement.

Overtime hours averaged 2.7 in April compared to 2.6 in March, and 2.5 in February. A year ago, factory employees worked 2.1 hours overtime.

At \$96.56, weekly earnings of manufacturing production workers increased 65 cents from March to April, regaining the all-time high level of December 1961.

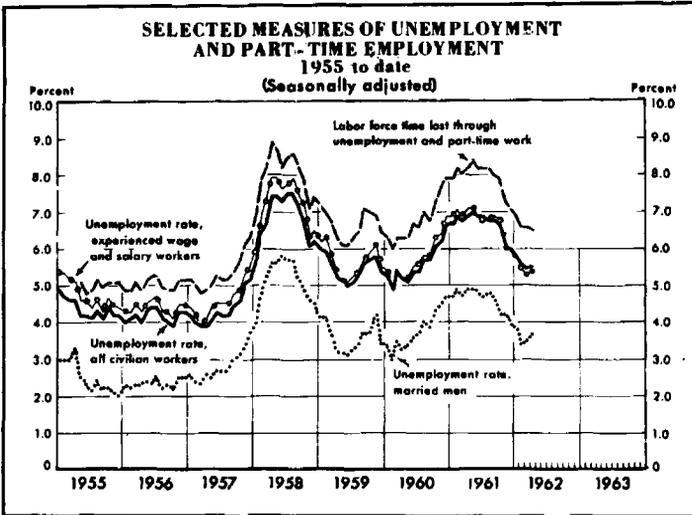
Compared to a year ago, weekly earnings are

\$5.78 or 6-1/2 percent higher. Hourly earnings at \$2.39 are 1 cent higher than last month and 8 cents higher than April 1961.

#### Total Employment

Total employment continued its regular spring expansion with a seasonal increase of 700,000 to an April record of 66.8 million. Total nonagricultural employment (including the self-employed, unpaid family workers and domestics) rose seasonally by 450,000 between March and April, and at 61.9 million, was also at a record high for April.

Agricultural employment rose by 250,000 over the month to 5.0 million. This increase was less than usual for April. Agricultural employment was at the same level as a year ago, but the number of farm workers in April 1961 was held down by adverse weather.



Explanatory notes to chart:

Labor force time lost represents the man-hours lost by the unemployed and those on part time for economic reasons, as a percent of total man-hours potentially available to the civilian labor force.

Man-hours lost are computed by assuming the unemployed lost 37.5 hours a week, and that those on part time for economic reasons lost the difference between 37.5 and the time they actually worked.

Man-hours potentially available (the base for the rate) are obtained by adding:

- (1) Man-hours actually worked
- (2) Man-hours that could have been worked by employed persons with a job but not at work, assuming a 37.5 hour workweek
- (3) Man-hours lost.

Unemployment rate, experienced wage and salary workers, is based on unemployment and labor force figures that exclude those who never worked, self-employed and unpaid family workers. All wage and salary workers are represented, including those in agriculture, domestic service, government, and all other nonfarm industries.

Unemployment rate, all civilian workers, is the standard seasonally adjusted rate of unemployment.

Unemployment rate, married men, represents the number of unemployed married men as a percent of all married men in the civilian labor force (employed plus unemployed). These figures exclude married men living apart from their wives. The rates for 1955 and 1956 are based on pre-1957 definitions of unemployment and employment.

NOTE: For a more detailed discussion of the time-lost measure, see Technical Note on "Some Alternative Indexes of Unemployment" in the Monthly Labor Review, February 1962, pp. 157 ff.

**Full- and Part-time Employment.** The number of nonfarm workers on full-time schedules rose seasonally in April by 550,000 to 50.8 million, with virtually all of the increase occurring among men. The 35.2 million men with full-time jobs this April also accounted for nearly all the 1.3 million increase in full-time work since April a year ago; however, relatively few women had been cut back from full- to part-time work during the recession.

The number of nonfarm workers on part time for economic reasons dropped by 100,000 after increasing in both February and March. At 2.2 million in April, the number of such part-time workers was at about its January level and about 800,000 below its year ago level. The over-the-year decline was almost evenly divided between persons who had been cut back from full-time to part-time work and persons usually working part time because full-time work was not available. (See Table B.)

#### Characteristics of the Unemployed

**Age and Sex.** Mainly because of the spring pickup in outdoor activities, the number of unemployed adult men fell seasonally in April by 350,000, accounting for four-fifths of the decline in total unemployment. After seasonal adjustment, however, their unemployment rate remained virtually unchanged over the month at 4.6 percent. Following a substantial decline between August 1961 and January 1962, the unemployment rate for adult men has shown no further improvement. Nevertheless, at 2.1 million this April, the number of unemployed adult men was 650,000 less than in April 1961 and their unemployment rate was well below the 6.0 percent of a year ago.

No significant changes have occurred recently in unemployment among women and teenagers. However, in both number and rate, unemployment among adult women was considerably below the high levels of a year ago. At 750,000, the number of unemployed 14 to 19 year-olds accounted for less than one-fifth of total unemployment, but their rate of unemployment was two and one-half times greater than the overall rate. There was no change in the number of unemployed teenagers over the year.

**Duration of Unemployment.** Virtually all of the reduction in unemployment was among persons who had been jobless for less than 15 weeks. Their number fell seasonally in April by 400,000 to 2.5 million with persons out of work for more than 4 weeks accounting for most of the decline. The number of persons unemployed for more than 15 weeks was unchanged at 1.5 million, but no seasonal change was expected.

Among those looking for work for 15 weeks or longer were 700,000 persons who had been looking for work for over 26 weeks, about the same number as in March. The number of very long-term unemployed was 200,000 below its year-ago level. While there has been virtually no change in the number of very long-term unemployed since the beginning of the year, this group was increasing steadily throughout the first half of 1961, reaching a recession high of about 1 million in July, several months after the trough in economic activity. After 14 months of recovery the number of very long-term jobless is 300,000 higher than its pre-recession levels. Although this pattern of lagging recovery also followed the 1958 trough in business activity, very long-term unemployment is currently some 450,000 higher than in the months prior to the 1957-58 recession.

**Industry of Last Job.** Unemployment rates in durable and nondurable goods manufacturing, mining, and construction were below their year-ago level this April, and in durable goods manufacturing they were also below the level in April 1960 before the recession began. In transportation, trade, and finance and service, unemployment rates while down over the year, were above those of April 1960. In every major industry group, unemployment rates were still well above those registered under the high employment conditions of April 1957.

**New Workers.** Among the unemployed in April were 450,000 persons looking for their first jobs, about the same number as a year ago. Virtually all of these inexperienced unemployed were under 25 years of age and four-fifths of them were between 14 and 19 years of age. Over the past 4 years, the total number of 14-24 year-olds in the population has increased by 17 percent. Partly because of the tendency for young people to remain in school longer, the number of 14-24 year-olds in the labor force has increased by only 12 percent. In contrast, the number of unemployed young people seeking their first job has increased by 30 percent, two and one-half times greater than the rate of their labor force increase. All of this increase in the inexperienced unemployed has been among teenagers; there has even been a slight decline in the number of unemployed new workers 20 years of age and over.

In April 1958, the trough of the 1958 recession, new workers accounted for 7 percent of the total unemployed. This April, they accounted for 12 percent. The increase in the number of unemployed new workers has been greatest at the two extremes in terms of duration of unemployment. Both the very short-term unemployed (1 to 4 weeks) and the very long-term unemployed (27 weeks or more) have increased by 50 percent over the past 4 years. In April 1962, nearly half of the inexperienced unemployed had been looking for work for less than a month, but 1 out of every 6 had been searching for his first job for over half a year.

#### Insured Unemployment

The number of insured jobless under State programs dropped by nearly one-fifth (400,000) to 1.9 million between March and April. Preliminary data indicate that the number of persons exhausting their regular State benefits edged down from 170,000 in March to an estimated 165,000 in April.

In addition to the insured unemployed under the regular State programs, some 234,000 persons who had exhausted their State benefit rights were insured under the Temporary Extended Unemployment Compensation program (TEC) in April. In March the total was 310,000. The sharp over-the-month decline was due to the "phase-out" provision of the TEC Act. Under this provision, eligibility for TEC benefits after March 31 is limited to qualified claimants who had been in compensable status under the TEC program on or before that date.

All but three States reported a decline in insured unemployment under the regular State programs over the month. The reductions amounted to 25,000 or more in five States--California (51,000), New York (43,000), Pennsylvania (34,000), Michigan (26,000), and Illinois (25,000). A large part of these declines reflected continuing seasonal expansions in outdoor work, and a pre-Easter pickup in trade. California also noted recalls in food processing and in fabricated metals plants, while Michigan reported increased activity in the auto industry.

The national rate of insured unemployment (not seasonally adjusted) was 4.6 percent in April compared with 5.6 percent in March and 7.0 percent a year ago. Five States--Alaska, Arkansas, Maine, North Dakota, and West Virginia--had rates in excess of 7.0 percent this April. However, the rates in all of these States except Maine were below those for March. In Maine, the start of a new benefit year on April 1 caused the rate to rise. Among the larger industrial States, the rates were between 5.0 and 6.0 percent in California, Massachusetts, Michigan, New Jersey, and Pennsylvania, and below 4.0 percent in Illinois, Indiana, Texas, and Wisconsin.

#### Labor Force

The labor force (including the Armed Forces) rose seasonally over the month by 300,000 to 73.7 million, despite the small increase in agricultural employment. About 650,000 workers have been added to the labor force since April 1961 and over 1.5 million workers since April 1960.

Table B. Nonfarm Workers on Full-time and Part-time Schedules  
(Thousands of persons)

Work schedules	April 1962	March 1962	April 1961
Total nonfarm employment.....	61,863	61,533	60,734
With a job but not at work....	1,822	1,929	1,811
At work:			
On full-time schedules <sup>1/</sup> ...	50,807	50,250	49,553
On part-time schedules.....	9,234	9,356	9,370
Economic reasons.....	2,221	2,336	2,978
Usually full time.....	1,050	1,110	1,466
Usually part time.....	1,171	1,226	1,512
Other reasons.....	7,013	7,020	6,392

<sup>1/</sup> Includes those who (a) actually worked 35 hours or more during the survey week, and those who (b) usually work full time but worked 1-34 hours during the survey week because of noneconomic reasons (bad weather, illness, holidays, etc.).

Revision in Estimation Procedure

Beginning with the figures for April 1962, information from the 1960 Census of Population replaces that from the 1950 Census in the estimation procedures for the labor force sample survey. The effects of the change are shown in the tables on the following pages presenting data on population and employment status on both the old and the new basis for April. Most of the differences between the old and the new labor force estimates are small and well within the normal range of sampling error.

Population information from the decennial census is used in two stages of the estimation procedure for the sample survey in order to improve the reliability of the results. Since labor force activity is highly correlated with such characteristics as age, color, urban-rural residence, and sex, the sampling variability of the estimates can be reduced if the sample population is brought into line with the known distributions of the total population by these characteristics. (See U. S. Bureau of the Census, Current Population Reports, "Concepts and Methods Used in the Current Employment and Unemployment Statistics Prepared by the Bureau of the Census," Series P. 23, No. 5, for detailed explanation.)

The first stage in the estimation process takes into account differences between the color and urban-rural residence distribution of the population in the sample counties and that of the total population in each of the four major regions of the country at the time of the census. These adjustment ratios remain constant until another census is taken or until changes are made in the counties in the sample.

The second stage adjustment takes account of current differences between the distribution of the sample population by age, color, and sex and that of the Nation as a whole. Each month, the Census Bureau prepares current independent estimates of the noninstitutional population by age, color, and sex by carrying forward the most recent census data to take account of the subsequent aging of the population, mortality, and migration between the United States and other countries. These are used as controls for the sample results for the month. In effect, the sample returns determine the percentage of the population within each age-color-sex group which is employed, unemployed, etc. The absolute numbers are derived by applying these percentages to the independent population figures.

The timing of the change-over to the 1960 Census material was determined by the date of completion of the tabulations of the necessary Census information for all counties. These results became available in time for the processing of the April 1962 survey. In order to measure the effect of the change to 1960 Census data, the survey results were also tabulated using 1950 data. Since the new population figures show a somewhat different age distribution than the old, the age distribution of the labor force and the employed will differ slightly. However, there is no effect on percent distributions within age groups, or on labor force or unemployment rates by age. The effect on comparability with data prior to April 1962 is so minor that no revisions of earlier statistics will be made. Users who wish to make allowances can do so on the basis of the data shown in the following tables.

Civilian Noninstitutional Population and Labor Force, by Age and Sex, April 1962  
On New and Old Basis

(Thousands of persons 14 years of age and over)

Age and Sex	Civilian Noninstitutional Population			Civilian Labor Force		
	New <sup>1</sup>	Old <sup>2</sup>	Net difference	New <sup>1</sup>	Old <sup>2</sup>	Net difference
Total.....	126,702	126,756	-54	70,769	70,979	-210
Male.....	60,193	60,121	72	46,717	46,790	-73
14 to 17 years.....	6,260	6,412	-152	1,614	1,651	-37
14 and 15 years..	3,552	3,661	-109	591	608	-17
16 and 17 years..	2,708	2,751	-43	1,023	1,043	-20
18 to 24 years.....	7,201	7,329	-128	5,566	5,665	-99
18 and 19 years..	2,376	2,423	-47	1,500	1,531	-31
20 to 24 years..	4,825	4,906	-81	4,066	4,134	-68
25 to 34 years.....	10,170	10,280	-110	9,867	9,972	-105
25 to 29 years..	4,866	4,916	-50	4,715	4,764	-49
30 to 34 years..	5,304	5,364	-60	5,152	5,208	-56
35 to 44 years.....	11,388	11,280	108	11,118	11,013	105
35 to 39 years..	5,775	5,719	56	5,647	5,591	56
40 to 44 years..	5,613	5,561	52	5,471	5,422	49
45 to 54 years.....	10,118	10,175	-57	9,649	9,705	-56
45 to 49 years..	5,313	5,306	7	5,110	5,104	6
50 to 54 years..	4,805	4,869	-64	4,539	4,601	-62
55 to 64 years.....	7,587	7,565	22	6,558	6,539	19
55 to 59 years..	4,158	4,121	37	3,798	3,765	33
60 to 64 years..	3,429	3,444	-15	2,760	2,774	-14
65 years and over....	7,468	7,080	388	2,345	2,244	101
65 to 69 years..	2,838	2,744	94	1,255	1,216	39
70 years and over	4,630	4,336	294	1,090	1,028	62
Female.....	66,510	66,635	-125	24,052	24,189	-137
14 to 17 years.....	6,138	6,221	-83	957	964	-7
14 and 15 years..	3,448	3,512	-64	360	364	-4
16 and 17 years..	2,690	2,709	-19	597	600	-3
18 to 24 years.....	8,617	8,662	-45	3,974	3,999	-25
18 and 19 years..	2,753	2,780	-27	1,301	1,312	-11
20 to 24 years..	5,864	5,882	-18	2,673	2,687	-14
25 to 34 years.....	11,300	11,314	-14	4,051	4,054	-3
25 to 29 years..	5,458	5,469	-11	1,885	1,892	-7
30 to 34 years..	5,842	5,845	-3	2,166	2,162	4
35 to 44 years.....	12,399	12,355	44	5,579	5,551	28
35 to 39 years..	6,317	6,300	17	2,656	2,646	10
40 to 44 years..	6,082	6,055	27	2,923	2,905	18
45 to 54 years.....	10,648	10,903	-255	5,327	5,455	-128
45 to 49 years..	5,611	5,704	-93	2,809	2,855	-46
50 to 54 years..	5,037	5,199	-162	2,518	2,600	-82
55 to 64 years.....	8,201	8,312	-111	3,222	3,260	-38
55 to 59 years..	4,408	4,451	-43	1,987	2,004	-17
60 to 64 years..	3,793	3,861	-68	1,235	1,256	-21
65 years and over....	9,207	8,868	339	942	907	35
65 to 69 years..	3,315	3,221	94	566	547	19
70 years and over	5,892	5,647	245	376	360	16

<sup>1</sup>1960 Population Census data used in estimation procedure.

<sup>2</sup>1950 Population Census data used in estimation procedure. April 1962 on old basis shown for comparative purposes only.

Employment and Unemployment, by Age and Sex, April 1962  
On New and Old Basis

(Thousands of persons 14 years of age and over)

Age and Sex	Employment				Unemployment	
	Agricultural		Nonagricultural		New <sup>1</sup>	Old <sup>2</sup>
	New <sup>1</sup>	Old <sup>2</sup>	New <sup>1</sup>	Old <sup>2</sup>		
Total.....	4,961	5,048	61,863	61,979	3,946	3,952
Male.....	4,258	4,329	39,925	39,925	2,534	2,535
14 to 19 years.....	486	504	2,209	2,251	420	427
20 to 24 years.....	307	318	3,397	3,445	363	371
25 to 34 years.....	583	600	8,844	8,929	440	443
35 to 44 years.....	748	755	9,899	9,796	471	462
45 to 54 years.....	842	865	8,380	8,412	427	427
55 to 64 years.....	756	765	5,505	5,478	297	295
65 years and over.....	538	520	1,690	1,614	117	110
Female.....	703	719	21,938	22,054	1,411	1,416
14 to 19 years.....	51	52	1,880	1,893	328	331
20 to 24 years.....	25	25	2,454	2,467	194	195
25 to 34 years.....	110	112	3,667	3,668	273	273
35 to 44 years.....	161	164	5,134	5,110	282	278
45 to 54 years.....	159	166	4,943	5,058	225	232
55 to 64 years.....	158	161	2,990	3,024	74	74
65 years and over.....	39	39	867	834	36	33

<sup>1</sup>1960 Population Census data used in estimation procedure.

<sup>2</sup>1950 Population Census data used in estimation procedure. April 1962 on old basis shown for comparative purposes only.

Table 1. Employment status of the noninstitutional population, by sex

Employment status	(Thousands of persons 14 years of age and over)								
	Total			Male			Female		
	Apr. 1962 <sup>1</sup>	Mar. 1962	Apr. 1961	Apr. 1962 <sup>1</sup>	Mar. 1962	Apr. 1961	Apr. 1962 <sup>1</sup>	Mar. 1962	Apr. 1961
Total noninstitutional population.....	129,587	129,471	127,337	63,044	62,896	61,905	66,544	66,576	65,431
Total labor force including									
Armed Forces.....	73,654	73,582	73,216	49,568	49,436	49,299	24,086	24,146	23,916
Civilian labor force.....	70,769	70,697	70,696	46,717	46,585	46,812	24,052	24,112	23,804
Employed.....	66,824	66,316	65,734	44,183	43,697	43,542	22,641	22,619	22,192
Agriculture.....	4,961	4,782	5,000	4,258	4,144	4,298	703	638	701
Nonagricultural industries.....	61,863	61,533	60,734	39,925	39,553	39,244	21,938	21,980	21,490
Unemployed.....	3,946	4,382	4,962	2,534	2,888	3,270	1,411	1,493	1,692
Not in labor force.....	55,933	55,889	54,121	13,475	13,459	12,606	42,457	42,430	41,515
Unemployment rate <sup>2</sup>									
Actual.....	5.6	6.2	7.0	5.4	6.2	7.0	5.9	6.2	7.1
Seasonally adjusted.....	5.5	5.5	6.9	5.3	5.1	6.8	6.0	6.1	7.2

<sup>1</sup>April 1962 figures are not strictly comparable with those for previous periods because of the introduction of 1960 Census data into the estimation procedure. The change primarily affected the labor force and employment totals, which were reduced by about 200,000. The unemployment totals were virtually unchanged. For more detailed information see page 3-1.

<sup>2</sup>Percent of civilian labor force unemployed.

Table 2. Employment status of the noninstitutional population, by age and sex, April 1962<sup>1</sup>

Age and sex	(Thousands of persons 14 years of age and over)								Not in labor force
	Total labor force including Armed Forces		Civilian labor force					Percent of labor force	
	Number	Percent of noninstitutional population	Total	Employed		Unemployed			
			Agriculture	Nonagricultural industries	Number				
Total.....	73,654	56.8	70,769	4,961	61,863	3,946	5.6	55,933	
Male.....	49,568	76.6	46,717	4,258	39,925	2,534	5.4	13,475	
14 to 19 years.....	3,590	39.4	3,114	486	2,209	440	13.5	5,382	
20 to 24 years.....	5,084	87.0	4,066	307	3,397	363	8.9	779	
25 to 34 years.....	10,689	97.2	9,867	583	8,844	440	4.5	304	
35 to 44 years.....	11,598	97.7	11,118	748	9,899	471	4.2	271	
45 to 54 years.....	9,739	95.4	9,249	842	8,300	447	4.4	468	
35 to 64 years.....	6,563	86.4	6,558	756	5,505	297	4.5	1,029	
65 years and over.....	2,345	31.4	2,345	536	1,690	117	5.0	5,184	
Female.....	24,086	36.2	24,052	703	21,938	1,411	5.9	42,457	
14 to 19 years.....	2,265	25.5	2,258	51	1,880	328	14.5	6,632	
20 to 24 years.....	2,685	45.7	2,673	25	2,454	194	7.2	3,191	
25 to 34 years.....	4,099	35.9	4,051	110	3,667	273	6.7	7,250	
35 to 44 years.....	5,584	45.0	5,579	161	5,154	262	5.1	6,622	
45 to 54 years.....	5,329	90.0	5,327	159	4,943	225	4.2	5,321	
55 to 64 years.....	3,222	39.3	3,222	158	2,990	74	2.3	4,979	
65 years and over.....	942	10.2	942	39	867	36	3.8	8,264	

<sup>1</sup>Not completely comparable with data for previous periods. (See footnote 1, table 1.)

NOTE: Total noninstitutional population may be obtained by summing total labor force and not in labor force; civilian noninstitutional population by summing civilian labor force and not in labor force.

Table 3. Employees on payrolls of nonagricultural establishments, actual and seasonally adjusted, by industry

Industry	[In thousands]						Seasonally adjusted		
	Actual			Apr. 1962 change from -			Apr. 1962	Mar. 1962	Feb. 1962
	Apr. 1962	Mar. 1962	Feb. 1962	Apr. 1962					
				Mar. 1962	Apr. 1961				
Total.....	54,699	54,025	53,823	674	1,528	55,112	54,871	54,773	
Mining.....	644	640	642	4	-13	652	654	653	
Contract construction.....	2,563	2,323	2,282	240	-56	2,706	2,643	2,694	
Manufacturing.....	16,598	16,518	16,452	80	694	16,814	16,676	16,572	
Durable goods.....	9,396	9,333	9,281	63	560	9,466	9,380	9,312	
Ordnance and accessories.....	210.1	209.6	207.0	.5	34.1	210	210	207	
Lumber and wood products.....	587.4	573.6	576.7	13.8	6.3	607	611	612	
Furniture and fixtures.....	376.9	375.9	374.1	1.4	17.4	382	379	375	
Stone, clay, and glass products.....	566.5	547.4	543.4	23.1	9.9	571	563	563	
Primary metal industries.....	1,223.0	1,220.2	1,213.4	2.8	123.9	1,225	1,216	1,211	
Fabricated metal products.....	1,110.5	1,101.0	1,096.1	9.5	65.8	1,124	1,108	1,097	
Machinery.....	1,455.1	1,444.6	1,434.1	8.5	47.8	1,442	1,430	1,421	
Electrical equipment.....	1,504.7	1,500.2	1,494.6	4.5	103.6	1,528	1,512	1,495	
Transportation equipment.....	1,626.2	1,628.1	1,625.2	-1.9	13.8	1,631	1,610	1,595	
Instruments and related products.....	353.8	355.3	351.9	-1.5	13.6	355	355	352	
Miscellaneous manufacturing.....	382.3	375.6	370.7	6.7	13.6	391	386	384	
Nondurable goods.....	7,202	7,185	7,165	17	134	7,348	7,296	7,260	
Food and kindred products.....	1,691.3	1,672.4	1,673.4	18.9	-5.9	1,780	1,777	1,776	
Tobacco manufactures.....	76.9	81.3	86.4	-4.4	-1.8	88	90	89	
Textile-mill products.....	884.6	881.6	880.0	3.0	13.3	891	886	884	
Apparel and related products.....	1,230.5	1,240.4	1,227.5	-9.9	52.0	1,257	1,227	1,206	
Paper and allied products.....	596.2	593.9	590.2	2.3	15.1	600	599	595	
Printing and publishing.....	932.7	930.1	926.6	2.6	11.4	936	931	929	
Chemicals and allied products.....	851.8	842.5	838.4	9.3	20.9	844	841	841	
Petroleum and related products.....	197.9	197.1	197.6	.8	-6.1	199	199	200	
Rubber and plastic products.....	383.1	381.7	381.3	1.4	31.5	387	384	381	
Leather and leather products.....	397.2	363.5	363.5	-6.3	3.7	366	362	359	
Transportation and public utilities.....	3,909	3,881	3,863	28	39	3,941	3,928	3,914	
Wholesale and retail trade.....	11,406	11,214	11,188	192	244	11,422	11,451	11,447	
Wholesale trade.....	3,026	3,021	3,021	5	71	3,060	3,048	3,036	
Retail trade.....	8,380	8,193	8,167	187	173	8,422	8,403	8,411	
Finance, insurance, and real estate.....	2,773	2,755	2,749	18	49	2,781	2,777	2,774	
Service and miscellaneous.....	7,670	7,572	7,545	98	222	7,655	7,620	7,675	
Government.....	9,136	9,142	9,102	14	349	9,081	9,062	9,044	
Federal.....	2,298	2,294	2,289	4	65	2,317	2,322	2,312	
State and local.....	6,838	6,848	6,813	10	284	6,764	6,740	6,732	

NOTE: Data for the 2 most recent months are preliminary.

Table 4. Production workers on manufacturing payrolls, actual and seasonally adjusted, by major industry group

(In thousands)

Major industry group	Actual					Seasonally adjusted		
	Apr. 1962	Mar. 1962	Feb. 1962	Apr. 1962 change from		Apr. 1962	Mar. 1962	Feb. 1962
				Mar. 1962	Apr. 1961			
Manufacturing.....	12,315	12,241	12,187	74	603	12,518	12,388	12,300
Durable goods.....	6,918	6,897	6,820	61	492	6,987	6,904	6,846
Ordnance and accessories.....	97.3	96.4	96.4	.9	6.4	97	96	96
Lumber and wood products.....	523.3	510.1	512.9	13.2	9.8	543	547	547
Furniture and fixtures.....	312.5	311.0	309.7	1.5	15.9	318	314	311
Stone, clay, and glass products.....	454.5	436.6	432.4	17.9	10.3	460	452	451
Primary metal industries.....	992.8	990.9	983.5	1.9	120.2	997	989	983
Fabricated metal products.....	851.5	842.2	836.7	9.3	61.9	865	848	839
Machinery.....	1,014.3	1,007.3	997.4	7.0	42.5	1,001	991	984
Electrical equipment.....	1,019.4	1,016.5	1,012.7	2.9	88.8	1,040	1,028	1,013
Transportation equipment.....	1,120.9	1,119.5	1,118.6	1.4	115.0	1,126	1,102	1,089
Instruments and related products.....	225.1	226.5	224.9	-1.4	8.4	226	227	225
Miscellaneous manufacturing.....	306.2	299.9	294.6	6.3	13.0	314	310	308
Non-durable goods.....	5,397	5,384	5,367	13	111	5,531	5,484	5,454
Food and kindred products.....	1,103.6	1,087.1	1,088.3	16.5	-10.5	1,186	1,183	1,181
Tobacco manufactures.....	65.3	69.9	75.1	-4.6	-2.7	75	78	77
Textile-mill products.....	796.6	794.2	792.9	2.4	11.7	803	799	798
Apparel and related products.....	1,094.7	1,104.7	1,093.1	-10.0	48.9	1,120	1,091	1,072
Paper and allied products.....	473.4	470.8	467.8	2.6	11.3	477	476	473
Printing and publishing.....	597.2	595.6	593.2	1.6	5.0	599	597	596
Chemicals and allied products.....	525.7	517.4	512.5	8.3	17.0	517	514	515
Petroleum and related products.....	128.0	127.2	127.4	.8	-3.0	129	129	129
Rubber and plastic products.....	297.1	295.0	294.9	2.1	29.3	300	297	295
Leather and leather products.....	315.6	321.9	322.0	-6.3	4.4	325	320	318

NOTE: Data for the 2 most recent months are preliminary.

Table 5. Employed persons, by hours worked or reason for not working

April 1962<sup>1</sup>

(Thousands of persons 14 years of age and over)

Hours worked	Total	Agricul- ture	Nonagri- cultural indus- tries	Reason for not working	Total	Agricul- ture	Nonagri- cultural indus- tries
Total employed.....	66,824	4,961	61,863	With a job but not at work.....	1,994	172	1,822
At work.....	64,830	4,789	60,041	Bad weather.....	104	52	52
1-34 hours.....	12,597	1,591	11,007	Industrial dispute.....	40	-	40
1-14 hours.....	4,269	475	3,794	Vacation.....	428	16	413
15-34 hours.....	8,328	1,116	7,213	Illness.....	949	66	883
35-40 hours.....	30,858	695	30,172	All other.....	474	39	435
41 hours and over.....	21,375	2,511	18,863				
Average hours.....	40.4	45.2	40.0				

<sup>1</sup>Not completely comparable with data for previous periods. (See footnote 1, table 1.)

NOTE: Excludes persons on layoff of less than 30 days (93,000), and persons scheduled to start new wage and salary jobs within 30 days (111,000).

Table 6. Gross hours and earnings of production workers on manufacturing payrolls, by major industry group

Major industry group	Average weekly earnings			Average weekly hours			Average hourly earnings		
	Apr. 1962	Mar. 1962	Apr. 1961	Apr. 1962	Mar. 1962	Apr. 1961	Apr. 1962	Mar. 1962	Apr. 1961
Manufacturing.....	\$26.56	\$25.91	\$20.78	40.4	40.3	39.3	\$2.39	\$2.36	\$2.31
Durable goods.....	\$104.96	\$104.30	\$98.31	41.0	40.9	39.8	\$2.56	\$2.55	\$2.47
Ordnance and accessories.....	117.03	117.03	112.06	41.5	41.5	40.6	2.82	2.82	2.76
Lumber and wood products.....	76.05	75.07	74.88	39.0	39.1	36.8	1.95	1.92	1.93
Furniture and fixtures.....	78.36	78.76	73.14	40.6	40.6	39.7	1.93	1.94	1.89
Stone, clay, and glass products..	97.75	95.68	93.03	40.9	40.2	40.1	2.39	2.36	2.32
Primary metal industries.....	123.41	123.41	111.25	41.0	41.0	39.9	3.01	3.01	2.86
Fabricated metal products.....	104.90	103.48	99.45	41.3	40.9	40.1	2.54	2.53	2.48
Machinery.....	113.67	112.98	106.49	42.1	42.0	40.8	2.70	2.69	2.61
Electrical equipment.....	96.63	96.39	93.13	40.6	40.5	39.8	2.36	2.35	2.34
Transportation equipment.....	119.39	118.40	110.95	41.6	41.4	40.2	2.87	2.86	2.76
Instruments and related products..	98.90	98.17	95.51	40.7	40.4	40.3	2.43	2.43	2.37
Miscellaneous manufacturing.....	78.60	79.00	75.27	39.9	40.1	39.0	1.97	1.97	1.93
Non-durable goods.....	85.75	85.94	81.27	39.7	39.6	38.7	2.16	2.16	2.10
Food and kindred products.....	91.76	90.68	87.30	40.6	40.3	40.0	2.26	2.25	2.18
Tobacco manufactures.....	78.69	72.20	71.05	36.3	37.8	36.2	1.95	1.91	1.86
Textile-mill products.....	68.94	68.94	63.18	40.8	40.8	39.0	1.68	1.68	1.62
Apparel and related products.....	61.46	61.49	56.51	36.8	36.6	35.1	1.67	1.68	1.61
Paper and allied products.....	100.67	100.91	97.90	42.3	42.4	42.2	2.36	2.36	2.32
Printing and publishing.....	107.52	107.80	104.01	38.4	38.5	36.1	2.80	2.80	2.73
Chemicals and allied products.....	109.10	108.05	104.24	41.8	41.4	41.2	2.61	2.61	2.53
Petroleum and related products....	125.14	123.62	124.42	41.3	40.8	41.2	3.03	3.03	3.02
Rubber and plastic products.....	98.90	98.25	93.69	40.7	40.6	39.7	2.43	2.42	2.36
Leather and leather products.....	64.53	65.53	59.95	37.3	38.1	35.9	1.73	1.72	1.67

NOTE: Data for the 2 most recent months are preliminary.

Table 7. Average weekly hours, seasonally adjusted, of production workers on manufacturing payrolls

Subdivision	Apr. 1962	Mar. 1962	Feb. 1962	Apr. 1961
Manufacturing.....	40.8	40.5	40.3	39.7
Durable goods.....	41.2	41.1	40.9	40.0
Non-durable goods.....	40.3	40.0	39.5	39.3

NOTE: Data for the 2 most recent months are preliminary.

Table 8. Average weekly overtime hours of production workers on manufacturing payrolls

Subdivision	Apr. 1962	Mar. 1962	Feb. 1962	Apr. 1961
Manufacturing.....	2.7	2.6	2.5	2.1
Durable goods.....	2.7	2.6	2.5	2.0
Non-durable goods.....	2.7	2.6	2.5	2.2

NOTE: Data for the 2 most recent months are preliminary.

Table 9. Persons employed part time in nonagricultural industries, by reason for part-time work

Usual status and reason working part time	(Thousands of persons 14 years of age and over)		
	Apr. 1962 <sup>1</sup>	Mar. 1962	Apr. 1961
Employed 1-34 hours.....	11,007	11,219	11,272
Usually work full time at present job.....	2,621	2,973	3,369
Worked part time for:			
Economic reasons.....	1,050	1,110	1,466
Other reasons.....	1,772	1,863	1,903
Usually work part time at present job.....	8,184	8,246	7,904
Worked part time for:			
Economic reasons.....	1,171	1,226	1,512
Other reasons.....	7,013	7,020	6,392

<sup>1</sup>Not completely comparable with data for previous periods. (See footnote 1, table 1.)

Table 10. Employed persons, by type of industry, class of worker, and sex

April 1962<sup>1</sup>

(Thousands of persons 14 years of age and over)

Class of worker	Total	Male	Female	Class of worker	Total	Male	Female
Total employed.....	66,824	44,183	22,641	Agricultural industries.....	61,863	39,925	21,938
Agriculture.....	4,961	4,258	703	Wage and salary workers.....	54,750	34,879	19,871
Wage and salary workers.....	1,487	1,343	124	In private households.....	2,586	294	2,292
Self-employed workers.....	2,763	2,619	144	Government workers.....	8,629	5,141	3,488
Unpaid family workers.....	731	297	434	Other.....	43,535	29,444	14,091
				Self-employed workers.....	6,464	4,966	1,498
				Unpaid family workers.....	692	80	612

<sup>1</sup>Not completely comparable with data for previous periods. (See footnote 1, table 1.)

Table 11. Selected unemployment data

(Persons 14 years of age and over)

Item	April 1962 <sup>1</sup>		Apr. 1961		Item	April 1962 <sup>1</sup>		Apr. 1961		
	Number (thousands)	Percent distribution	Number (thousands)	Percent distribution		Rate <sup>2</sup>	Percent distribution	Rate <sup>2</sup>	Percent distribution	
<b>DURATION</b>				<b>INDUSTRY</b>						
Total unemployed.....	3,946	100.0	4,962		Total unemployed <sup>3</sup> .....	5.6	100.0	7.0		
Less than 5 weeks.....	1,527	38.7	1,600		Experienced wage and salary workers.....	5.6	85.2	7.3		
5 to 14 weeks.....	936	23.7	1,234		Agriculture.....	9.1	3.7	10.5		
15 to 26 weeks.....	764	19.4	1,205		Agricultural industries.....	5.5	81.5	7.2		
27 weeks and over.....	719	18.2	923		Mining, forestry, fisheries.....	8.8	1.5	14.2		
Average duration (weeks)...	16.9	-	17.5		Construction.....	14.1	13.6	17.9		
					Manufacturing.....	5.5	49.0	8.3		
					Durable goods.....	5.4	13.7	9.6		
					Nondurable goods.....	5.6	11.3	6.7		
					Transportation and public utilities.....	4.7	5.3	5.4		
					Wholesale and retail trade.....	6.4	17.6	7.4		
					Finance, insurance, and real estate.....	3.0	2.1	4.2		
					Service industries.....	4.0	14.1	4.7		
					Public administration.....	2.6	2.3	2.3		
					<b>OCCUPATION</b>					
					Total unemployed.....	5.6	100.0	7.0		
					Professional, technical, and kindred workers.....	1.5	3.2	1.7		
					Farmers and farm managers.....	.4	.3	.1		
					Managers, officials, and proprietors, except farm.....	1.5	2.9	2.2		
					Clerical and kindred workers.....	3.8	10.1	4.6		
					Sales workers.....	3.4	3.9	4.3		
					Craftsmen, foremen, and kindred workers.....	5.6	13.0	7.7		
					Operatives and kindred workers.....	7.4	23.8	10.3		
					Private household workers.....	5.3	3.3	6.3		
					Service workers, except private household.....	6.7	11.4	7.3		
					Farm laborers and foremen.....	5.4	2.7	6.9		
					Laborers, except farm and mine.....	13.8	13.7	17.4		
					No previous work experience.....	-	11.8	-		
<b>AGE AND SEX</b>										
Total unemployed.....	5.6	100.0	7.0							
Male.....	5.4	64.2	7.0							
14 to 24 years.....	10.9	19.8	14.5							
25 years and over.....	4.4	44.4	5.6							
Female.....	5.9	35.8	7.1							
14 to 24 years.....	10.6	13.2	12.3							
25 years and over.....	4.7	22.5	5.7							
<b>MARITAL STATUS AND SEX</b>										
Male.....	5.4	64.2	7.0							
Single.....	11.1	21.6	14.2							
Married, wife present.....	3.9	35.9	5.1							
Other marital status.....	10.3	6.7	10.9							
Female.....	5.9	35.8	7.1							
Single.....	7.5	10.2	8.0							
Married, husband present.....	5.1	17.7	6.5							
Other marital status.....	6.1	7.9	7.5							
<b>COLOR AND SEX</b>										
White.....	4.8	76.3	6.3							
Male.....	4.7	49.9	6.3							
Female.....	5.0	26.3	6.4							
Nonwhite.....	12.1	23.7	13.0							
Male.....	12.1	14.3	13.5							
Female.....	12.0	9.5	12.1							

<sup>1</sup>Not completely comparable with data for previous periods. (See footnote 1, table 1.)

<sup>2</sup>Percent of civilian labor force in each category who were unemployed.

<sup>3</sup>Includes self-employed, unpaid family workers, and persons without previous work experience, not shown separately.

Table 12. The long-term unemployed, by selected characteristics

	Unemployed 13 weeks or more				Unemployed 27 weeks or more			
	April 1962 <sup>1</sup>		April 1961		April 1962 <sup>1</sup>		April 1961	
	Percent distribution	Percent of unemployed in each group	Percent distribution	Percent of unemployed in each group	Percent distribution	Percent of unemployed in each group	Percent distribution	Percent of unemployed in each group
<b>AGE AND SEX</b>								
Total.....	100.0	37.6	100.0	42.9	100.0	18.2	100.0	18.6
Male.....	69.9	40.9	73.8	48.0	71.6	20.3	70.4	19.9
14 to 19 years.....	7.4	26.2	7.9	34.0	9.2	16.0	8.6	15.9
20 to 24 years.....	9.4	38.6	11.6	45.5	9.7	19.3	9.9	16.8
25 to 44 years.....	25.5	41.5	27.9	50.7	22.8	18.0	23.4	18.4
45 years and over.....	27.5	48.5	26.3	52.8	29.8	25.4	28.6	24.9
Female.....	30.1	31.7	26.2	33.0	28.4	14.5	29.6	16.1
14 to 19 years.....	5.1	23.2	2.9	21.7	4.2	9.1	2.7	8.9
20 to 24 years.....	3.4	26.3	4.4	29.7	2.2	8.2	5.2	15.2
25 to 44 years.....	12.3	33.0	10.3	35.8	12.7	16.4	11.1	16.6
45 years and over.....	9.2	40.6	8.7	36.3	9.3	20.0	10.6	20.4
<b>COLOR</b>								
Total.....	100.0	37.6	100.0	42.9	100.0	18.2	100.0	18.6
White.....	73.1	36.0	78.4	42.0	71.6	17.1	77.4	18.0
Nonwhite.....	26.9	42.6	21.6	46.4	28.4	21.8	22.6	21.1
<b>OCCUPATION</b>								
Total.....	100.0	37.6	100.0	42.9	100.0	18.2	100.0	18.6
Professional, technical, and kindred workers.....	2.4	27.6	2.0	30.4	1.8	10.2	2.4	15.9
Farmers and farm managers.....	.2	(2)	-	-	.1	(2)	-	-
Managers, officials, and proprietors, except farm.....	2.5	32.2	2.4	30.5	3.5	21.7	3.6	20.1
Clerical and kindred workers.....	8.4	31.5	6.3	28.4	10.2	18.4	7.3	14.1
Sales workers.....	3.2	31.6	3.9	42.1	4.5	21.1	3.3	15.2
Craftsmen, foremen, and kindred workers.....	15.0	43.2	17.1	51.7	10.0	14.0	13.6	17.8
Operatives and kindred workers.....	24.5	36.6	29.5	47.9	23.5	18.0	26.9	20.3
Private household workers.....	2.6	30.2	1.9	26.8	2.2	12.4	2.1	12.4
Service workers, except private household.....	11.1	36.6	8.3	35.5	12.1	19.4	7.9	14.7
Farm laborers and foremen.....	2.5	34.3	2.7	38.4	3.5	23.1	2.2	13.2
Laborers, except farm and mine.....	18.0	49.4	18.1	56.4	17.4	23.1	18.0	24.3
No previous work experience.....	9.5	30.2	7.8	33.9	11.1	17.1	11.0	20.7
<b>INDUSTRY</b>								
Total.....	100.0	37.6	100.0	42.9	100.0	18.2	100.0	18.6
Experienced wage and salary workers.....	88.1	36.9	89.8	44.2	86.2	18.4	85.8	18.3
Agriculture.....	3.6	37.0	3.2	40.1	4.2	20.5	2.5	13.4
Mining, forestry, fisheries.....	2.1	(2)	2.8	(2)	2.1	(2)	2.9	(2)
Construction.....	16.9	46.5	17.1	53.2	9.9	13.2	10.1	13.7
Manufacturing.....	25.5	38.4	33.7	48.4	27.3	20.0	37.2	23.1
Durable goods.....	13.9	38.1	23.8	53.4	17.5	23.3	26.0	25.3
Non-durable goods.....	11.6	38.7	9.9	36.5	9.7	15.8	11.2	19.3
Transportation and public utilities.....	5.6	39.7	5.1	43.9	6.4	22.0	4.7	17.5
Wholesale and retail trade.....	18.0	38.4	13.8	36.9	18.5	19.2	12.4	14.3
Service and finance, insurance, and real estate.....	13.4	31.1	12.1	33.2	15.5	17.4	14.0	16.6
Public administration.....	3.0	(2)	2.0	(2)	2.4	(2)	2.1	(2)
Self-employed and unpaid family workers.....	2.4	30.2	2.5	34.9	2.6	16.4	3.3	19.7
No previous work experience.....	9.5	30.2	7.8	33.9	11.1	17.1	11.0	20.7

<sup>1</sup>Not completely comparable with data for previous periods. (See footnote 1, table 1.)

<sup>2</sup>Percent not shown where base is less than 100,000.

Table 13. Insured unemployment under State programs  
(Week ending nearest the 10th of the month)

State	Regular programs								Temporary program <sup>1</sup>	
	Number (in thousands)					Rate (percent of average covered employment)			Number (in thousands)	
	April 1962	March 1962	April 1961	April 1962 change from <sup>2</sup>		April 1962	March 1962	April 1961	April 1962	March 1962
			March 1962	April 1961						
Total .....	1,871.5	2,271.1	2,837.5	-399.6	-966.0	4.6	5.6	7.0	234.3	310.5
Alabama.....	26.3	28.3	39.0	-2.0	-12.8	5.1	5.4	7.4	3.8	5.1
Alaska.....	5.7	6.1	6.2	-2.4	-3.7	17.4	18.2	18.9	5	1.4
Arizona.....	9.5	11.8	13.2	-2.3	-7.7	3.9	4.9	5.7	1.8	3.0
Arkansas.....	21.3	21.8	29.0	-2.6	-7.7	7.7	8.0	10.7	1.8	3.0
California.....	224.8	276.1	287.2	-51.3	-62.4	5.8	7.2	7.5	27.1	34.3
Colorado.....	10.6	13.8	14.3	-3.2	-3.7	2.9	3.9	4.1	.7	1.1
Connecticut.....	27.9	34.2	45.9	-6.3	-18.0	3.7	4.5	6.0	3.9	6.0
Delaware.....	4.2	8.1	6.6	-3.9	-2.4	3.4	5.6	5.3	.6	.8
District of Columbia.....	5.5	7.1	6.8	-1.6	-1.3	8.1	2.7	2.6	.7	.9
Florida.....	30.0	33.2	45.2	-3.8	-11.3	3.3	3.7	6.1	5.1	6.0
Georgia.....	21.8	29.0	46.1	-1.2	-18.3	3.8	3.9	6.1	4.9	6.0
Hawaii.....	7.3	8.4	5.3	-1.1	2.0	4.2	4.8	3.1	1.0	1.5
Idaho.....	5.1	7.8	6.9	-2.7	-1.8	4.3	6.6	5.9	.6	.7
Illinois.....	92.8	118.3	140.9	-25.4	-48.0	3.6	4.6	5.3	13.3	16.9
Indiana.....	34.0	45.7	66.9	-11.7	-32.9	3.2	4.3	6.1	5.0	8.2
Iowa.....	13.9	20.2	18.2	-6.3	-4.4	3.1	4.5	4.1	1.6	2.3
Kansas.....	9.5	13.9	16.9	-4.4	-7.4	2.7	4.0	4.9	1.0	1.5
Kentucky.....	30.4	31.8	52.3	-1.4	-21.9	5.9	7.2	11.6	4.1	5.8
Louisiana.....	29.2	31.0	40.4	-1.8	-11.2	5.4	5.7	7.3	4.5	5.3
Maine.....	15.3	13.1	22.8	2.2	-7.5	8.1	6.9	11.9	.8	3.7
Maryland.....	30.7	40.5	44.1	-9.7	-13.3	4.5	6.0	6.5	3.5	5.0
Massachusetts.....	75.1	91.7	100.4	-16.3	-25.3	5.0	6.1	6.6	8.5	10.1
Michigan.....	87.1	113.6	185.6	-26.5	-98.5	5.1	6.5	10.3	13.2	16.1
Minnesota.....	42.2	47.4	54.0	-5.2	-11.2	6.0	6.7	7.6	3.4	4.7
Mississippi.....	15.2	17.1	24.5	-2.0	-9.3	5.6	6.4	9.0	2.0	2.7
Missouri.....	41.4	52.1	59.9	-10.7	-18.5	4.4	5.5	6.2	4.7	6.7
Montana.....	6.9	10.5	11.7	-3.6	-4.7	6.4	9.7	10.8	.6	1.2
Nebraska.....	7.2	13.2	8.6	-6.0	-1.4	3.1	5.6	3.8	.7	1.0
Nevada.....	3.8	5.1	5.5	-1.3	-1.7	4.6	6.2	6.9	.4	.6
New Hampshire.....	6.6	6.5	11.1	.2	-4.5	4.3	4.2	7.2	.6	1.2
New Jersey.....	82.1	97.7	110.5	-15.5	-28.4	5.3	6.3	7.1	14.1	16.5
New Mexico.....	7.6	8.7	10.8	-1.1	-3.2	4.2	5.5	6.7	.7	.9
New York.....	233.5	276.2	341.8	-42.7	-108.2	4.7	5.3	6.8	23.9	31.6
North Carolina.....	39.0	48.1	60.2	-6.1	-21.2	3.3	3.0	6.7	5.3	7.7
North Dakota.....	6.0	7.6	6.1	-1.6	-1.1	8.9	11.2	8.9	.3	.5
Ohio.....	96.8	120.5	189.6	-23.7	-92.9	4.1	5.1	7.8	12.6	17.2
Oklahoma.....	18.7	19.8	26.7	-1.1	-8.0	5.0	5.3	7.2	2.1	2.8
Oregon.....	23.5	30.6	32.9	-7.1	-9.4	5.9	7.7	8.2	2.7	3.9
Pennsylvania.....	173.5	207.8	277.1	-34.2	-103.6	6.0	7.1	9.3	15.6	19.3
Puerto Rico.....	13.9	12.7	13.6	1.2	-6.3	5.9	5.3	6.2	2.1	2.9
Rhode Island.....	12.0	15.2	18.6	-3.2	-6.6	5.1	6.3	7.8	1.5	2.0
South Carolina.....	13.6	15.2	22.3	-1.6	-8.7	3.2	3.6	5.3	2.4	3.0
South Dakota.....	3.0	5.0	2.6	-2.0	.3	3.8	6.5	3.5	.2	.3
Tennessee.....	36.4	44.6	57.3	-8.2	-20.9	5.5	6.8	8.7	5.9	8.8
Texas.....	50.5	54.0	69.3	-3.5	-18.8	2.8	3.1	3.9	8.0	10.8
Utah.....	6.2	9.4	8.4	-3.1	-2.2	3.4	5.1	4.7	.6	.9
Vermont.....	4.5	5.4	6.6	-.9	-2.0	6.3	7.5	8.9	.3	.4
Virginia.....	17.4	25.8	29.5	-8.4	-12.1	2.5	3.7	4.2	2.4	3.0
Washington.....	33.0	44.3	48.4	-11.3	-15.4	5.5	7.4	8.0	7.8	8.4
West Virginia.....	22.3	26.3	36.5	-4.0	-14.2	7.1	8.3	11.0	2.5	3.4
Wisconsin.....	26.6	36.1	49.1	-9.6	-22.6	3.0	4.0	5.4	3.1	3.6
Wyoming.....	4.1	5.4	4.4	-1.3	-.3	6.1	8.0	6.4	.4	.5

<sup>1</sup> Temporary Extended Compensation program, effective April 8, 1961, covering claimants exhausting benefits under regular State programs only. April data excludes 14,961 insured unemployed under extended duration provisions of regular State laws (ED) as follows: California (8,883), Idaho (1,494), Illinois (3,863), and Vermont (629).

<sup>2</sup> Based on unrounded data.

Table 14. Insured unemployment<sup>1</sup> in 147 major labor market areas<sup>2</sup>

(In thousands, for week ending nearest the 15th of the month)

State and area	Regular programs		Temporary program		State and area	Regular programs		Temporary program	
	April 1962	March 1962	April 1962	March 1962		April 1962	March 1962	April 1962	March 1962
<b>Alabama</b>					<b>Indiana</b>				
Birmingham....	5.9	6.3	9	1.2	Evansville....	2.1	2.2	3	4
Mobile.....	2.8	3.3	3	5	Pt. Wayne....	1.1	1.6	2	3
					Gary-Hammond..	4.8	6.1	8	1.1
<b>Arizona</b>					Indianapolis..	4.8	6.7	9	1.4
Phoenix.....	5.1	6.7	5	8	South Bend....	2.0	2.7	3	5
					Terre Haute...	1.2	1.6	2	3
<b>Arkansas</b>					<b>Iowa</b>				
Little Rock...	1.5	1.8	1	2	Cedar Rapids..	.7	.9	1	1
					Des Moines....	1.7	2.6	2	3
<b>California</b>					<b>Kansas</b>				
Fresno.....	7.4	8.9	1.3	1.3	Wichita.....	2.1	2.7	3	4
Los Angeles...	94.0	106.5	15.7	16.9					
Sacramento....	6.3	9.5	.9	1.1	<b>Kentucky</b>				
San Bernardino	9.6	10.5	1.5	1.5	Louisville....	6.3	8.0	1.2	1.6
San Diego.....	17.5	19.9	2.8	2.8					
San Francisco..	37.4	45.0	6.4	6.3	<b>Louisiana</b>				
San Jose.....	9.7	13.4	2.3	2.2	Baton Rouge...	1.9	1.9	3	4
Stockton.....	5.0	7.5	.8	1.0	New Orleans...	8.1	8.7	1.5	1.6
					Shreveport...	2.1	2.3	3	3
<b>Colorado</b>					<b>Maine</b>				
Denver.....	5.5	7.0	.4	.6	Portland.....	1.7	1.7	1	4
<b>Connecticut</b>					<b>Maryland</b>				
Bridgeport...	4.8	5.4	.8	1.1	Baltimore....	20.2	25.5	2.4	3.3
Hartford.....	5.2	6.2	.7	1.1					
New Britain...	1.8	2.1	.3	.4	<b>Massachusetts</b>				
New Haven....	3.2	3.8	.4	.6	Boston.....	31.1	37.8	3.8	4.5
Stamford.....	1.3	1.7	.2	.3	Brockton.....	2.7	3.2	3	3
Waterbury....	2.6	3.3	.4	.7	Fall River...	4.4	6.1	2	3
					Lawrence.....	4.2	4.0	3	4
<b>Delaware</b>					Lowell.....	3.6	4.1	3	3
Wilmington...	3.8	7.4	.6	.8	New Bedford..	3.2	4.0	.4	.4
					Springfield..	8.0	9.2	1.0	1.2
<b>Dist. of Col.</b>					Worcester....	4.4	5.1	.6	.6
Washington...	8.0	10.9	1.0	1.4					
<b>Florida</b>					<b>Michigan</b>				
Jacksonville..	2.2	2.8	.4	.5	Battle Creek..	1.4	2.0	2	3
Miami.....	8.2	8.8	1.4	1.7	Detroit.....	45.1	58.8	7.2	8.6
Tampa.....	5.8	*6.5	1.0	1.3	Flint.....	1.9	2.4	3	4
					Grand Rapids..	2.9	4.5	.4	.6
<b>Georgia</b>					Kalamazoo....	1.5	2.2	2	2
Atlanta.....	5.9	6.5	1.1	1.5	Lansing.....	1.9	2.5	3	3
Augusta.....	1.1	1.1	.2	.2	Marquette....	1.5	2.1	.4	.5
Columbus....	1.6	1.3	.2	.3	Saginaw.....	1.5	1.9	2	3
Macon.....	1.0	1.3	.2	.3					
Savannah....	1.7	1.6	.2	.3	<b>Minnesota</b>				
					Duluth.....	2.9	3.2	3	4
<b>Hawaii</b>					Minneapolis..	14.3	16.3	1.5	1.9
Honolulu.....	5.8	6.7	9	1.3					
					<b>Mississippi</b>				
<b>Illinois</b>					Jackson.....	1.2	1.6	2	2
Chicago.....	56.1	69.9	12.0	10.7					
Davenport....	1.9	2.7	.3	.3	<b>Missouri</b>				
Peoria.....	3.5	4.4	.5	.4	Kansas City..	8.0	11.3	1.0	1.6
Rockford.....	2.0	2.6	.4	.3	St. Louis....	23.7	28.6	3.2	4.0

See footnotes at end of table.

Table 14. Insured unemployment<sup>1</sup> in 147 major labor market areas<sup>2</sup>—continued

(In thousands, for week ending nearest the 15th of the month)

State and area	Regular program		Temporary program <sup>3</sup>		State and area	Regular program		Temporary program <sup>3</sup>	
	April 1962	March 1962	April 1962	March 1962		April 1962	March 1962	April 1962	March 1962
<b>Nebraska</b>					<b>Pa.—Con.</b>				
Omaha.....	3.4	4.6	.4	.6	Johnstown.....	7.0	7.9	.6	.7
<b>New Hampshire</b>					Lancaster.....	1.8	2.4	.2	.3
Manchester....	1.7	1.4	1	3	Philadelphia....	57.2	69.4	6.2	7.7
<b>Hay Jersey</b>					Pittsburgh.....	42.4	50.3	4.5	5.6
Atlantic City..	3.7	5.4	.8	.8	Reading.....	2.9	3.4	.2	.2
Jersey City....	9.4	10.0	1.5	1.8	Scranton.....	6.0	6.9	.5	.6
Newark.....	23.3	27.7	4.7	5.2	Wilkes-Barre...	8.5	9.3	.6	.8
New Brunswick..	8.3	8.7	1.2	1.4	York.....	3.4	4.8	.3	.4
Paterson.....	14.9	16.7	2.1	2.8	<b>Rhode Island</b>				
Trenton.....	3.3	4.4	.7	.8	Providence....	12.5	16.0	1.6	2.1
<b>New Mexico</b>					<b>South Carolina</b>				
Albuquerque....	3.1	3.5	.3	.3	Charleston....	1.0	1.1	.2	.3
<b>New York</b>					Greenville....	1.4	1.4	.3	.3
Albany.....	7.1	9.3	.9	1.2	<b>Tennessee</b>				
Binghamton....	2.3	3.2	.3	.4	Chattanooga... <sup>4</sup>	4.5	5.4	1.0	1.2
Buffalo.....	21.6	24.6	3.0	3.7	Knoxville.....	4.2	4.6	.8	1.0
New York.....	148.2	173.4	14.5	19.8	Memphis.....	4.5	5.3	.9	1.3
Rochester.....	6.0	7.0	.8	1.0	Nashville.....	2.9	3.6	.5	.8
Rochester.....	6.6	7.9	.9	1.0	<b>Texas</b>				
Syracuse.....	5.2	6.1	.5	.7	Austin.....	.6	.6	.1	.1
Utica.....					Beaumont.....	3.3	3.1	.4	.5
<b>North Carolina</b>					Corpus Christi	1.7	1.6	.3	.3
Asheville.....	1.4	1.6	.3	.4	Dallas.....	5.6	6.2	.9	1.3
Charlotte.....	1.7	2.0	.3	.4	El Paso.....	2.6	2.5	.4	.5
Durham.....	1.4	1.8	.2	.3	Ft. Worth.....	3.7	3.7	.5	.6
Greensboro....	2.3	2.6	.3	.4	Houston.....	6.0	6.5	1.1	1.4
Winston-Salem..	2.2	2.3	.4	.6	San Antonio... <sup>4</sup>	3.2	3.4	.5	.7
<b>Ohio</b>					<b>Utah</b>				
Akron.....	5.0	5.9	.8	1.1	Salt Lake City	2.3	3.3	.2	.3
Canton.....	4.6	5.4	.5	.8	<b>Virginia</b>				
Cincinnati....	9.6	11.3	1.4	2.0	Hampton.....	1.0	1.2	.1	.2
Cleveland.....	20.9	25.3	3.4	4.2	Norfolk.....	2.0	2.2	.3	.4
Columbus.....	4.4	6.1	.5	.7	Richmond.....	1.3	1.7	.2	.2
Dayton.....	5.5	7.2	.7	1.0	Roanoke.....	.8	1.1	.1	.1
Dayton.....	2.8	3.4	.3	.5	<b>Washington</b>				
Hamilton.....	2.0	2.5	.2	.3	Seattle.....	10.9	14.3	2.9	3.2
Lorain.....	1.4	1.7	.2	.2	Spokane.....	4.0	5.8	.8	.9
Steubenville... <sup>4</sup>	6.3	7.3	.9	1.3	Tacoma.....	3.8	3.8	.6	.8
Toledo.....	5.8	6.4	.7	1.0	<b>West Virginia</b>				
Youngstown....					Charleston....	2.7	3.0	.3	.3
<b>Oklahoma</b>					Huntington....	2.9	3.5	.3	.4
Oklahoma City.	3.2	3.6	.4	.5	Wheeling.....	2.9	3.6	.3	.5
Tulsa.....	3.7	3.9	.4	.5	<b>Wisconsin</b>				
<b>Oregon</b>					Kenosha.....	.5	.6	.1	.1
Portland.....	10.3	12.2	1.5	1.9	Madison.....	1.0	1.6	.1	.1
<b>Pennsylvania</b>					Milwaukee....	9.2	12.1	.9	1.1
Allentown....	6.1	7.5	.4	.6	Racine.....	1.1	1.6	.1	.1
Altoona.....	1.9	2.3	.2	.2					
Erie.....	4.1	4.9	.3	.4					
Harrisburg....	4.8	6.0	.3	.4					

<sup>1</sup> Insured jobless under State, Federal Employee, and Ex-Servicemen's unemployment insurance programs.<sup>2</sup> For full name of labor market area, see Area Labor Market Trends published by the Bureau of Employment Security.<sup>3</sup> Temporary Extended Compensation program, effective April 8, 1961 covering claimants exhausting benefits under the regular State and Federal programs.<sup>4</sup> Revised.

## EXPLANATORY NOTES

Current statistics on employment and unemployment are compiled from household interviews, payroll reports from employers, and administrative statistics of unemployment insurance systems. Data from these different sources give valuable insights into various aspects of the labor market. The household survey gives an unduplicated count of individuals who are employed or unemployed and detailed information on their personal characteristics such as age, sex, color, and marital status. The payroll reports give detailed estimates of nonagricultural employment, hours and earnings, by industry and geographic locality. Data from the unemployment insurance systems yield geographic detail on the total number of workers drawing unemployment compensation under State unemployment insurance programs. These three series require different definitions, concepts, and methods of measurement. Because of this and because of sampling variability, response or reporting errors, and administrative factors, month-to-month changes shown by the series may differ.

Following is a brief description of each series. For more detail, see Employment and Earnings of the Bureau of Labor Statistics and publications of the Bureau of Employment Security.

The sample survey of households, collected and tabulated by the Bureau of the Census, U. S. Department of Commerce, for the Bureau of Labor Statistics, provides a comprehensive measure of the labor force, i. e., the total number of persons 14 years of age and over who are employed or unemployed. The information is obtained from a scientifically selected sample of about 35,000 interviewed households in 333 areas throughout the country and is based on the activity or status reported by surveyed persons for the calendar week ending nearest the 15th day of the month.

The sample survey of employers provides estimates of the number of employees on the payrolls in nonagricultural establishments, by industry. Statistics on employment of production or nonsupervisory workers, average weekly hours and average hourly and weekly earnings are also available for a large number of industries.

The figures are based on reports from a sample of establishments employing approximately 25 million workers. The employee figures include all persons who received pay from nonagricultural establishments during the payroll period ending nearest the 15th of the month.

Administrative statistics of unemployment insurance systems furnish a complete count of insured unemployment among the two-thirds of the Nation's labor force covered by unemployment insurance programs.

Weekly reports, by State, are issued on the number of initial claims, the volume and rate of insured unemployment under State unemployment insurance programs, and the volumes under the programs of unemployment compensation for Federal employees, for veterans, and for ex-servicemen. These statistics are published by the Bureau of Employment Security, U. S. Department of Labor in "Unemployment Insurance Claims."

## Concepts and Definitions

Employment Data

The employed total from the household survey includes all wage and salary workers and self-employed persons who worked at all during the survey week or who had jobs or businesses from which they were temporarily absent because of illness, vacation, industrial dispute, or various other reasons, regardless of whether pay was received. It also includes unpaid workers in family-operated enterprises who worked 15 or more hours during the survey week. Employed persons include those working in agriculture, or in nonagricultural industries; those holding more than one job are counted only once and are classified according to the job at which they worked the greatest number of hours during the survey week.

Payroll employment from the employer survey includes nonfarm wage and salary workers who received pay for any part of the pay period. Persons on paid sick leave, paid holiday, or paid vacation are included, but those on leave without pay for the entire payroll period are excluded.

Persons on the payroll of more than one establishment during the period are counted each time reported. Self-employed persons, unpaid family workers, and domestics are excluded.

Because these payroll data are based upon records of a relatively large sample of establishments, they provide industry information in considerable detail which cannot be obtained with equal accuracy from a survey of households. The household survey, on the other hand, furnishes detail on personal characteristics of the labor force.

#### Unemployment Data

The unemployed total from the household survey includes all jobless persons who were looking for work, regardless of whether or not they were eligible for unemployment insurance. Also counted as unemployed are persons waiting to be called back to jobs from which they had been laid off; those scheduled to start new wage or salary jobs within 30 days (except students); and those who would have been looking for work except that they were temporarily ill or believed no work was available in their line of work or in the community.

Insured unemployment represents the number of persons reporting a week of unemployment under an unemployment insurance program. It includes some persons who are working part time who would be counted as employed in the payroll and household surveys. Excluded are persons who have exhausted their benefit rights; new workers who have not earned rights to unemployment insurance; and persons losing jobs not covered by unemployment insurance systems (agriculture, State and local government, domestic service, self-employment, unpaid family work, nonprofit organizations, and firms below a minimum size). The rate of insured unemployment is the number of insured unemployed expressed as a percentage of average covered employment in a 12-month period ending 6 to 8 months prior to the week of reference. Initial claims are notices filed by those losing jobs covered by an unemployment insurance program that they are starting periods of unemployment. A claimant who continues to be unemployed a full week is then counted in the insured unemployment figure.

#### Hours of Work

Average weekly hours of work from the employer survey are available for detailed industries in manufacturing and for selected nonmanufacturing industries. The data relate to production or nonsupervisory workers and measure the total number of hours for which pay was received.

The hours of work from the household survey include all hours worked (paid or unpaid) in farm and nonfarm employment as reported by individuals. The total number of hours worked by persons holding more than one job is credited to the activity at which they worked the most hours.

#### Statistical Reliability

#### Household Survey

Since the data from the household survey are based on a sample, they may differ from the figures that would have been obtained if it were possible to take a complete census using the same schedules, enumerators, and procedures.

The standard error is primarily a measure of sampling variability, that is, the variations that might occur by chance because only a sample of the population is surveyed. The chances are about two out of three that an estimate from the sample would differ from a complete census by less than the standard error. The chances are about 19 out of 20 that the difference would be less than twice the standard error.

The following table shows the average standard error for the major employment status categories, computed from data for 12 recent months. Estimates of change derived from the survey are also subject to sampling variability. The standard error of change for consecutive months is also shown. The standard errors of level are acceptable approximations of the standard errors

of year-to-year change. For more details on statistical reliability, see Employment and Earnings of the Bureau of Labor Statistics.

Average standard error of major employment status categories  
(In thousands)

Employment status	Average standard error of--	
	Monthly level	Month-to-month change (consecutive months only)
Labor force and total employment .....	250	180
Agriculture .....	200	120
Nonagricultural employment .....	300	180
Unemployment .....	100	100

#### Employer Survey

This survey is designed primarily to measure month-to-month changes in employment, as indicated by a sample of employers who report in successive pairs of months. The estimated employment levels are adjusted periodically to benchmarks obtained from a variety of sources, the most important of which are records of employment in establishments covered by State unemployment insurance laws. These data are compiled by State agencies under the direction of the Bureau of Employment Security. The extent of adjustments needed to make the monthly series conform with the benchmarks provides a check on the accuracy of the estimates.

Significant causes of difference between the benchmarks and estimates include changes in industrial classification of individual establishments, as well as sampling and response errors. The following table presents a comparison of nonagricultural payroll employment estimates for industry divisions for March 1959. This comparison relates to the series published prior to conversion to the 1957 Standard Industrial Classification, and reflects only those differences which would result from a normal benchmark adjustment. However, apart from sampling and related problems, the March 1959 benchmark levels actually used for the series on the 1957 SIC were affected by 1) additions to employment amounting to 670,000 (an increase of 1.3 percent in the total estimate) for certain categories not adequately represented before, and 2) shifts between industry divisions in accordance with the new SIC, as described in the article in the November 1961 issue of Employment and Earnings.

Comparison of nonagricultural payroll employment estimates with March 1959 benchmarks,  
by industry division

Industry division	Employment estimate	
	In thousands	As percentage of benchmark
TOTAL .....	51,093	99.4
Mining .....	689	96.1
Contract construction .....	2,435	95.1
Manufacturing .....	15,995	99.1
Transportation and public utilities .....	3,883	100.3
Wholesale and retail trade .....	11,134	100.8
Finance, insurance, and real estate .....	2,393	98.8
Service and miscellaneous .....	6,409	98.6
Government .....	8,155	100.0

Representative CURTIS. Would the gentleman yield at that point? Senator PROXMIRE. I would be happy to yield.

Representative CURTIS. I got the figures for January 1961, February and March, before this revision census data, and we show a similar decline before that element entered in. I don't know the significance, but it does show a 100,000 decline. I think your point on armed services is well taken from the standpoint that they had increased about 300,000, but we still get back to the basic thing of a decline of the labor force in relation to our total population, which I think bears on this economic gap theory.

Senator PROXMIRE. I would like to say this is a neglected area of our whole economic approach. There has been laudatory emphasis on the demand aspects of the situation, but I think too little emphasis on the supply part of the employment equation.

As I analyze your statement, and I think it is a very, very fine one, there is an indication that you feel that the main problem is unemployment. There are other problems of growth and so forth, but unemployment is certainly a nagging and real and vital problem.

It is possible that we can solve this problem entirely in the area of increasing effective demand. I wonder if we can really do so. I can see nothing wrong at all with working constructively on reducing the size of the labor force because I think we can do so without reducing our standard of living and providing greater values for our people.

I am thinking particularly in two areas. One you mentioned, the earlier retirement age and social security from 65 to 62 made a real contribution. Why isn't this good? If people want to retire, can retire earlier, open up jobs for other people, I think this is fine.

Another possibility which has not been developed is to keep our young people in school longer. In the first panel discussion we had here it was emphasized that the most serious problem of unemployment is the people who are young and just entering the labor force. If they can be kept in school, and their remaining in school can be dovetailed with an effective and aggressive vocational program, then you solve the problem of diminishing unemployment and have them at constructive work so when they do enter the labor force they can make a substantial contribution, and a job will be more readily available.

I might conclude this statement with one point, and that is that if it were not for the social security system we have today, and did not have in the thirties, we would today have not 5½ percent of our work force out of work, but probably 14 or 15 percent of our work force out of work, because the 13 or 14 million people on social security, most of them, would have to work so that they would have the income to stay alive. Therefore, it would seem to me that a constructive and limited extension of social security may be another constructive way to cope with this economic problem rather than try to do it entirely with fiscal measures which can take us into a deeper and deeper national debt and aggravate our problems in that direction.

Dr. HELLER. We have been very much concerned about the supply side, particularly the employment problem. We have stressed in earlier testimony and in the annual report of the Council that, side by side with attention to expanding demand and expanding rates of investment and modernization which release labor, it is extremely

important to improve the mobility and the skill structure of the labor force.

You are suggesting with respect to education and vocational training, that these work at two ends of the problem. First, such training takes people off the labor market for the time being, and second, it upgrades the skills and education and knowledge of these individuals. I couldn't agree more with your suggestion.

It is true, of course, that increased training costs money. An expansion in the Federal budget and in State and local budgets would be necessary to provide this higher level and longer period of training. The same is true of social security as well. If we were to make limited and modest advances in the provision of social security for the aged, that, too, would require revisions that cost money.

I am not saying that the increased budgetary costs makes your proposals undesirable. We have to balance the costs against the benefits. But it does run into some problems on the budgetary side that have to be considered.

Senator PROXMIRE. In this connection I understand the reduction in retirement from 65 to 62 did not cost a significant amount because it was accompanied by a reduction in the pension to be received. Similarly, a reduction from 62 to 60 might be accompanied by a reduction in the benefits to be received and it would be completely voluntary whether the people wanted to remain in the labor force and continue to work or whether they would prefer to retire and take a lower pension.

At any rate, the dollar cost could be adjusted, I would think, so it would not be significant.

Dr. HELLER. Yes. This whole question of how much of our advance in economic potential we take out in the form of increased leisure and how much we take out in the form of increased production is a very difficult one and depends a great deal on some of the basic philosophical goals of the society in which we live.

To the extent that we put emphasis on growth for domestic fulfillment and international leadership, we are a little more reluctant to cut down on the size of the labor force and its growth than if we felt that we were at a stage where we were truly affluent and could afford the cost.

I think this administration has placed somewhat more emphasis on the maintenance of high rates of labor force participation and improved opportunities for education and training as a means to faster economic growth.

Senator PROXMIRE. I think we can do both vigorously at the same time. The Senator from New York has 3 minutes remaining.

Senator JAVRS. Thank you very much, Senator.

Mr. Chairman, I have one other line of questioning which I shall make expeditious.

I notice in the various things you laid out under the heading of policy actions you list entirely matters which are already before us. You don't list any measures other than those already before us.

I just wondered whether you would, yourself, consider these actions as being everything that is needed, or what would be your attitude, for example, on the widespread view that we need some better mechanism in law for dealing with national strikes. We have just had a bill introduced by one of our colleagues which I didn't join in because I

didn't like the way it was developed, but nonetheless it does seem to be a general feeling that strikes which affect the total national interest are beyond the reach of effective law.

Would it come within the compass of your activities to include in your prescription as to what we ought to do with any such ideas?

Dr. HELLER. As you know, Senator, we are primarily charged under the Employment Act of 1946 with problems and policy relating to economic stability, economic growth and price stability. We do not get as directly into problems of the kind you are raising.

We certainly do not have a policy position on the matter you refer to that I could very usefully comment on at the present time.

Senator JAVITS. Would the same be true as to how business ought to finance the worker in respect of the transition to automation?

Dr. HELLER. This gets into the basic question of how best to stimulate investment and modernization and to improve technology in the economy, and it is something on which the Council might naturally be consulted and concerned, although I would not say we have a specific program to lay before you.

Senator JAVITS. You did not hesitate to prescribe what you thought should be guidelines for labor-management wage negotiations.

Dr. HELLER. This is an area so directly related to wage and price levels in the economy, and to the whole question of the possible resumption of the wage-price spiral, that it is directly related to our responsibilities concerning maximum purchasing power which, as you know, we interpret to include concern with the maintenance of reasonable price stability.

Senator JAVITS. Would it be fair to say, therefore, and this is my last question because my time is up, that the policy actions which are specified are by no means an exclusive list as you see the needs of the economy to move it forward and avoid a recession?

Dr. HELLER. That is correct.

Senator JAVITS. Thank you. I thank my colleague.

Senator PROXMIRE. I will ask a few questions and then defer to Congressman Reuss.

I would like to go back to something we Democrats have been neglecting today, the monetary policy, and ask you a further question on it.

Most of our fire has been directed at the Federal Reserve Board. I think Senator Douglas and Congressman Reuss did a marvelous job of laying the groundwork for the question I want to ask. Senator Douglas pointed out that traditionally, monetary policy has been to ease the situation when the expansion slowed down. All the evidence is that we have not done so this time.

Congressman Reuss certainly documented it well. I am referring to a New York Times article on last Sunday which is headlined "Kennedy Revises His Fiscal Goals," and frankly, this is one of the most alarming articles I have read as a Democrat and one who is deeply interested in economic policy. It reads in part:

The interest of the Kennedy administration in a steady or even higher interest structure both short- and long-term was attested last week by the outcome of an \$8,800 million financing operation, most of which was intended to refund maturing debt and the rest to raise about a billion dollars in new money. All of the money could have been raised readily at short term at a cost of 3½ percent. Still, the Treasury saw fit to borrow \$1,695 million of the total on bonds due in

6½ years at a cost of 4 percent, and \$316 million on bonds due in 30 years at a cost of nearly 4¼ percent.

I might say in this connection that the administration expected to be able to sell \$500 million worth of bonds, 4¼, 30 years. They stood ready to sell \$750 million of bonds and they could only sell \$316 million, indicating the serious plight of our money market.

The fact that interest rates have gone so high and risen so sharply, expectation of higher interest rates, is so apparent in the money market that they refused to buy the Treasury bonds at this very enticing rate.

It goes on to say that the reason for the long-term borrowings at rates closely approaching the highest incurred by the Treasury in the postwar period is perhaps best summed up in the declaration by the Federal Reserve Bank of New York in January:

As an objective of monetary policy, the defense of the international value of the dollar has come to occupy a position alongside of the goal of stable economic growth.

You used some very strong words about the importance of monetary ease for the domestic economy.

Now I want to read briefly from what Chairman Martin said to us in February.

There is no invariable relationship between relative interest rates in various capital markets. While interest differentials can be an important factor in movements of capital, there are others.

He goes on to say what they are.

Capital movements are sometimes viewed in the narrow concept of short maturity. The differences that existed last year between money rates here and abroad on this kind of paper do not appear to have been a primary determinate of international movements of funds of this type.

Under Secretary of the Treasury Roosa has written the same kind of thing. Mr. Gemmill, a top monetary economist with the Federal Reserve Board, has written similarly.

As I understand, there has been no change in the forward cover premium. Chairman Martin indicated this to us 3 weeks ago when I asked him about this, so I just can't see what all the concern about the international balance of payments situation is that would warrant a deliberate policy of raising long-term interest rates, and the evidence is overwhelming, as well as short-term interest rates.

Dr. HELLER. As I believe I suggested in my response to earlier questions, the rise of about 20 basis points in the long-term rate is a matter of very serious concern to us, on the same general grounds as it is to you. It has made the cost of long-term money more expensive and might have touched off expectations of further rises. As you suggest, such expectations might have had some impact on the rather modest amount—I think you said \$316 million—that the Treasury was able to borrow on long term.

Senator PROXMIRE. This is the Treasury Department policy determination. This is not the Federal Reserve Board.

Dr. HELLER. This is a source of concern to us as well as to you. I think in our consideration of the interest rate and monetary spectrum we should not leave out of account that, contrary to the development you just pointed out, in some areas—such as mortgage rates—

there has been no increase. Indeed, there has been a decline since the beginning of the year in mortgage rates.

Senator PROXMIRE. The figures I have been given show the conventional rates for mortgages in the last several months have been very high. July, 5.90; October, 5.95; April, 5.95; July, 5.95. The all-time high was January 1960, 6.24, but that is very high.

I hate to ask a question and run, but I will miss my rollcall unless I do go.

Dr. HELLER. I was hoping Mr. Gordon could comment on this.

Senator PROXMIRE. Would he defer that? I will be back in 5 minutes.

Chairman PATMAN. Congressman Curtis?

Representative CURTIS. I just wanted to pick up on that one little point on the labor force. I am reading now from table D, labor force participation rates by age and sex. I want to be sure what I am reading from now. This is the monthly report of the labor force.

Labor force growth appears to be slowing down for reasons which are not entirely clear. Second quarter 1962 increased 600,000 over the year, was about 400,000 short of what might have been expected on the basis of past trends. Most of the difference was among women 25 to 54 years of age who have accounted for such a large part of our expanding work force since World War II.

Young people, on the other hand, joined the work force in about the expected numbers over the year. Shortage of job opportunities could not be the full explanation of the slowdown in growth. Over the year the labor force participation of women 55 to 64 years of age has risen sharply as it has in all recent years. There is no evidence that jobs are available for them, but not for younger women.

I just wanted to add that into this discussion because it does seem to me this becomes a very critical area of examination. In the gap theory that the Council is advancing, certainly this should be interjected. I say that again as one who doesn't agree with the gap theory as an accurate way of viewing our economy.

Dr. HELLER. We recognize that many people remain outside the labor force when they are discouraged by the inadequate availability of job opportunities. Our estimate of potential output is, therefore, based on the expected normal size of the labor force at full employment. On the other hand, actual output is affected only by persons actually employed, and not by persons either unemployed or outside of the labor force. The gap is obtained by subtracting actual from potential output, and our calculations of the size of the gap, therefore, make an allowance for the response of the labor force to job opportunities.

So on the question of what the economy is capable of at full employment—which is really all we are talking about and what you identify as the “gap theory”—we do take both the present labor force and the prospective labor force into our calculations.

Representative CURTIS. If I am wrong, I want to be corrected. In your estimates, the gap has diminished in a year and a half. I would say that if the labor force were increasing at the same rate that it had been, roughly about a million a year, I suggest probably you have not closed at all. I don't know whether it would be that big, but it is a million more people in the unemployed sector, which would make a sizable difference.

Dr. HELLER. Mr. Congressman, the increase in the gross national product has been about \$50 billion. We assume that approximately \$30 billion of that has been keeping up with the growth in the economy's potential and about \$20 billion has been a narrowing of the gap. That calculated gap of \$30 billion does not rest on the difference between the present 5.3- or 5.4-percent unemployment rate and the so-called full employment rate of 4 percent; rather it does take into account the labor force that would be drawn into the economy at full employment, of course, not with perfect accuracy.

Representative CURTIS. How can it if you use unemployment figures, because unemployment figures do not reveal these people who are not in the work force.

Dr. HELLER. On the basis of previous experience of what happens to the growth of the labor force, as the economy approaches 4 percent unemployment, one can calculate approximately the additions to the labor force that high levels of economic activity will generate.

Representative CURTIS. You don't have to use hypothetical figures. We can simply use the figures as of any month, such as the current month of 1962, or take the year 1962 and compute if there had been the usual increase in the civilian labor force. It would be only in the one area. It would be in the unemployment area which would be roughly another million people there.

That is not, in my judgment, taken into your computations on your gap theory of where you are in 1962.

Dr. HELLER. This is, I guess, a difficult point on which to establish clear understanding. I want to state just once more, first, that the differential in the labor force projection and the actual is not really a million when we take account of the 350,000 increase in the Armed Forces and the 210,000 adjustment in the labor force figures in response to the 1960 census.

Representative CURTIS. I think it is. I agree on the armed services. But again the armed services are hardly a basis of referring to the private sector.

Dr. HELLER. That takes potential labor force out of the private sector. I want to say secondly that we would not get as big an increase as \$30 billion in our total output if we were to use only the people now in the labor force. In measuring the gap, we are calculating an increment to that labor force from the sources you suggest.

Representative CURTIS. Our employment actually has increased. That part is clear. Employment has increased each year.

Dr. HELLER. That is correct.

Representative CURTIS. It has increased from 1961 to 1962. But the area where there has not been an increase has been the civilian labor force. That consists of the employed people and the unemployed people. I was at first afraid that it might be a statistical error in our computation of the unemployed because this is something that has never happened in our recent history. This is new that our civilian labor force has not been increasing. Even in the three post-World War II recessions the civilian labor force increased. You are confronted with a new phenomena of decline in the civilian labor force which to me is highly significant and must be fitted in somewhere in the gap theory because it is perhaps even more ominous than those who are listed as "unemployed." Let me go on to one other area. It

is basic. But in your whole presentation of this deficit financing theory there is only one paragraph devoted to what I think is one of the great problems in deficit financing—debt management. I have asked other witnesses who have suggested this quickie tax cut to stimulate the economy—and I am using just the figure of \$5 billion for convenience—we could use 10—that you cut taxes by \$5 billion and thereby release that money to the private sector, but we have to sell \$5 billion worth of bonds to the private sector and thereby we withdraw \$5 billion from the private sector. Unless you want to use the banks of the Federal Reserve System to buy these bonds.

In your paper you say, and this is the only reference I found to debt management, that—

if budget deficits are incurred, the method of financing them must be carefully adapted to the prevailing economic circumstances. A careful balance must be struck between bank and nonbank financing, a balance which will not thwart or nullify the expansionary effect of budget measures in an economy with excessive unemployment and excess capacity, but will prudently shift Federal debts into nonbank hands as the economy comes close to or reaches full employment.

As one who sits on the Ways and Means Committee, that has to figure how we are going to market these bonds, all you are really saying is that we have a problem. I think any one who advocates deficit financing, particularly right now, should be ready to discuss the economic impact of having to market these bonds.

May I relate it to one thing before I turn it over.

In monetary policy we find that the discipline that has entered the picture is balance of payments. So we can't follow the monetary policy that otherwise we would. So I suggest with the Federal debt the size it is, and the problems that we already have in marketing that debt, I think just the rollover is around \$90 billion next year, what is the economic impact of superimposing another \$5 billion on top of this tremendous amount we have in debt management.

Dr. HELLER. I think you are putting your finger on a very important part of expansionary policy, and, indeed, on one of the key areas where monetary policy has to be coordinated with fiscal policy. Essentially, in response to the very type of concern and question that you have raised, what this paragraph says is that when the economy is in a slack condition, when there are underemployed resources and manpower, a budgetary deficit can lead to an expansion of employment, production, incomes, and profits, without an increase in prices, and can do so even if it is bank financed.

Representative CURTIS. That is the thesis.

Dr. HELLER. This has been shown to be the case in past recessions when we have had deficits that were financed in large part by selling Government securities at the short end of the spectrum which were in large part placed in by the banking system.

Representative CURTIS. That is the area for debate. I don't know that it has been shown. I am not willing to presume that is so. I want the debate to center around the question, Is the theory of deficit financing sound? Your presentation and the presentation of others who advanced this theory begs the question throughout that the economy will be stimulated. I think we need to examine into whether it will or not. I doubt if it has in the past. People point to the fact that in the thirties this theory didn't work out. That is countered

by those who say, "Well, the deficits were not large enough, we did not spend enough." After all, when the expenditures of World War II came the economy did come back. However, I relate World War II result to the fact that we took 10 million young men and women and put them in uniform. That is where you got rid of your unemployment situation. You had the war psychology and you had the forced savings in those periods with wage and price controls and a lot of other disciplines which people put up with because our country was at war. This was dictatorship and I am certain our people will not put up with this kind of government domination in peacetime. I certainly don't believe that this deficit financing theory is one that can be accepted without its proponents coming forward with their working papers to prove it. I have sat through almost 2 weeks of Ways and Means Committee hearings and listened to all of this re-statement of this novel theory without anyone advancing it coming forward to establish it with their working papers. It is always presented more or less as you do, that we all agree. Maybe the bulk of the economists in the universities agree but there are some of us who do not agree and do not understand it.

Dr. HELLER. I think you are suggesting that a look at the statistical record over the years would be a useful exercise.

Representative CURTIS. Partly that, and also whether or not the statistics really give us enough information of what really has been going on.

Dr. HELLER. In our thinking about this problem we should also take into account the fact that in a period of economic expansion when there is still a considerable degree of unemployment and excess capacity, there is always substantial deficit financing by the private economy. Some of that deficit is covered by bank financing, some comes out of other sources. In terms of the principles involved this is really no different from the question of the impact of bank financing of Government deficits.

Representative CURTIS. I must make one comment that we can come back to. This business of relating private financing to Government financing in my judgment is an unsound reference. Private financing puts up collateral either in the way of buildings or equities but Federal financing doesn't.

Dr. HELLER. May I make one comment on the statistics that Mr. Gordon has called to my attention?

In financing the \$12.9 billion deficit of fiscal year 1959, the banks absorbed about \$10 billion of additional short-term securities. This was done without any increase, as you know, in the wholesale price level. We had a stable price level straight through.

Representative CURTIS. I was critical at the time of what we did in 1959 and it was my own administration; we are still paying for it.

Chairman PATMAN. Senator Pell.

Senator PELL. Thank you, Mr. Chairman.

Dr. Heller, just for the record, when you talk about the five quarters in which this growth has occurred, what exact period do we mean from the viewpoint of the calendar?

Dr. HELLER. From the first quarter of 1961 to the second quarter of 1962, I believe.

Senator PELL. You say since the beginning of the current expansion in 1961. Does that mean from February 1 until April 30?

Dr. HELLER. When we are dealing with quarterly figures, we use, in effect, the average for the first 3 months of 1961 compared with figures for the second 3-month period of 1962. That is for quarterly figures. The monthly comparisons are based on February 1961, and run up the latest month for which data are available, usually June of 1962.

Senator PELL. I found it a little confusing trying to discover the exact calendar period you were referring to in which this improvement occurred.

Dr. HELLER. I am sorry. Some data are only available quarterly, some monthly. Of the latter, the latest available data are in some cases for May, some for June, and some for July.

Senator PELL. In other words, our GNP has gone from 500.8 to 552 billion in the period from February 1 to April 30.

Dr. HELLER. No. From the first quarter of 1961 to the second quarter of 1962.

Senator PELL. What would be the calendar dates?

Dr. HELLER. The calendar dates are the average for January, February, and March 1961 and the average for April, May, and June 1962.

Senator PELL. Thank you very much.

Dr. HELLER. We don't have GNP on a monthly basis, only quarterly.

Senator PELL. In line with Senator Bush's question as to whether we have tried a reduction in tax before to ward off a recession or depression, I wonder if this same process has been tried in any foreign countries of which you are aware.

Dr. HELLER. There is a flexible tax authority that is now available to the British Government. They have the authority to vary certain excise tax rates and employment taxes in response to the requirements of economic policy. So far they have used only one of those two, their consumption taxes, and they moved those up last summer in order to cut down the level of demand.

Secondly, the Swedish authorities have an investment credit which is moved up and down. As I recall the operation of that, businesses are given a tax incentive to put a portion of their profits in escrow, so to speak, during boom times. Then, in slack times, they are allowed to use them for investment projects.

So there have been some experiments here and there, but there is no precise parallel to what we are talking about. I might say, however, that the 1954 experience offers some parallel, to be sure, not in the sense of a conscious, antirecessionary tax policy, but the effects are the same. Congress, as I recall, enacted a very quick cut of about \$4 billion in the Korean war taxes. Then, in the longrun "tax overhaul," as it was called, there was added another billion and a half of income tax reduction. In other words, that gives us an experience that is quite relevant, although not in the sense of deliberate congressional action to cut taxes for business cycle reasons.

Senator PELL. If it is decided that a tax cut is a good idea—and I personally agree with Senator Douglas that it would not be right at this moment, although I am most certainly for an income tax cut—what kind of tax cut would you be inclined to consider as the most favorable or advisable? Would you incline to a cut in the lower bracket, or employing the withholding mechanism in which the withholding tax would be suspended for 2½ to 3 months, would you

divide the cut pretty equally between corporations and individuals, or perhaps a straight matter of points across the board?

Dr. HELLER. As I indicated earlier, no decisions have been made. I do think as a general principle, however, if you were attempting to compensate for a short-run deficiency of demand, a good part of your increase would have to go into personal income tax reductions. We have, however, side by side with this a longer run problem of investment stimulus. We have corporate rates—

Senator PELL. Forgive me for interrupting, but isn't the whole purpose of this current discussion to consider the short-run problem?

Dr. HELLER. In talking about tax reduction any time from now on, it is necessary to take into account both the short-run cyclical considerations and the longer run reduction of the drag of taxes on the economy.

Senator PELL. But when thought is given to making a tax reduction in this session of Congress, I was under the impression it should be considered primarily from the short-term viewpoint because the longer term problem will be taken care of in the next Congress in a general bill.

Dr. HELLER. What I am saying is this: Given the background of the projected recommended tax cut for next year side by side with tax reform, it is impossible to discuss any 1962 tax reduction without relating it to what might happen in 1963. I should note, however, that apropos of your general comment on antirecessionary tax cuts, the President's request for standby authority proposed only reductions in individual income tax rates of up to 5 points on an across-the-board basis.

Senator PELL. If an immediate tax cut is approved, what would be your reaction to the idea of the withholding tax device for the reasons: No. 1, that since the lower income groups would get the principal benefit, the money would be more quickly pumped into the national economy by virtue of the fact that this group is more likely to use it to immediately purchase consumer goods. And secondly, by using the withholding device the general public would not be really aware of having received the reduction. They would just have thicker pay envelopes. And when the time comes for the temporary cut to be ended, there would not be such an outcry.

As Congressman Curtis pointed out, that might be balanced by the increase in the social security tax. At the same time when it came time for a permanent reduction you would have a little sugar with which to coat the general tax bill with which we will be presented at that time.

Dr. HELLER. The exact form in which you carry a short-run tax cut into effect is not preordained either by any administration or congressional decisions that have been made. I think this is something where we still have a great deal to learn. I don't think we can necessarily say that any one method is necessarily best in every respect, and I believe the President has made that very clear in inviting Congress to suggest alternative approaches to temporary tax-cutting authority that might be substituted for his request.

Senator PELL. Do you think the idea of suspending withholding for several months would be an effective device?

Dr. HELLER. I think it is one of the devices that deserves consideration. I don't think I can go beyond that comment.

Senator PELL. Thank you.

Chairman PATMAN. I believe you stated, Dr. Heller, that you had a table that would show what the different methods would produce in a tax reduction bill. Will you insert that table in connection with your remarks, please?

Dr. HELLER. Yes, Mr. Chairman.

(The table referred to follows:)

TABLE I.—*Tax liabilities under alternative tax schedules*<sup>1</sup> (revised July 23, 1962)—*Married persons, 2 children*

## KEY

Schedule A: Present law

Schedule B: 3 percentage point reduction in tax rates

Schedule C: Chamber of commerce proposal

Schedule D: \$200 increase in the per capita exemption

Schedule E: 5 percentage point reduction in first bracket only

Schedule F: 12½ percent reduction in tax liabilities

TABLE I-1.—*Tax liabilities under alternative tax schedules—Married persons, 2 children*

Income	Taxable income <sup>1</sup>	Amount of tax in dollars					
		A	B	C	D	E	F
\$1,000.....	0	0	0	0	0	0	0
\$2,000.....	0	0	0	0	0	0	0
\$3,000.....	\$300	\$60	\$51	\$45	0	\$45	\$33
\$4,000.....	1,200	240	204	180	\$80	180	210
\$5,000.....	2,100	420	357	320	200	315	366
\$6,000.....	3,000	600	510	500	440	450	525
\$8,000.....	4,800	975	832	868	800	775	834
\$10,000.....	6,600	1,372	1,174	1,245	1,195	1,172	1,200
\$15,000.....	11,100	2,485	2,153	2,284	2,275	2,285	2,175
\$20,000.....	15,600	3,598	3,232	3,472	3,560	3,600	3,325
\$25,000.....	20,100	4,711	4,115	4,513	5,042	5,115	4,653
\$30,000.....	24,600	5,824	5,118	5,626	6,155	6,228	5,766
\$40,000.....	34,100	7,937	7,031	7,739	8,268	8,441	7,879
\$50,000.....	43,600	10,050	9,024	9,852	10,380	10,653	10,394
\$60,000.....	53,100	12,163	11,137	12,065	12,593	12,866	12,507
\$80,000.....	72,600	16,342	15,316	16,444	16,812	17,180	16,690
\$100,000.....	92,100	20,521	19,495	20,772	21,140	21,508	20,873
\$200,000.....	184,200	41,042	38,990	41,544	42,280	42,816	41,746
\$1,000,000.....	897,000	205,210	194,975	207,720	211,400	215,080	208,735

<sup>1</sup> Assuming deductions equal to 10 percent of income

TABLE I-2.—*Tax liabilities under alternative tax schedules—Married persons, 2 children*

Income	Amount of tax as percent of income					
	A	B	C	D	E	F
\$1,000.....	0	0	0	0	0	0
\$2,000.....	0	0	0	0	0	0
\$3,000.....	2.0	1.7	1.5	0	1.5	1.7
\$4,000.....	6.0	5.1	4.5	2.0	4.5	5.2
\$5,000.....	8.4	7.1	6.4	5.2	6.3	7.4
\$6,000.....	10.0	8.5	8.3	7.3	7.5	8.8
\$8,000.....	12.2	10.4	10.8	10.0	9.7	10.7
\$10,000.....	13.7	11.7	12.5	12.0	11.7	12.0
\$15,000.....	16.6	14.4	15.2	15.2	15.2	14.5
\$20,000.....	19.0	16.7	17.4	17.8	18.0	16.6
\$25,000.....	21.3	18.9	19.3	20.2	20.5	18.6
\$30,000.....	23.0	20.4	20.8	21.1	21.6	20.0
\$40,000.....	27.6	24.1	24.4	24.2	24.5	23.1
\$50,000.....	31.0	27.4	27.8	27.8	28.0	26.5
\$60,000.....	34.4	30.7	30.8	30.8	31.0	29.0
\$80,000.....	41.0	37.4	37.4	37.4	37.4	35.0
\$100,000.....	47.4	44.0	44.0	44.0	44.0	41.5
\$200,000.....	94.4	88.4	88.4	88.4	88.4	86.5
\$1,000,000.....	22.6	21.0	21.5	21.5	21.5	21.0

<sup>1</sup> All 5 tax proposals would reduce total liability by approximately \$6 billion.

TABLE I-3.—*Tax liabilities under alternative tax schedules—Married persons, 2 children*

Income	Amount of tax reduction from present law				
	B	C	D	E	F
\$1,000.....	0	0	0	0	0
\$2,000.....	0	0	0	0	0
\$3,000.....	\$9	\$15	\$80	\$15	\$8
\$4,000.....	36	60	160	60	30
\$5,000.....	63	100	160	105	52
\$6,000.....	90	100	160	150	75
\$8,000.....	144	108	176	200	122
\$10,000.....	198	126	176	200	172
\$15,000.....	333	202	208	200	311
\$20,000.....	468	328	240	200	475
\$25,000.....	603	505	276	200	665
\$50,000.....	1,278	2,054	448	200	1,987
\$100,000.....	2,668	7,364	552	200	5,550
\$500,000.....	13,428	94,596	728	200	44,620
\$1,000,000.....	26,928	211,596	728	200	95,807

TABLE I-4.—*Tax liabilities under alternative tax schedules—Married persons, 2 children*

Income	Tax reduction as percent of income				
	B	C	D	E	F
\$1,000.....	0	0	0	0	0
\$2,000.....	0	0	0	0	0
\$3,000.....	.3	.5	2.0	.5	.3
\$4,000.....	.9	1.5	4.0	1.5	.8
\$5,000.....	1.3	2.0	3.2	2.1	1.0
\$6,000.....	1.6	1.7	2.7	2.5	1.2
\$8,000.....	1.8	1.4	2.2	2.6	1.5
\$10,000.....	2.0	1.3	1.8	2.0	1.7
\$15,000.....	2.2	1.3	1.4	1.3	2.1
\$20,000.....	2.3	1.6	1.2	1.0	2.4
\$25,000.....	2.4	2.0	1.1	.8	2.7
\$50,000.....	2.6	4.1	.9	.4	4.0
\$100,000.....	2.7	7.4	.6	.2	5.6
\$500,000.....	2.7	18.9	.1	0	8.9
\$1,000,000.....	2.7	21.2	.1	0	9.6

TABLE I-5.—*Tax liabilities under alternative tax schedules—Married persons, 2 children*

Income	Tax reduction as percent of disposable income				
	B	C	D	E	F
\$1,000.....	0	0	0	0	0
\$2,000.....	0	0	0	0	0
\$3,000.....	.3	.5	2.0	.5	.3
\$4,000.....	1.0	1.6	4.3	1.6	.8
\$5,000.....	1.4	2.2	3.5	2.3	1.1
\$6,000.....	1.7	1.9	3.0	2.8	1.4
\$8,000.....	2.1	1.5	2.5	2.8	1.7
\$10,000.....	2.3	1.5	2.0	2.3	2.0
\$15,000.....	2.7	1.6	1.7	1.6	2.5
\$20,000.....	2.9	2.0	1.5	1.2	2.9
\$25,000.....	3.1	2.6	1.4	1.0	3.3
\$50,000.....	3.3	6.1	1.3	.6	5.9
\$100,000.....	4.3	13.3	1.0	.4	10.1
\$500,000.....	4.4	68.1	.5	.1	31.2
\$1,000,000.....	11.5	90.6	.3	.1	41.0

Dr. HELLER. If the committee members would like to have copies, I believe we have a supply.

Chairman PATMAN. Thank you.

Senator Douglas?

Senator DOUGLAS. I want to pursue this question of whether it is necessary to increase interest rates in order to protect our gold supply. I think we brought out in previous questioning that the U.S. 3-month bill rate is about nine-tenths of 1 percent higher than the Swiss rate. The Swiss rate has remained steady for a long time. So difference in the interest rate in itself has thus not led to any major movement of funds from the United States to Switzerland. That is true, is it not?

Dr. HELLER. That is right.

Senator DOUGLAS. So far as the Dutch are concerned, the Dutch rate has fallen slightly in the last 2 months—the figure was 2.32 percent for June as compared to an American figure for June of 2.72 roughly. So they were four-tenths of 1 percent underneath the American rate. The West German rate for July was 2.38. The American rate for July was about 2.92. So you have an American rate which was almost six-tenths of 1 percent higher than the German rate. As far as interest rates are concerned, the American rate was thus already higher than in Netherlands and Germany. It was not necessary therefore to raise the American rate still more. The three remaining countries in the Federal Reserve table are France, Canada, and the United Kingdom. I don't have figures for France more recent than April—then it was 3.91.

Let us grant for the moment that the French rate is above the American rate. It is doubtful if there is important movement here as France does not have huge amounts on deposit in this country. So we come down to Canada and the United Kingdom.

Mr. Johnson has prepared some charts that I think are noteworthy. The upper chart (p. 183) shows the comparison of Treasury bill rates. You will notice that the British rate came down very markedly in the past year. The New York rate was rising at the very time that the London rate was falling. There would thus not be any increased strain in this case upon our currency, since the differential between those two actually fell substantially during this time. But to get at the real costs of converting dollars into pounds one must consider also the arbitrage trend. If you add the arbitrage, with forward exchange cover, to the New York rate you will see that, while the differences in favor of London and in favor of New York are small and vary from time to time, at other times recently the London rate is only one-sixth of the 1 percent or less in preference of London over the New York dollar. I think it has been testified that where the difference in net rates is less than one-quarter of 1 percent interest rate considerations do not enter. So if you allow for rates with forward arbitrage cover, there is really no material difference between London and New York.

Then we come to Canada. Here there is a difference in Canada because Canada has been facing a financial crisis. Their short-time rate has shot up very sharply. They are recently up to 5½ percent or more.

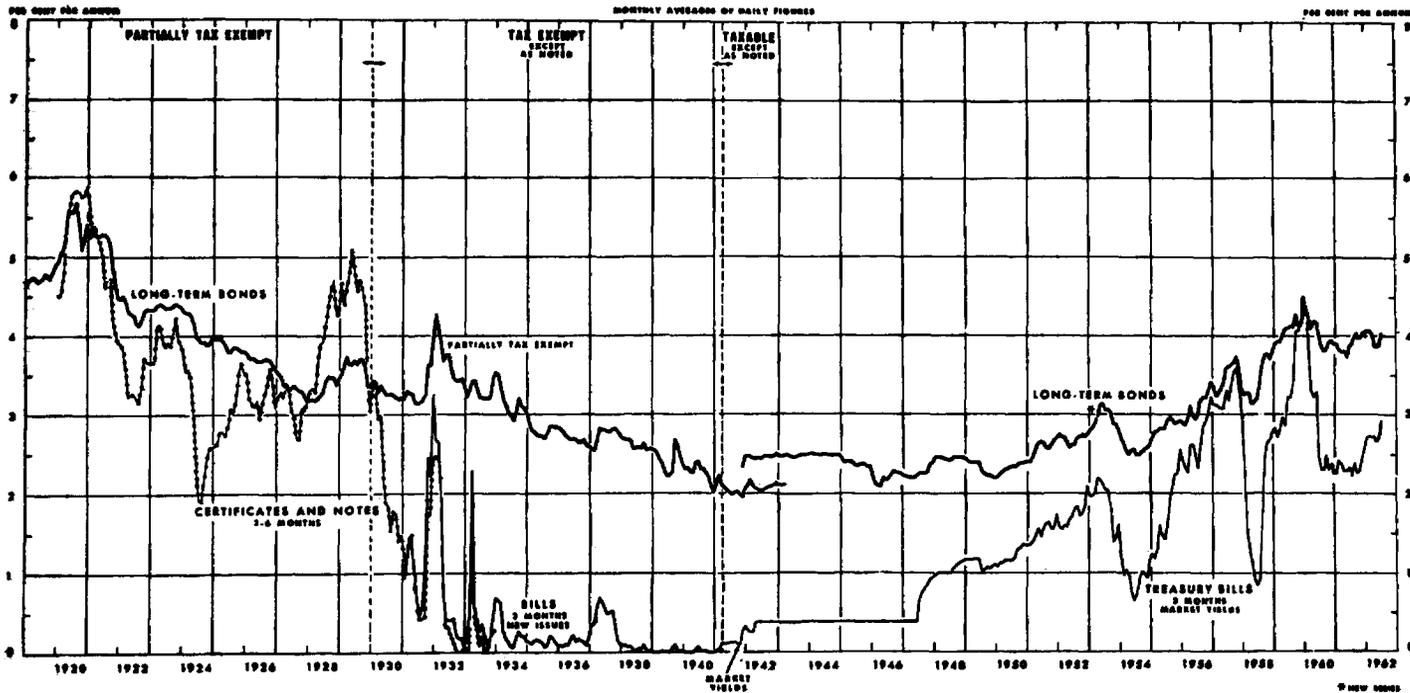
Chairman PATMAN. Would you like to add those charts to the record?

Senator DOUGLAS. Yes, I would.

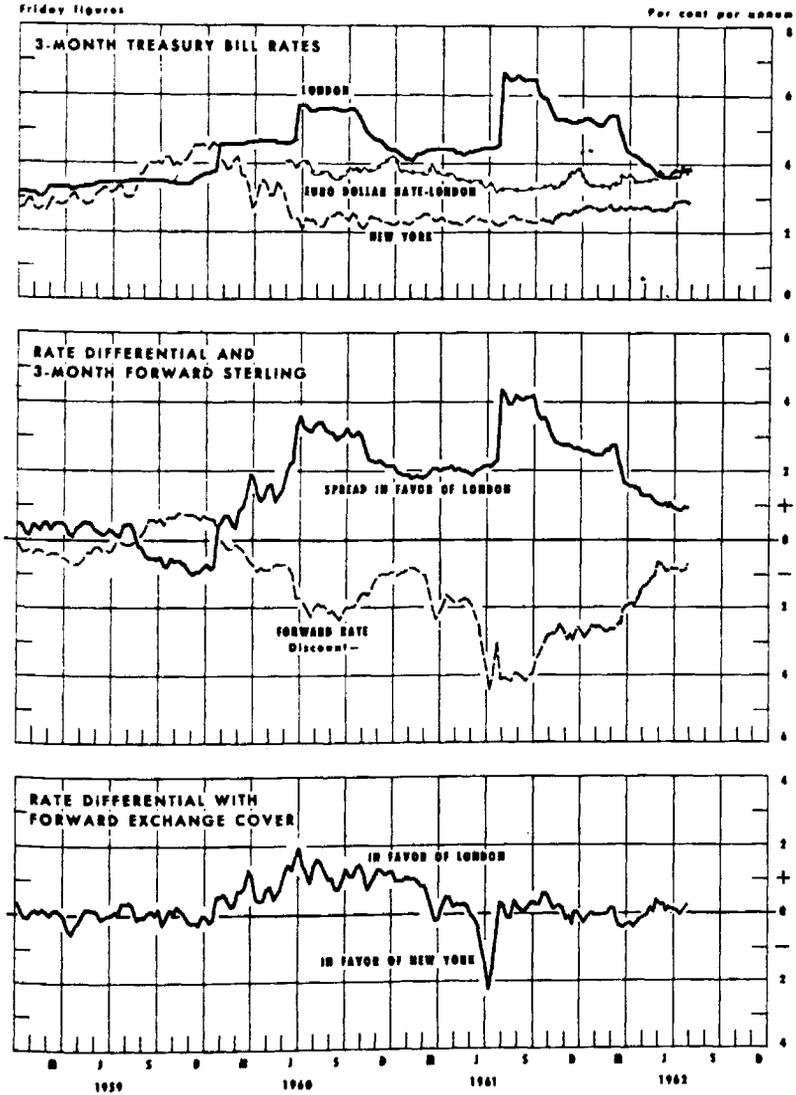
Chairman PATMAN. Without objection, it is so ordered.

(The data referred to follow:)

YIELDS OF U. S. GOVERNMENT SECURITIES



**INTEREST ARBITRAGE, NEW YORK/LONDON**

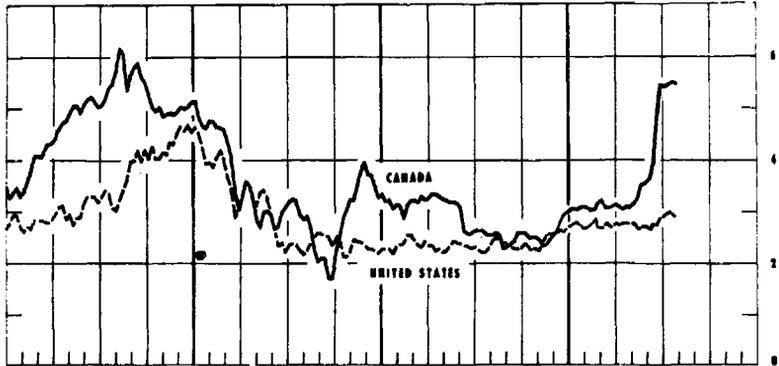


**INTEREST ARBITRAGE, UNITED STATES / CANADA**

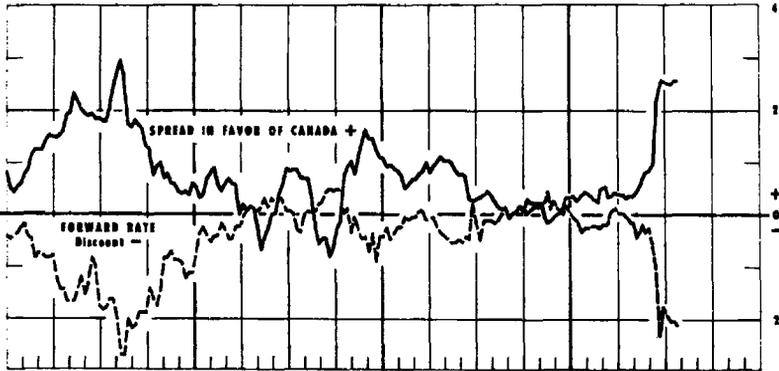
Thursday figures

**THREE-MONTH TREASURY BILL RATES**

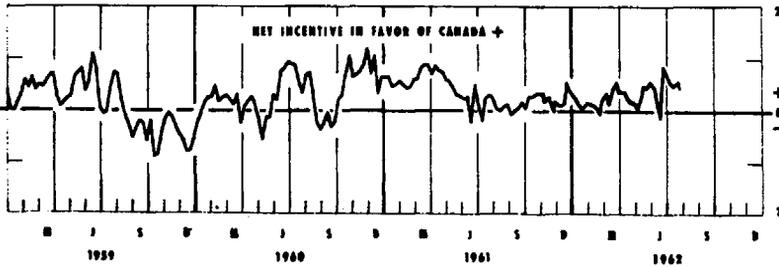
Per cent per annum



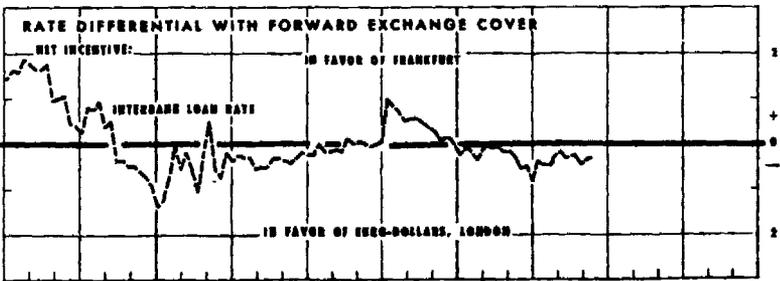
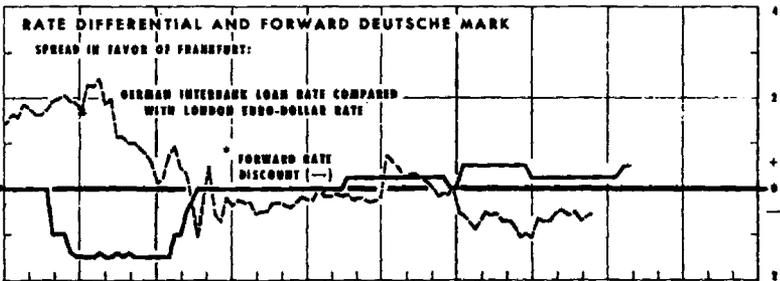
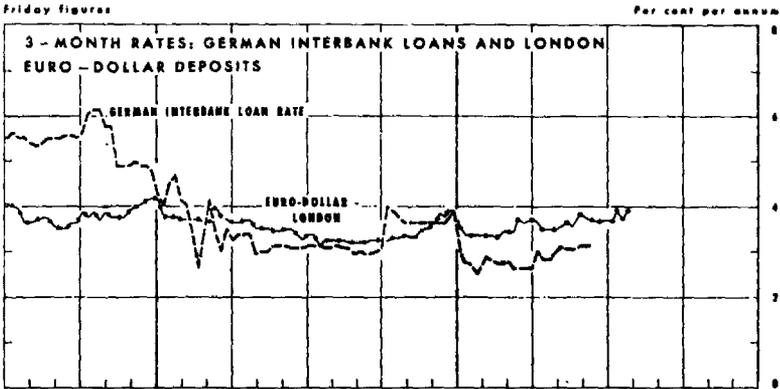
**RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR**



**RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER**



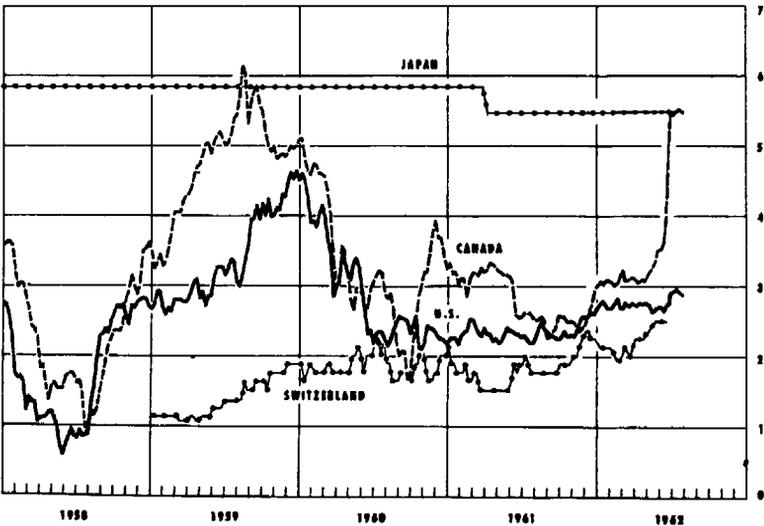
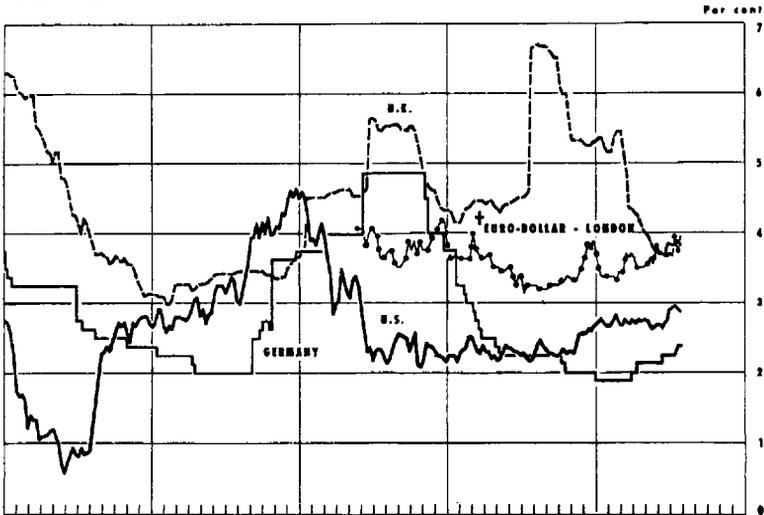
**INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS**



1960 1961 1962

Note: Special forward rate available to German commercial banks.

SHORT-TERM INTEREST RATES \*



\* 3-month treasury bill rate for all countries except Japan (3-month interbank deposit rate) and Switzerland (3-month deposit rate)  
 † 3-month rate for U. S. dollar deposits in London.

Senator DOUGLAS. The point I want to make is that only in the case of the United Kingdom and Canada do you have any real difference in rates. The difference between United Kingdom and United States is accounted for by the arbitrage cost. This does not account for the full difference in the case of Canada. But I can't believe that Canada, with a population of 20 million, subjects the American dollar to such great strain, particularly in view of the highly uncertain financial situation of Canada. Both political parties concealed it during the election but it has come out after the election. I should think with the devaluation of the Canadian dollar down to 92 cents, whereas some time ago it was \$1.05, that people would not be getting Canadian dollars in preference to American dollars. So, very frankly, I am puzzled by the claim that it is necessary to increase the domestic interest rate, both short term and long term, to meet the balance-of-payments problem.

In view of these facts, we know the adverse effect which a higher interest rate has in dampening off business recovery. I hope this will not be regarded as libelous, but I heard a wag say the other day that a good new Chairman of the Federal Reserve Board would be worth a \$10 billion tax cut.

Dr. HELLER. I have heard it said that the Chairman of the Council is worth 50 points on the Dow-Jones.

Senator DOUGLAS. No; I think you are doing a fine job. I have a sneaky feeling that now you have become a Government official you feel an obligation to defend all policies of all branches of the Government.

Dr. HELLER. May I respond to two or three of the points you made?

First, while the points you make are very well taken, and while it is extremely difficult to judge whether the exact degree of tightening that has occurred is really necessary to meet balance-of-payments and gold pressures, it is necessary to take into account that the so-called Euro-dollar market is offering rates of over 3½ percent in Europe and without any exchange risk, is perhaps attracting dollars on that ground.

In other words, these are the dollars that are circulating, so to speak, and used from bank to bank and country to country in Europe, financed in effect with U.S. funds.

Second, the U.S. dollar is at a forward discount against the Dutch guilder, against the Swiss franc, and against the German mark. This may not be a huge factor, but it does mean that U.S. rates have to be slightly higher than you have suggested to prevent a flow of funds.

Senator DOUGLAS. Are Euro-dollars convertible into gold?

Dr. HELLER. Euro-dollars which find their way into the hands of foreign central banks are convertible to gold. They are not convertible to gold in the hands of private individuals at the U.S. Treasury, but they also may cause some problem by being converted to gold in the London gold market. This is only an indirect gold-conversion problem. But we must include it if we are talking about the total withdrawal of funds or the total attraction of funds overseas.

Senator DOUGLAS. So far as the Netherlands, Germany, Switzerland are concerned—countries that are held up to us as the great examples—our interest rates are higher. If they are economical men they would not call their short-term deposits with us and put them on

deposit in Zurich because our interest rates are above those in Switzerland.

Dr. HELLER. We have to consider not only discount rates and bill rates, but also a number of other short-term rates. For example, the local authorities in the United Kingdom surprisingly enough offer 4½ percent on 7-day money. There is a whole range of short-term rates that we have to take account of. I think that is a factor that has to be weighed in making this assessment.

I am not suggesting, Senator Douglas, that the interest rate movements that have occurred are a kind of a categorical imperative in the light of international balance-of-payments considerations. That is a matter of judgment on which we are not prepared to reach any final conclusion here. However, I am prepared to suggest that, particularly at the long end, the increase in rates does not seem to make much of a contribution to the balance-of-payments problem.

Senator DOUGLAS. Do you think there is any relationship between the fact that in May and June, as interest rates started to move up under the policy of the Federal Reserve, business activity started to move down. The Commerce Department publishes its series of business cycle indexes. Congressman Reuss introduced this into the record yesterday. It shows on page 5 that the index turned down in May and June and this is what in the past advocates of the tax cut brought forward. I raise the question whether there is any connection between the fact that durable goods, hours per week, accession rate, and so forth turned down at the time interest rates turned up. Is it possible that the second factor was the cause of the first?

Dr. HELLER. We certainly cannot always know the precise cause-and-effect relationships. But it does seem that some of these things that have happened in recent months have occurred too fast or too soon to be directly related to the monetary tightening that has taken place very recently. The disappointing Commerce-SEC survey of plant and equipment investment plans came in March, well before this recent tightening.

Inventory-sales ratios have been low for some time and cannot be directly related to that. Of course, it is possible that there might be some other results that are directly related to the recent tightening, although I cannot think of any obvious ones.

Chairman PATMAN. Congressman Reuss, you may proceed, sir.

Representative REUSS. Dr. Heller, you have been defending the Federal Reserve for some time now. I am going to ask you to defend the State Department for a while. In your statement you pointed out that the proposed Trade Expansion Act could, by expanding our exports, not only help us from the standpoint of our balance of payments but increase the demand for the output of our farms and factories. I agree that it has that potential, and I am one of those who think that it is a very important potential.

I want to ask, however, a question about it. Because my question necessarily is somewhat long, I wrote up the main points of the question and handed you a copy of it earlier. It reads as follows:

Bearing in mind the following:

1. There is not in sight today any stimulant to demand comparable to automobiles in the 1920's or homes and appliances in the early 1950's.

2. Western Europe, on the other hand, has a large pent-up demand for all sorts of household appliances—washers, driers, dishwashers—a potential \$6 billion annual market, of which the United States could well aim at a \$2 billion share.

3. Western Europe, with its over-full employment, is unlikely to be able to satisfy its domestic demand for consumer durable goods by its own production in the years immediately ahead. The United States has ample existing plant capacity.

4. A massive U.S. entry into the European market as soon as possible would help diminish U.S. unemployment, and accelerate our growth rate. Reciprocal tariff reductions which would make this possible would also reduce or eliminate our payments deficits, since the probability for the short-term is that our trade surplus with Western Europe would increase.

5. From the European standpoint, accepting larger U.S. exports would enable European employers to grant wage increases without severe inflationary consequences, thus helping to bring United States and European wages more closely into line as well as improving the European standard of living.

6. The biggest single obstacle to our entering this vast export market is the high tariff wall—20 percent or more—of the Common Market and of other European countries on these household appliances.

7. The special bargaining authority of the Trade Expansion Act to permit the tariffs to be reduced to zero on commodities for which the United States and the Common Market account for 80 percent of world trade is now largely meaningless since aircraft is the only major category affected, until and unless the United Kingdom and other EFTA countries join the Common Market. A current guess is that the United Kingdom is unlikely to become a member of the Common Market until at least 1964.

8. If the Trade Expansion Act were amended so that we had the power to bargain European tariffs down to zero, independently of the United Kingdom's joining the Common Market, we could start vigorous bargaining immediately, with active negotiations to start in 6 months. This would provide no incentive for the United Kingdom to refrain from joining the Common Market, since its own independent tariffs would have to be reduced.

Why does not the administration recognize the realities of the situation, amend the Trade Expansion Act, and move vigorously for lower tariffs to help us and the free world?

**DR. HELLER.** Mr. Reuss, may I make just one general comment and then turn this question over to Mr. Gordon, who has been working with the State Department, the White House staff, and the Commerce Department in the general area of the Trade Expansion Act?

I hope your question does not imply that the American consumer is not a pretty ingenious fellow. We have certainly found over the years that when additional income is put into the hand of consumers, they are quite capable of finding ways and means of putting it to good use to the tune of 92 to 94 percent of their incomes, year in and year out.

I believe what you are stressing, however, is that there is apparent on the horizon no big, new, durable goods to take the lead in expansion; and you are suggesting that we do everything possible to exploit

the expanding European market in this area. I want to say that we surely agree with that objective and then ask Mr. Gordon to comment on the specific proposal.

Representative REUSS. And to comment on your comment before we hear Mr. Gordon, I agree with you about the propensity to spend of the American consumer. However, in order to have that 92 percent propensity to spend applied to a higher income total, you have to give a tax cut or otherwise increase income, which in the immediate period ahead would increase the deficit.

I am looking, as you are, for additional and auxiliary or substitute methods which would stimulate the economy without increasing the deficit.

Dr. HELLER. I think that clarifies any possible misunderstanding on that point.

Mr. GORDON. Mr. Reuss, this is my first exposure to this proposal. I think it is a very bold and stimulating idea which I presume has been discussed with the State Department. I didn't know that.

Representative REUSS. The State Department's position is that the United Kingdom's entry into the Common Market is so desperately important we should do anything, including cutting our own economic throat, to help force the issue. I don't see their logic. I wonder what you think of their economics.

Dr. HELLER. That was not a direct quotation from the State Department?

Representative REUSS. No, it was an embroidery, but I defy you to produce from them any justification much different from what I have just said.

Mr. GORDON. On the economics of the matter, I must say I would agree virtually completely with your premises. I think there unquestionably is a very substantial potential market for consumer durable goods in Western Europe. I think that the effect of this kind of action might well be attractive to European countries as a means of reducing inflationary pressures which some of them are now having considerable difficulty with. It would obviously have very beneficial effects for our balance of payments. So in the quite narrow economic analysis of the proposal, I must say it strikes me as very attractive.

But it is clearly a proposal which has dimensions that go beyond the narrow economics. I think it is on this score that I would want to be somewhat reticent. As all of us know, the United Kingdom and the Common Market are presently engaged in negotiations. These negotiations apparently have reached a very delicate state. I would think that it might be argued, although I haven't had an opportunity to think it through, that a proposal of this kind at this stage would constitute a very disturbing element in the present delicate state of these negotiations.

But if I can separate the appraisal of the economic effects from the political-diplomatic effects, I would certainly say that on economic grounds it is most attractive.

Representative REUSS. Thank you for your answer. I will ask just one more question on it. Don't you think that looking at the opportunities available to us to achieve our economic goals of maximum employment, maximum growth and expansion of our exports so as to improve our balance of payments, this is one of the more promising opportunities that presents itself?

Mr. GORDON. I think it is very promising, with one qualification with which I am sure you would agree. I think it would be a mistake to think that measures of this kind would have a very significant effect on the U.S. economy in the short run. Negotiations of the sort you propose—multilateral negotiations, quite complex international negotiations—invariably take a considerable period of time to complete. So I think we ought to be realistic to expect that such negotiations, if we decide to enter them, would not have visible economic effects in the near future.

Representative REUSS. It is equally true, is it not, that the sooner you equip yourself to start negotiations, the sooner you complete them?

Mr. GORDON. Yes.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. The main thing I want to do, Dr. Heller, now that we have indicated that we are not wildly enthusiastic about the higher interest rates, I would like to relate that to the possibility of a tax cut.

You indicate in your statement that taxes and savings would be drawing \$14 or \$15 billion too much, from the economy which would have to be offset by additional investment and Government expenditures for full employment to be attained.

I presume this \$14 to \$15 billion indicates that a substantial tax cut would be necessary in order to correct this situation, but I presume it would be somewhat less than \$14 to \$15 billion, is that correct?

Dr. HELLER. Yes, it is, Senator. We would have to take into account not only the initial impact of the tax cut itself, but the multiplied effects, and the impact on inventory investment, and on investment in plant and equipment and in housing. So these numbers were not meant to suggest in any way, shape, or manner the size of any tax cut.

Senator PROXMIRE. Let me ask you about that multiplier. I won't say you have been quoted, but people have said that the economists on the Council of Economic Advisers indicate one specific multiplier; others say others. I understand from some competent economists that a tax cut of \$10 billion would mean an increase in the GNP of \$20 billion. Others say \$25 billion. Would you have a rough estimate?

Dr. HELLER. It is extremely difficult to tie oneself down to a specific estimate in the absence of test-tube evidence. As was pointed out earlier, a tax cut would show up primarily as an increase in disposable income, quite undifferentiated from any other source of increase in income. In other words, it would not appear to most people as a special kind of income, labeled "Cut in Tax Liabilities." For the most part, it would simply show up as an increase in take-home pay. That touches off spending and re-spending.

Senator PROXMIRE. I understand the multiplier and I certainly agree.

Dr. HELLER. I am trying to get to a rough approximation of the magnitude, without suggesting that we are tied to any specific multiplier figure. Very conservatively estimated, the multiplier effect as such might be one and a half to two times the initial tax cut when it works through the spending stream and on into an increase in GNP.

Depending in part on the level of economic activity relative to capacity, there would be further magnification of the original figure,

through the impact which the higher levels of consumption may have on investment in inventories and plant and equipment. Depending on the conditions in the economy and a number of variables that are terribly hard to tie down, that would increase the total impact from  $1\frac{1}{2}$  or 2 to  $2\frac{1}{2}$  or 3 times the size of the initial tax cut—and under very favorable circumstances, even more. It depends in large part on conditions that exist at the particular moment the tax cut is made, and in what direction you are moving—that is, whether the economy is expanding, leveling off, or declining.

Senator PROXMIRE. It would vary on the kind of tax cut. For example, if you had an increase in exemptions or if you had further modification of depreciation or investment credit, would these have varying impacts in your judgment on the multiplier? If so, what kind of tax cut would have the greatest multiplier and which the least?

Dr. HELLER. It makes some difference, certainly. But we must not exaggerate its amount. We know that, on the average, persons in low-income brackets spend their entire incomes, while in the highest brackets they save as much of their incomes as they spend. But some studies suggest that the amount spent of an additional dollar of income is not nearly so different across the range of incomes, or at least across the brackets that really account for the bulk of taxable incomes.

Senator PROXMIRE. But I think almost all of the proposals we have here, with maybe a couple of exceptions, there would be a much bigger dollar tax cut with a bigger income.

I was going to say if you have a person with a \$5,000 income and you have a \$4 billion tax cut for individuals, as I calculate it, he would get about a \$2 week increase in income or something in that area; whereas a person with a \$50,000 income would have a somewhat larger dollar benefit.

Under these circumstances, while the dollar differences might be somewhat the same, if you had the same dollar tax cut, you wouldn't have it. Therefore, the difference in spending would be quite marked. You see, I am trying to get at two things, frankly, and my time is limited, so I am going to have to cut short.

The first thing I am getting at is that I am wondering even if a big tax cut of \$6 or \$7 or even \$10 billion is going to give consumers the kind of money in their pocket that is going to result in their buying a house or car or buying anything of that kind. That is No. 1.

No. 2, which is somewhat unrelated but which is the whole point of what the chairman and Senator Douglas and Congressman Reuss and I have been arguing, if you do have a tax cut coupled with higher interest rates, is it not true you will have to have a much bigger tax cut to accomplish the same stimulation of the economy? Isn't it true that, whereas you might be able to achieve what you say you need to achieve on page 10 with a \$7 billion or \$8 billion tax cut, and the multiplier you have described, that if you have an increase in interest rates of the kind we have been reading about overwhelmingly in the news papers, and it seems to be in the cards on the basis of the Federal Reserve and Treasury policy, that you will need a 50-percent higher tax cut or maybe a 100-percent higher tax cut to achieve the same degree of stimulation?

Dr. HELLER. Let me answer the second question first, because I think we can dispose of that very quickly. It is perfectly true that if you

had a tax cut and then proceeded to shrink private spending by the same amount by monetary policy, you would simply nullify the tax cut.

Senator PROXMIRE. That is very important. If you have a tax cut and if you sell bonds to the public to absorb all of the increase in monetary supply or the increase in funds that results from a tax cut, you say you would eliminate much of the effect of the tax cut.

Dr. HELLER. I think it is somewhat more complicated than that. If you sell bonds to the public, you will be in part activating idle funds, so that this would not go all the way to offset the effects of the tax cut. The proposition I was stating was one in which the method of financing would increase interest rates so much as to cut back the amount of private spending by the full amount of the tax cut. Then you would nullify the tax cut. But this would be extremely hard to do and would require a highly restrictive monetary policy—one that actually reduced the money supply severely. Of course, it is true that for any given stimulus to the national product, the size of a tax cut would have to be greater the tighter the monetary policy. That is just arithmetical, and I am only too happy to underscore that arithmetical fact.

Going back to the first question, concerning the impact of a tax cut. If we look at this hypothetical set of figures that we put together for a \$6 billion cut in individual tax liabilities—

Senator PROXMIRE. May I just interrupt to put something in the record? I want to put in the record here, Chairman Martin's reply to Chairman Patman on this very question when Chairman Patman asked him what we ought to do to stimulate the economy with a large deficit. Martin said:

I will return to the simple statement I made earlier. In the event a decision is made which widens or further deepens the deficit we are already running, I want to put the Federal Reserve specifically on record this morning, if I have not already, that I think we must not finance the deficit by bank created funds. It should be financed by bona fide savings and not by writing up the funds on one or the other side of the bank's ledger. It would mean that the expansionary effect of the tax cut would be enormously reduced.

Is my observation roughly correct?

Dr. HELLER. As against other methods of financing that would activate bank funds and increase the money supply, there is not any question that this approach would be more restrictive, and would require a larger tax cut for any given result in employment and production.

I believe, as Congressman Curtis mentioned earlier, that this is an area that requires a great deal of additional attention, partly because we don't know all the facts and partly because there is much misunderstanding and misuse of such terms as "real" saving, bank and non-bank funds, activating idle funds, and so forth.

I would hope that our Council and this committee and others would continue to discuss this problem, because it is one of the critical areas of economic policy.

Chairman PATMAN. Will you yield for a brief observation?

Senator PROXMIRE. Yes.

Chairman PATMAN. You are emphasizing bringing out of hiding some idle funds. Don't you think that the amount of such funds would be so small and so insignificant that they would not be a significant factor in our analysis of the monetary problem?

Dr. HELLER. I am not in a very good position to judge that. I would hate to make a quantitative answer to something for which I don't have the underlying evidences before me.

Representative CURRIS. You said liquidity was low. That would indicate not so much idle funds, would it not?

Dr. HELLER. The extent of liquidity in the economy cannot be measured entirely in terms of the money supply, as conventionally defined.

Senator PROXMIRE. At any rate it would drive up interest rates, and in doing so, tend to reduce the accelerator principle?

Dr. HELLER. It would drive up interest rates. It would reduce the attractiveness of holding inventories and making plant and equipment investment.

Senator PROXMIRE. And the attractiveness of buying a house?

Dr. HELLER. Yes, sir; in the long term, there is no question about it. I would like now to come back for a moment to that earlier question about the stimulating effects of a tax cut, leaving aside monetary policy. The amounts that are involved in table I-3, if you have it in front of you, are really not inconsequential. Take, for example, plan B, which is a 3 percentage point reduction in tax rates.

Senator PROXMIRE. This is on an annual basis?

Dr. HELLER. These are on an annual basis. Either plan B or plan C which is the chamber of commerce proposal, or plan D, which is the \$200 increase in the per capita exemption—all involve some very appreciable tax savings. The fact that they might be distributed in small amounts from week to week doesn't mean they will not have a stimulative effect. They don't have to go into houses, TV sets, and so forth, to have an expansionary effect on the economy.

Finally, apropos of the distributional point, it is interesting that a one point across-the-board cut, as indicated in schedule B costs about \$2 billion of revenue.

Senator PROXMIRE. For \$5,000 income that would be a \$21-a-year tax cut and \$63 for a 3-point cut.

Dr. HELLER. That is right. For \$1.3 billion of each \$2 billion of the across-the-board cut would go to the first bracket. Most of the rest would go to the next few brackets. So that even if you had an across-the-board cut, the great bulk of the tax reduction would go to the first bracket—\$1.3 out of each \$2 billion—and the bulk of the remainder to the next few brackets above the first bracket. I think this is an important factor.

Senator PROXMIRE. Mr. Gallup has conducted some studies and there have been some other studies conducted. The Wall Street Journal had a survey, indicating that the people would not be inclined to spend the increased income received from the tax cut. While the propensity to spend is 92 to 94 percent of income, I wonder if there were not a psychologically adverse effect particularly if there was as much opposition as there is now to the tax cut. People might say this is a forerunner of trouble.

Dr. HELLER. This gets one again into the psychological realm as you suggest.

Past history does not support the results of Mr. Gallup's survey. I think Mr. Katona would have told you this morning that what people say they are going to do with an increase in income, particularly when they are full of good intentions about saving, is not very closely

related to what they actually do with their increase in income when they get it. They are much more likely to spend it than they intended.

Senator PROXMIRE. He indicated that, but certainly the record of past tax cuts is not very reassuring. The tax cut we had in 1926 was followed by a recession. In 1929 we know what happened after the tax cut. That was a major tax cut. We had the worst depression in history. The tax cut in 1948 was followed by a recession. It is true in 1954 and some other tax cuts were followed by an improvement in business conditions. There certainly is not anything automatic in the tax cut itself which can assure us that we will have an expansion in business as a result of the tax cut.

I would say that on the basis of having had 9 years out of the past 40 in which we have had tax cuts and in 3 of those years we had a drop in business conditions and in some of those other years the effects were at best mixed, that is, business was improving anyway, I can't see that we have very good empirical evidence that a tax cut is going to be our solution.

Dr. HELLER. I think we have very good empirical evidence that additions to income result in higher spending and higher investment.

Senator PROXMIRE. Those tax cuts were additions to income.

Dr. HELLER. It doesn't matter whether it comes from a tax reduction or other sources.

Senator PROXMIRE. Do we have any study that indicates what happens when you cut taxes and increase interest rates which seems to be the plan? I know it is not your plan.

Dr. HELLER. If that is the plan, I am not privy to it.

I don't think we have any direct evidence on this point, although it would be interesting to check the 1954 experience when there was a very good economic expansion and a very quick restoration of Federal revenues after a \$7½ billion tax cut. This occurred in a period when monetary ease ruled for quite some time, before tightening occurred in the later phases of expansion.

Senator PROXMIRE. Certainly in 1954, wouldn't you agree, that the impact of the Korean war, although as in all our wars, with a great increase in Government expenditure, with the increase in the size of the Armed Forces, all that kind of thing, pent-up wartime demand of various kinds had a more serious impact perhaps than the tax reductions did?

Furthermore, there was a particular business investment gimmick there, a change in depreciation policies, that resulted in a great deal of the expansion being concentrated in investment by business plant and equipment.

Dr. HELLER. In the early part of that recovery investment was not so much the initiating force. The investment surge developed later, particularly in the 1955-57 period. There was about \$3 billion of individual income tax reduction at the beginning of 1954 and another \$1 billion reduction of excise taxes, and then the \$1.4 billion reductions from the overhaul of the income tax. The efforts of the latter were concentrated mainly on business, and perhaps primarily affected business investment. But overall the larger part of it, or at least half of it, was devoted to a reduction of income and excise taxes on consumers.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman PATMAN. We have had you gentlemen here about 3½ hours. That is quite a long time. I wonder if you would not be willing to answer any questions we might submit to you, Dr. Heller, if we get them to you in writing before you correct your transcript? Would you be willing to answer them in connection with the examination and correction of your transcript?

Dr. HELLER. We would be happy to do our best on that score, Mr. Chairman.

Chairman PATMAN. You may submit anything that you think is germane or material.

Chairman PATMAN. Before closing, I think Congressman Curtis has a question.

Representative CURTIS. I have one question. I will have some others. On the questioning of Senator Proxmire on the 1954 cut, I think we are leaving out some factors. There was a \$10 billion and more cut in Federal expenditures.

Dr. HELLER. Which preceded the tax reduction.

Representative CURTIS. Yes, but it occurred right at the time. That was the basis on which we felt we could cut back in Federal revenue because it was not deficit financing that we were engaged in at the time. I was on the committee in writing it. We had the dividend credit there which took a great deal of the release of money and that was certainly in the investment area.

In the consumer area, as far as the income tax cutting was concerned, which was increasing the exemption from \$500 to \$600, we at the same time increased the social security tax, as I was pointing out this morning, which took about a million out of the economy.

Dr. HELLER. Yes, that is a point.

Representative CURTIS. And almost equalized in the consumer area. I think if we examined into it, the only way that would have affected the consumer would have been below the billion dollar figure.

Chairman PATMAN. Thank you, gentlemen, very much. We will submit the questions to you.

Thursday morning we have Mr. Otto Eckstein, professor of economics, Harvard University; Mr. McCracken of the University of Michigan; Mr. Pechman of the Brookings Institution.

Without objection, the committee will stand in recess until 10 o'clock here in this room, tomorrow morning.

(Whereupon, at 5:35 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, August 9, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

THURSDAY, AUGUST 9, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, of the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, and Thomas B. Curtis; Senators Douglas, Proxmire, Bush, and Javits.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will come to order.

The committee continues hearings on the state of the economy and on improvements in policies to help achieve maximum employment, production and purchasing power.

This morning we will consider fiscal policies in general and tax policies in particular.

We have a very distinguished panel of experts on this subject, all of whom are old friends of the committee. Prof. Otto Eckstein, Harvard University; Prof. Paul W. McCracken, University of Michigan; Dr. Joseph Pechman, director of economic studies, of the Brookings Institution. It is delightful to have you, gentlemen.

Each of the panelists may make an opening statement if he has one, and then members of the committee will put questions to the panel under the 10-minute rule.

Dr. Otto Eckstein, you may proceed in your own way. You have a prepared statement, I believe.

## STATEMENT OF OTTO ECKSTEIN, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. ECKSTEIN. Thank you, Mr. Chairman. It is a pleasure to be back with the committee.

If the reports of usually well-informed reporters are correct, the prospect of a tax cut this year is fading. As has occurred repeatedly through the postwar period, the President and the Congress seem to lean to the view that a tax cut is either not necessary, or that the decision can wait a few more months, until short-term economic indicators cease to be mixed.

The decision has now waited for over 4 years. In the meantime, we have progressively lowered our sights about the performance of our economy, satisfying ourselves with higher rates of unemployment, talking bravely about growth, but, in fact, accepting a rate of expan-

sion which is clearly below the normal rate which the ordinary increase in the labor force and in the stock of capital would produce.

I believe I can best serve this committee and the formation of economic policy by talking about three things today. First, I shall report on some statistical analyses conducted in collaboration with Professor Duesenberry of my department and Professor Lintner of the Harvard Graduate School of Business Administration, about the general economic outlook and the effects of tax cuts.

Second, I shall analyze some of the reasons for our hesitancy to act, and finally I shall give a few preliminary ideas which may be of relevance early in 1963 when we shall face the tax-cut problem again.

#### PROJECTIONS

Two projections were prepared, not as forecasts but to provide a realistic setting for the evaluation of a tax cut. We projected movements of the gross national product to the middle of 1963 on two assumptions. One, an optimistic set, under which business spends as much for investment in plant and equipment as it said it would spend before the stock market declined; residential construction continues to rise substantially to a rate of \$25 billion a year and then remains at that level; net exports remain high; the increase in the outlays of State and local governments continues at the upper end of the rates of increase of recent years; and the Federal Government spends as much on goods and services as it announced in the recent budget.

If all of these optimistic assumptions come true, an unlikely combination of events, gross national product might reach a level of \$580 billion by the second quarter of 1963.

We also prepared a set of projections making restrained pessimistic assumptions. In this set we assume that fixed investment by business would begin to decline slightly after the middle of this year, and continue to decline at a moderate rate to the middle of 1963; residential construction maintains current levels; net exports fall slightly; State and local governments increase outlays at a high rate but not quite as high as under the optimistic set, and the Federal Government again sticks pretty closely to its announced plans.

This set of projections gives a gross national product of about \$547 billion by the middle of 1963, which is slightly below the current level.

To gain some perspective on these figures, it is useful to estimate that rates of unemployment that are likely to be associated with them. Even the optimistic projection produces no significant improvement in the unemployment rate below its current high level. Under the projection of restrained pessimism, unemployment rises above 7 percent by the middle of 1963.

To see what difference a tax cut would make, we assumed that personal taxes would be cut \$4 billion and business taxes on the order of \$2 billion or so, enough to raise business investment by \$1 billion. By comparing the resultant GNP figures with the above projections, the net impact of a tax cut was estimated.

We find that this \$6 billion tax cut leads to an increase in GNP by the middle of 1963 of about \$12 billion. If the tax cut is added to the optimistic projections, GNP might reach \$592 billion. When added

to the pessimistic projects, it results in a GNP of about \$560 billion. Thus, what we call the multiplier of the tax cut is about 2.

It may also be of interest that of the \$6 billion initial tax cut, something like a third to a half would be recovered through the higher tax yields of improved economic activity. Let me add that we did not suggest that a \$6 billion tax cut was the right amount. Larger tax cuts would have larger effects, of course, but we see no immediate reason to expect the resultant impact on the economy to be greater in a more than a proportionate manner. Thus, a \$10 billion tax cut might improve GNP by about \$20 billion, a \$4 billion tax cut by \$8 billion.

What do tax cuts do to unemployment? The \$6 billion tax cut would lower the rate of unemployment by about 0.6 percent, or 400,000 persons. The improvement in employment would be greater as the labor force returns closer to its normal rate of expansion.

The single most interesting fact about these figures is this: even if the optimistic assumptions come true, that is, if the present supposedly "mixed bag of signals" resolves itself on the side of optimism, a tax cut would still be appropriate, since there is virtually no prospect of a real improvement in the unemployment situation.

If the tax cut were enacted, even under these circumstances, the resultant rate of unemployment would still be above 4.5 percent, and therefore short of full employment. Thus, a tax cut would not be a mistake even if the optimists were correct and things turned out just as well as one could reasonably hope for. The risks of policy, therefore, are not being run with regard to inflation, but recession and depression. For if things really go sour after this lengthy period of under-utilization of capacity and high unemployment and after the large decline in the stock market, no one can foresee just how the decline will occur and when and where it will stop. The prudent action, therefore, is a tax cut.

#### REASONS FOR INACTION

The diagnosis I have just presented is now held very widely both by economists and by business and labor leaders. It would take someone with a lot more understanding of the political process than I possess to explain the present dim outlook for action in the face of this agreement. Let me discuss a few of the more economic points, however.

First, we are much too preoccupied with the ups and downs of recessions and expansions, and have lost sight of the longer-term trend of the economy in the process. It is indeed a fascinating sport to collect the straws in the wind every week about the immediate direction of movement of the economy.

In fact, however, the business cycle per se has become extremely mild. Inventory movements, as the recent studies prepared for this committee showed, are a large part of the quick ups and downs of recession. As the economy has become more slack and supplies abundant, business has gotten more and more cautious in its inventory policies. The inventory movement of the 1960-61 recession was substantially smaller than in the 1958 recession. Inventory buying during the present expansion was even more hand-to-mouth. Policies for fixed investment have also become more cautious and based on low assumptions of economic growth. These factors make recessions mild,

though one must mention on the other side that the stock market crash is a new factor which may worsen the process of decline when it next occurs.

This mildness of recession militates against the use of fiscal policy. Decisions to pursue an expansionary fiscal policy have only come long after the signs of recession were clear, that is, when the inventory decumulation was fully underway and most statistics were declining sharply. A mild recession, even starting from a low point, does not produce unambiguous short-run indicators. Only a sharp recession does that.

What is important about the present situation is not the direction of movement in any particular week, but the long-term output in relation to the capacity of the economy. Our concern about the direction of movement has distracted us from the longer term deterioration of continued high unemployment and slow growth of the labor force, of low utilization of capital and squeezed profit margins, and of diminishing job opportunities in the face of a rapidly increasing number of young people entering the working age brackets.

If we devoted as much attention to the measurement of the actual trends of the economy as compared to the potential trends as we do to the identification of business-cycle turning points, our fiscal policy might be different.

Let me add I just received in the mail this committee's study of measurement of productive capacity, and I hope this marks a turning point in our focus of attention.

#### BUDGET BALANCING

Fear of deficits and the desire for an annually balanced budget is another major factor. This is not the place to rehearse all the pros and cons of the balanced budget, but let me point out two salient facts: first, if we really attempted to achieve an annually balanced budget in a deteriorating economic situation, it would plunge the country into depression.. Attempts to balance the budget by raising tax rates and cutting expenditures in the thirties were important contributory causes to the magnitude of that disaster.

Second, the only valid reason for favoring an annually balanced budget is the pressure which this principle puts on the President and the Congress to resist the many pressure groups that always want the Government to spend more money. That argument is clearly irrelevant in the present context.

If there is objection to a high volume of spending, a tax cut is much more likely to place a check on expenditures growth than stumbling into recession. A reduction in tax rates will force the Government to scrutinize expenditures more closely in the coming budget, while a recession, if recent history is any guide, will lead to a series of hasty new expenditure programs.

#### LINKING THE TAX CUT TO AN IMMEDIATE EXPENDITURE CUT

Recently, the idea has been advanced that a tax cut should not be enacted unless expenditures are cut at the same time. As a point of political strategy, of using this opportunity to insist on expenditure reduction, it is not a point for me to judge. But when the same

point is offered by economists as policy advice, it must be judged on economic grounds. I do not doubt for a moment that the United States would be better off if certain lines of Government expenditures were substantially cut. I am also certain that my list would not be somebody else's list. We all have our own preferences about Government expenditures. But I fail to see any logical connection between the desirability of a tax cut which would permit business and consumer demand in the economy to grow in line with potential supply, and the necessity of reduction of Government expenditure programs as a precondition.

I cannot see why a sound tax policy has to await reform of the agriculture program, of veterans' benefits, of urban renewal, of welfare programs, of subsidiaries of business, of defense, or space, or foreign aid, or whatever programs are in the minds of the economists advocating this view. As a matter of general economic policy, the argument is clearly upside down. If expenditures were really cut—even foolish expenditures—this would be a reduction in purchasing power which would have to be offset by further tax cuts. The deficit that would be associated with a policy of joint expenditure and tax reduction would have to be larger than a deficit from a tax cut alone to achieve any given degree of improvement in output and employment.

#### RELATION TO MONETARY POLICY

Concern has also been expressed that the additional deficit which would result from a tax cut would force up interest rates, which might defeat the purpose of the tax cut. No doubt, a few more billions of deficit that have to be financed by borrowing will add to the demand for funds, and other things being equal, would have some impact on interest rates.

However, I do not believe that this increase in the deficit would in fact be decisive about the trends of interest rates in the coming months. I would not judge the situation heavily on the experience of 1958 and 1959 when a record cash deficit was financed while the money supply shrank, and when interest rates did, of course, reach record levels.

This time, the deficit presumably would be smaller and the money supply would be allowed to increase at some modest rate. Of course, the authorities will have to pass a judgment on the appropriate monetary policy in the coming year and on the methods of financing the deficit. But it is my belief that these decisions will be less influenced by the increment in the deficit that can be attributed to the tax cut than by our international monetary position weighed against the volume of unemployment.

#### TAX POLICY IN 1963

Let us begin to look ahead to the next moment of decision early in 1963, when, presumably, some tax cut will be made in connection with tax reform. It is now much too early to reach definitive conclusions about proper policy at that date; however, a few simple ideas might prove useful. First, the tax changes at that time must deal both with long-run and with short-run problems.

On the one hand, if economic growth really is a serious objective of policy, the tax system should be further changed in a manner designed to raise the fraction of our gross national product which is invested. On the other hand, consumer purchasing power must also be stimulated. In practical terms, this means that the tax cut must somehow be divided between reduction of upper bracket rates of personal and of business taxes and reduction in the lower bracket personal taxes.

We have already had a liberalization of depreciation allowances which will save business about \$2 billion a year. The investment credit which may be enacted in this session would add at least another billion-plus to business tax relief.

Thus, these two measures alone would reduce corporation income tax payments by \$3 to \$4 billion, thereby increasing the supply of investible funds. If further substantial relief is given in business taxation, while at the same time lack of growth of consumer purchasing power keeps the demand for final products relatively low, there is little chance that the additional savings being made available will in fact be invested.

Thus, a tax cut which only adds to savings may very well do more harm than good in dealing with the central economic problem of our day, which is the short fall of demand below potential supply. On the other side, increased international competition and the need for high long-term growth to meet our obligations requires us to take some additional steps toward raising the fraction of GNP which is invested.

The Congress would be well advised to take with a large grain of salt any advice which would confine the emphasis of a tax cut either to business investment alone or just to consumption. Obviously some balance is the right answer, and what that balance is will depend on the circumstances at that time. The higher the rate of unemployment, the more weight will have to be given to the short-run stimulation of demand, which is best accomplished by stimulating consumption.

Let me add at this point, that in the event that an extensive tax reform bill is going to be tied to a tax cut, it might be wise for the Treasury to get an immediate effect out of such a policy by reducing the withholding tax schedule effective January 1.

As I understand it, they have some administrative discretion about the amount of withholding which they insist on from the first of the year. If, in fact, it is going to be a tax bill which is debated well into the fall, if it is to have any economic impact as far as the short-run problem is concerned, it would be too late. I believe they have discretion to reduce withholding earlier, presumably on the assumption that the final tax bill would contain a tax rate cut.

In conclusion, the history of tax policy reveals one lesson very clearly: most of the time there are reasons for not engaging in a positive tax policy, or for at least deferring the decision over and over again. Our tax system is choking off the growth of the economy. The longer we delay its regearing, the more it costs us in terms of lost output, lost wages and profits, a permanently shrunk workweek, a resistance to technological change, permanently lost capital formation and just plain human suffering.

Chairman PATMAN. Thank you very much, sir.

Our next witness will be Professor McCracken, of the University of Michigan. Professor, we are glad to have you.

**STATEMENT OF PAUL W. McCracken, PROFESSOR OF ECONOMICS,  
UNIVERSITY OF MICHIGAN**

Mr. McCracken. Thank you, Mr. Chairman.

First I want to say I very greatly appreciate this opportunity to appear before the committee as it considers the implications of current business conditions for fiscal policy.

I do have a prepared statement, but I am going to read excerpts only since the full statement is somewhat long.

Chairman PATMAN. You may proceed as you desire.

Representative REUSS. Mr. Chairman, I wonder if Dr. McCracken would be good enough from time to time to tell us about what page of his prepared statement he is reading from.

Mr. McCracken. Yes, I shall.

Clearly the first question to pose is this: Does the evidence indicate that the economic situation presently needs to be strengthened in a fundamental way? Obviously there are reassuring aspects in the evidence that we have at hand. And certainly we would all agree that we need to avoid being "nervous Nellies," irrationally rushing into major policy changes each time we get a little bad news or have a little bad luck.

On the other hand, three considerations suggest to me that the economy does need strengthening in a very fundamental way.

First, there is the fact that the economy has for some years been operating somewhat below par. This has been widely recognized and discussed and needs no further elaboration here. The work of this committee has done a great deal, I think, to provide the statistical underpinning for documenting this problem.

Second, the current cyclical expansion, beginning after February 1961, has turned out to be the weakest since the First World War. The facts can be usefully summarized something like this.

The data in table I of my prepared statement show the gains in eight measures of business activity during the first 16 months of each cyclical expansion since World War I. If data were fully available for the entire period, it would be possible to make 64 comparisons of the current cyclical expansion with these others. For each of eight measures of business activity, post-1961 gains could be compared with that during the eight other cyclical expansions. Since, for the earlier period, some data are not available, only 55 such comparisons can actually be made.

It is interesting to note that in 48 of the 55 the comparison is unfavorable to the economic performance since early last year; in 6 there is a favorable comparison; and in one case it turns out to be a tie. There can hardly be any question, therefore, that this is a candidate for the weakest recovery since World War I.

Third, we are beginning to wonder if the present expansion will turn out to be not only the weakest but also one of the shortest in the postwar period. We must, of course, beware of attaching excessive importance to very current data. On the other hand, some facts are undeniably disturbing.

The gain in business activity during June, the last month at the moment for which a full statistical picture is available, was roughly one-third the average monthly gain since the present expansion got underway. There is also some evidence in the data on table II of a slowing down in the rate of the expansion throughout the second quarter. (P. 5 of my statement.)

Finally, leading indicators generally have not been looking strong for some time. New orders for durable goods have been declining since the first of the year, and the June fall was particularly sharp. The length of the workweek moved downward in May and June. In fact, the most recent data available for the 30 leading indicators in Business Cycle Developments show 18 declining and 12 rising. Leading indicators can be affected by capricious developments, and in any case the length of the leads is often quite variable. It would be difficult, however, to give the present pattern a very optimistic interpretation.

If this review of the current economic situation is realistic, we clearly face more than the problem of an off 1 or 2 months in the inevitably irregular pattern of cyclical expansion. It is more accurate to say that we confront an uncertain short-run business outlook following upon a particularly weak cyclical expansion, all of this superimposed upon an economic performance that has been subpar for some years.

What is our problem? There are, broadly speaking, two possibilities. People are either disinclined to spend their purchasing power, or there is a shortage of purchasing power. In one respect there may be a lessened inclination to spend. Consumer attitudes have never regained the levels of buoyancy reached in 1955, and there has been some deterioration since the events of April and May. And the evidence is clear that changes in consumer attitudes do influence the level of spending.

There is also some concern about the possibility that wants have been saturated. There are persuasive reasons for believing that this problem of saturation of wants is not the core of the present situation, and on page 7 of my testimony I have a couple of paragraphs summarizing the rather substantial body of evidence on this that comes from the work of the Survey Research Center at the University of Michigan.

Continuing at the top of page 8—the evidence suggests to me that the problem is a shortage of purchasing power. Since the low quarter of 1961, private incomes after taxes (disposable income plus corporate profits after taxes), have increased \$32.7 billion, but private demand for output has increased \$35.9 billion. Thus private demand has increased \$1.21 for each dollar. This is less than the \$1.32 in the corresponding period after 1958 or the \$1.54 after 1954. But it is still true, in the five quarters following the low point last year, that private demand for goods and services increased more rapidly than income after taxes.

It is, I think, increasingly clear that the economic policies of Government have been making a substantial contribution to the economy's shortage of purchasing power in recent years. At times the monetary authorities clearly have stepped too hard on the brake pedal—for example, in 1957 and again in 1959. It is equally clear to me that

monetary policy has not impeded economic expansion for roughly 2½ years. The reserve position of banks has been easy—and this continues to be true in spite of the slightly recent tightening. Commercial banks are eager to expand their loans, in contrast to the loaned-up banking sentiment in 1957 and 1959. Bank credit has increased 8½ percent during the last year. Reflecting this, interest rates, contrary to the expectation of many experienced market observers earlier this year, have remained relatively low. Bond yields are only slightly above those of the low point of the recession early last year. Whatever quarrels we may have with the Federal Reserve about the details, the evidence does not seem to me to support the view that monetary policy has had very much to do with the current sluggishness of the economy. Nor does the recent slightly less easy credit policy yet constitute much threat to further expansion.

The principal drag has come from the tax side of Government fiscal operations. For years we have pointed with gratification to the stabilizing effect of our tax structure as a major defense against a recession. (Top of p. 10.)

Chairman PATMAN. I assume you will put your whole statement in the record?

Mr. McCracken. I would like to.

Chairman PATMAN. That will be done.

Senator PROXMIRE. I hesitate to interrupt, but I would appreciate it if Dr. McCracken would define "money supply" for us.

Mr. McCracken. Yes, sir, that is a good point, Senator. My definition of the money supply here would include time deposits. I suspect that is the point of your question.

I continue at the top of page 10. That total cash receipts of government (Federal, State and local) have absorbed a large and growing proportion of the national income is well enough known, though the quantitative magnitudes are not always fully appreciated. The ratio of Government cash receipts (on a national income basis) to national income rose from 26.6 percent in 1948 to 33.9 percent in 1960, and it is probably about 34½ percent right now. Now let us look more closely at the last year and one-half to see how this works out cyclically.

Chairman PATMAN. I would like to have one clarification here. You say "ratio of Government cash receipts." You mean all governments, Federal, State and local political subdivisions?

Mr. McCracken. That is correct. And on a national income basis.

Let us now look more closely at the last year and one-half to see how this works out cyclically. From the low first quarter of 1961 to the second quarter of 1962 private incomes before taxes (personal income plus corporate profits) increased \$45 billion. Government receipts, however, absorbed almost 44 percent.

Now the sluggishness of the present recovery and the one in 1958 to 1960 begins to look a little less mysterious. The tax structure, by absorbing 40 to 45 percent of the rise in private incomes, left a gain in incomes after taxes so moderate that, with no special elements of strength present, we could not get an expansion in private demand vigorous enough to carry the economy back to reasonably full employment.

Now if the neutral position of the budget, where revenues and outlays are equal, is at full employment, we should theoretically find it

possible to avoid persistent unemployment, though a tax structure absorbing such large and growing proportions of income increases would still have adverse implications for economic growth. If, however, this neutral budgetary position is at a level of business activity considerably below what would constitute reasonably full employment, we have also a short-run problem.

The fiscal drag would make full employment difficult to attain, which would cause a short fall in revenue, which would make the budget look bad, which might make us disinclined to take needed tax action, and so forth. This, I think, is not an unfair characterization of the present situation.

In the January report the Council of Economic Advisers estimated that at reasonably full employment, the present tax structure would produce a Federal surplus of perhaps \$8 billion this year (on a national income basis), with this full employment surplus approaching something like \$10 billion by the first half of calendar 1963. In short, the budget now moves from a neutral to a restrictive position substantially before the economy reaches reasonably full employment, and with Government receipts siphoning off 40 percent of the addition to income, it has been very difficult to get the needed thrust of increased private demand.

If this diagnosis is correct, what does it suggest for fiscal policy? It means three things. First, the tax structure should be lowered so that the budget does not begin to exert a brake on the economy quite so far below reasonably fully employment.

Second, the tax structure now absorbs too large a proportion of increases in the national income.

Third, we must slow down the tendency for Federal Government receipts to absorb a growing proportion of the national income.

Most of my time has been consumed in an endeavor to establish the case that the fiscal operations of Government are an important source of our present economic problem, and vigorous fiscal action must play a major role in this problem. This leaves little time to spell out the specifics. This is not, I think, particularly fatal, because it seems to me there is a rather surprising consensus on what the tax actions ought to be if they can be undertaken.

First of all, budgetary procedures should be modified so that we give more explicit attention to this question: How rapidly should Federal expenditures grow in the years ahead? The excellent work on expenditures at both ends of Pennsylvania Avenue does an effective, and I think unappreciated, job of sifting out waste and unessentiality in the technical sense. It is less well designed to tell us whether these individually well-considered programs add up to more than ought to be spent in the aggregate.

The ratio of Federal budget cash outlays to GNP in fiscal year 1962 was 2.1 percentage points above that of fiscal 1960. Thus, if the rate of increase of Federal cash outlays had been limited to the rate of increase of GNP, Federal outlays last year would have been \$12 billion less. This growth has reduced the scope of otherwise desirable incentive-promoting tax reductions.

It is not unreasonable to expect from the administration an explicit declaration of its longer range policy with respect to total outlays. And the Congress should reexamine its own procedures to see if more

explicit attention can be given to the total on the expenditure side of each year's budget.

Second, the economic situation would benefit from tax actions now that would reduce the level of the structure and move it in the direction of a better system. As I mentioned, fortunately, there is a rather surprisingly narrow range of disagreement on what the elements of such a package might be—some reduction in the corporate income tax and some reduction in the personal income tax. The total package should be such that the resulting tax structure would still produce enough revenues comfortably to cover expenditures at reasonably full employment. On this basis, something like \$7 billion would probably be the outside limit of any tax reduction at this time. The action should not be quickie or temporary in character. We should capitalize on the substantial current consensus in order to move toward a better basic pattern of Federal taxes.

Third, I would, myself, support the proposal that the President be given limited power to alter certain tax rates. This could be hedged with adequate safeguards, limited as to amount and perhaps requiring that the President transmit to the Congress a full report setting forth reasons for his actions. Without this authority, each recession produces inexorable pressures to do something on the expenditure side which, history suggests, will be moving expenditures to a substantially higher level.

This proposal, in other words, would be a step toward fiscal conservatism. In the long run it would make for a less rapid increase for expenditures and more elbow room on the tax side for further needed reform.

One further question. Would tax reduction and reform now be apt to worsen further the already somewhat nervous position of the dollar internationally? This is possible. If the resulting expansion sets in motion an accelerated rise in our cost-price level, and if we insist that the monetary authorities adhere to unrealistically low interest rates, and if needed improvements in profits were seemingly interpreted as evidence of malevolence, the dollar could quickly be in real trouble. And it must be stated flatly that such trouble would then be deserved. If, however, we manage our affairs carefully, there is good reason to think that the international position of the dollar would not be worsened by tax reform and reduction now, and it might well be strengthened. The resulting higher level of national income would, of course, tend to increase imports and that would enlarge the deficit in our international balance of payments.

There are, however, forces that would work the other way. The more active demand for funds would produce higher interest rates in the U.S. money and capital markets. The invigorated pace of economic activity would enlarge the opportunities for more profitable investment of capital in the domestic economy, reducing the incentives to seek investment outlets abroad. The innovational activity that accompanies a more lively pace of economic expansion should, in time, have some favorable effects on U.S. exports. Since in the U.S. economy imports are relatively small and the international capital outflow is relatively large, there is at least an even chance that policies proposed here would help to narrow the deficit in our balance of payments.

Now, there does, of course, remain the potentially adverse effect on psychology and confidence in the dollar both here and abroad. My own view would be that if the tangible, concrete, objective factors can be expected to be at least neutral and possibly helpful, then we ought to be able to manage that.

In conclusion, the becalmed state of the economy at present—coming on the heels of a particularly weak cyclical expansion superimposed on a protracted period of less than reasonably full employment—strongly suggests to me that the economy needs strengthening in a fundamental way, and it also suggests that within reasonable limits this can be done without courting the risk of a disorderly expansion.

The basic problem is the shortage of income and purchasing power, but this deficiency must be remedied in ways that do not increase costs per unit of output and do not produce monetary conditions which would further weaken the dollar. This calls for tax adjustments that lower and otherwise improve the structure. The magnitude of the reduction should still leave us with a tax structure whose revenues would cover expenditures when productive resources are being utilized reasonably fully. Such actions need not weaken the dollar internationally, and there is an even chance they might strengthen it.

In fact, we are fortunate that what is needed to step up the pace of job creation and economic expansion at home could also add strength to the dollar internationally; namely, a more innovative and prosperous and profitable economy.

Chairman PATMAN. Thank you.  
(The full statement is as follows:)

TESTIMONY OF PAUL W. McCracken, Professor of Business Conditions, School of Business Administration, University of Michigan

I

Mr. Chairman, I greatly appreciate the opportunity to appear before this committee to consider the implications of current business conditions for economic policy. Clearly the first question to pose is this: Does the evidence indicate that the economic situation needs to be strengthened in a fundamental way? The situation is not, of course, without its hopeful aspects. Even if this cyclical expansion were to be a bit on the short side, business cycle history suggests that economic conditions should continue to improve for several months yet. By the end of this year the present expansion would still be of only 22 months' duration. Only one upswing since World War I (November 1927, to August 1929) was shorter than this. Moreover, we know that the course of any upswing is irregular, with flat months and air pockets occasionally developing. The fact is that in recent months the economy has been bombarded with an unusual run of bad luck—such as the steel price donnybrook, the stock market break, and recurring nervousness about the international position of the dollar. Good economic policy clearly requires that we not be "nervous Nellies," rashly proposing major changes each time a cluster of bad news or bad luck comes along.

Three considerations suggest that the economy does need strengthening in a fundamental way. First, there is the fact that the economy has for some years been operating somewhat below par. This has been widely recognized and discussed. In his study for this committee (published in 1960) Mr. Knowles estimated for each year from 1909 to date the output that would have represented reasonably full utilization of the Nation's productive resources. In 9 of the 15 years from 1947 to 1961, output was below par (including all years since 1957). By contrast in the 17 years from 1909 to 1929 (excluding the years 1917-20) the

record was notably better. "Full employment" years in those two decades outnumbered those when output was subpar by about 2 to 1.

Interpretations of this experience will differ, but one conclusion is clear. The economy for several years has had an evident lack of bounce and steam. Our current problem is more than just one of those normal momentary air pockets in a cyclical expansion.

Second, the current cyclical expansion (beginning after February 1961) has turned out to be the weakest since the First World War. During the 16 months from February 1961 to June 1962, nonagricultural employment gained 3.6 percent. The average employment gain in the first 16 months of the eight other cyclical expansions since World War I was 11.3 percent, and even following the hardly discernible recession of 1927 employment increased 7.6 percent. The improvement in industrial production this time has been less than in any of the other cyclical expansions since the First World War. The same is true for gross national product. The gain in retail sales has been slightly greater than that following July 1921, and November 1927, but it falls considerably short of those after the other six recessions. The facts can usefully be summarized something like this. The data in table I show the gains in eight measures of business activity during the first 16 months of each cyclical expansion since World War I. If data were fully available it would be possible to make 64 comparisons of the current cyclical expansion with others—for each of eight measures of business activity comparing the post-1961 gain with that during the eight other cyclical expansions. Since for earlier periods some data are not available, only 55 such comparisons can be made. In 48 of these 55 the comparison is unfavorable to the performance since early last year, in 6 there is a favorable comparison, and in one case it is a tie.

That the current cyclical expansion has been a particularly weak and sluggish one is quite evident from these facts. It is the Nation's poorest performance in four decades, and probably one of the poorest in our history. It is, of course, true that expansions after very mild recessions (such as the one in 1960-61) tend to be on the mild side, but the current expansion is weak even relative to that following the 1927 recession.

Third, we are beginning to wonder if the present expansion will turn out to be not only the weakest but also one of the shortest in the postwar period. We must beware of attaching excessive importance to very current data. On the other hand, certain facts are undeniably disturbing. The gain in business activity during June (the last month at the moment for which data are fully available) was about one-third the average monthly gain since the present expansion got underway. There is also some evidence in the data in table II of a slowing down in the expansion throughout the second quarter. Moreover, it is clear that business sentiment has been adversely affected by events in recent months. The stock market break has had a substantial effect on the thinking of both business people and consumers.

Many businessmen were alarmed by the inferences they drew from the administration's handling of the steel price dispute, even though they did not support the actions of the steel industry. It would be reasonable to expect that an already anemic expansion would at least not be helped by the adverse cumulative effect of these more or less fortuitous developments.

Finally, leading indicators generally have not been looking strong for some time. New orders for durable goods have been declining since January, and the June fall was fairly sharp. The length of the workweek moved downward in May and again in June. In fact, the most recent data available for the 30 leading indicators in Business Cycle Developments show 18 of them declining and 12 rising. Leading indicators are, of course, difficult to interpret. They can be affected by capricious developments, and in any case the length of the leads is quite variable. It would be difficult, however, to give their present pattern a very optimistic interpretation.

If this review of the current economic situation is realistic, we clearly face more than the problem of an off 1 or 2 months in the inevitably somewhat irregular path of a cyclical expansion. It is more accurate to say that we confront an uncertain short-run business outlook following upon a particularly weak cyclical expansion—all of this superimposed upon an economic performance that has been subpar for some years.

**TABLE I.—Percentage increase in 8 measures of business activity during the 1st 16 months of cyclical expansions since World War I**

Indicator	After recession ending—								
	July 1921	July 1924	November 1927	March 1933	June 1938	October 1949	August 1954	April 1958	February 1961
Number of employees in nonagricultural establishments.....	+21.6	+11.4	+7.6	+18.2	+9.4	+11.0	+6.1	+4.8	+3.6
Unemployment rate, total (inverted).....	(1)	(1)	(1)	+35.0	+29.2	+123.7	+43.0	+38.7	+26.6
Index of industrial production.....	+50.0	+27.5	+18.4	+34.5	+47.7	+30.7	+17.2	+18.9	+15.4
Gross national product in current dollars (Q) <sup>2</sup> .....	(1)	+16.2	+11.8	+23.5	+12.0	+23.7	+13.0	+10.4	+10.2
Gross national product in 1954 dollars (Q) <sup>3</sup> .....	(1)	(1)	(1)	(1)	(1)	+13.2	+9.8	+9.8	+7.7
Bank debits outside New York City, 343 centers.....	+11.3	+19.3	+13.0	+22.5	+13.7	+29.7	+16.2	+16.0	+16.0
Personal income.....	+21.0	+12.6	+10.2	+26.5	+10.8	+21.1	+11.5	+8.5	+9.0
Sales of retail stores.....	+4.5	+6.9	+5.4	+20.0	+18.9	+22.1	+11.3	+10.6	+6.5

<sup>1</sup> Not available.

<sup>2</sup> 5 quarters.

<sup>3</sup> 4 quarters.

Source: Business Cycle Developments. July 1962, p. 57.

**TABLE II.—Monthly changes in selected measures of business activity (seasonally adjusted)**

1962	Nonagricultural employment	Industrial production	Personal income	Retail sales
(1)	(2)	(3)	(4)	(5)
January.....	-58	-1.3	-\$1.7	+\$9
February.....	+339	+1.3	+3.2	+120
March.....	+128	+9	+2.6	+302
April.....	+359	+1.1	+2.4	+338
May.....	+11	+7	+1.4	-117
June.....	+43	+3	+7	-431
February 1961-June 1962 average.....	+121	+1.0	+2.3	+80

Source: Col. 2, BLS estimates of nonagricultural workers on payrolls (in thousands); col. 3, percentage points for the FRB index of industrial production; col. 4, Department of Commerce (in billions); col. 5, Department of Commerce (in millions).

## II

What is our problem? There are, broadly speaking, two possibilities. People are either disinclined to spend their purchasing power, or there is a shortage of purchasing power. In one respect there may be a lessened inclination to spend. Consumer attitudes have never regained the levels of buoyancy that were reached in 1955, and there has been some deterioration since events of April and May. And the evidence is clear from work at the University of Michigan's Survey Research Center that changes in consumer attitudes do influence the level of spending. There is also some concern about the possibility that wants have simply been saturated. This argument has taken many forms—ranging from that of the affluent society to the fear that consumers are so fully in debt that the further expansion of credit necessary to sustain vigorous prosperity cannot take place.

There are persuasive reasons, however, for believing that the problem is not primarily saturation of wants. Research evidence is fairly clear on this point. The simple fact is that as levels of living rise, levels of aspiration rise also. The achievement of one scale of living sets the stage for the desire to stage an assault on the next. Periodically during the last decade the University of Michigan's Survey Research Center has probed people about their needs and whether they would like to make special expenditures in the coming year. In their 1962 monograph the center summarizes the evidence as follows:

"1. Today, as they did 10 years ago, the great majority of American people express wishes and desires for consumer goods. This is true in all income groups. Those who do not express such wishes are most commonly old \* \* \* or poor \* \* \*. The proportion having no wishes and desires has not increased in the last 10 years. Being well stocked with goods, or having made large expenditures recently, does not make for 'needlessness.'

"2. The kinds of things desired have changed substantially in the postwar period. Desires for summer houses, boats, travel, and various hobby expenditures have increased in frequency. At the same time, desires for automobiles have not diminished in frequency (partly as the result of an increase in desires for second cars). Because people have a great many wants and desires, they feel they must economize and shop carefully. (There was, therefore, a change in the kind of automobile desired.)"<sup>1</sup>

The evidence suggests to me that the problem is a shortage of purchasing power. Since the low quarter of 1961 private incomes after taxes (disposable personal income plus corporate profits after taxes) have increased \$32.7 billion but private demand for output has increased \$39.5 billion. Thus private demand has increased \$1.21 for each dollar increase in private incomes after taxes. This is less than the \$1.32 in the corresponding period after 1958, or the \$1.54 after 1954, but it is still true that in the five quarters following the low point last year private demand for goods and services has increased more rapidly than incomes after taxes.

To some a shortage of purchasing power is synonymous with the need to accelerate the rise in wage rates. This approach would, of course, be self-defeating because it would also raise costs of production and, therefore, prices. And if the price line were held, the resulting deterioration in profits would give us a more acute case of the economic anemia we were trying to cure. On this our experience of the last several years is quite clear. The fact that costs per unit of output rose more rapidly than prices after the mid-1950's, with the consequent sharp decline in profits per unit of output, unquestionably played a major role in the sluggish performance of the economy in that period.

TABLE III.—*Indexes of corporate income and output in manufacturing*

[1955=100]

Year	Output	Employment costs	Profits	Per unit of output	
				Employment costs	Profits
(1)	(2)	(3)	(4)	(5)	(6)
1955.....	100.0	100.0	100.0	100.0	100.0
1956.....	102.9	107.9	94.0	105.0	91.6
1957.....	103.3	112.9	91.6	109.0	88.7
1958.....	96.5	108.9	73.2	112.8	75.9
1959.....	109.0	118.0	101.6	109.1	93.2
1960.....	112.0	123.5	96.0	110.1	85.6
1961.....	112.6	124.0	94.0	110.1	83.5

Source: Column (2), Federal Reserve Index; columns (3) and (4), basic data from Department of Commerce; column (5), column 3 divided by column 2; column (6), column 4 divided by column 2.

It is, I think, increasingly clear that the economic policies of Government have been making a substantial contribution to the economy's shortage of purchasing power in recent years. At times the monetary authorities clearly have stepped too hard on the brake pedal, e.g., in 1957 and again in 1959. It is equally clear, however, that monetary policy has not impeded economic expansion for roughly 2½ years. The reserve position of the banks has been easy. Commercial banks are eager to expand their loans, in contrast to the "loaned-up" banking sentiment in the tight-reserve eras of 1957 and 1959. Bank credit has increased 8½ percent in the last year. Reflecting this, interest rates (contrary to the expectation of many experienced market observers early this year) have remained relatively low. Bond yields are only slightly above those at the low point of the recession early last year. Whatever quarrels we may have with

<sup>1</sup> George Katona, Charles A. Lininger, James N. Morgan, and Eva Mueller, "1961 Survey of Consumer Finances" (University of Michigan, Survey Research Center, 1962), p. 96.

the Federal Reserve about details, the evidence does not support the view that monetary policy has had much to do with the current sluggishness of the economy.

The principal drag has come from the tax side of Government fiscal operations. For years we have pointed with gratification to the stabilizing effect of our tax structure as a major defense in a recession. The large volume of tax collections relative to national income and the tax structure's progressive nature have meant that much of the decline in incomes has been at the expense of the tax collector. Incomes after taxes tended to stay put—to be stabilized. We are all familiar with this story. For some curious reason we have not seemed to perceive fully the implications of this for expansion, even though we usually recited the right words.

The fact is, however, that a tax structure which stabilizes incomes after taxes during a recession also "stabilizes" them in an expansion, i.e., it retards their expansion. That total cash receipts of government (Federal, State, and local) have absorbed a large and growing proportion of the national income is well enough known, though the quantitative magnitudes are not always appreciated. The ratio of Government cash receipts (on a national income basis) to national income rose from 26.6 percent in 1948 to 33.9 percent in 1960, and it is probably about 34½ percent now.

TABLE IV.—Government receipts and gross national product at postwar cyclical peaks

(Dollar amounts in billions)

Year	National income	Government receipts	
		Amount	Percent National income
1948.....	\$223.5	\$59.2	26.6
1953.....	305.6	94.9	31.1
1957.....	368.9	116.3	31.8
1960.....	415.5	141.0	33.9
1962—2d quarter.....	457.0	158.0	34.6

<sup>1</sup> Estimated.

Sources: Basic data from the Department of Commerce.

TABLE V.—Change in private incomes before taxes and Government receipts 5 quarters after recession lows

(Dollar amounts in billions)

	1958-59	1961-62
Private incomes.....	\$49.6	\$45.0
Total Government receipts.....	\$20.5	\$19.6
As percent change, private income.....	41.4	43.5
Federal Government receipts.....	\$16.5	\$15.7
As percent change, private income.....	33.3	34.5

Sources: Basic data from Department of Commerce.

Let us now look more closely at the last year and one-half to see how this works out cyclically. From the low first quarter of 1961 to the second quarter of 1962 private incomes before taxes (personal income plus corporate profits and the inventory valuation adjustment) increased \$45 billion. Government receipts, however, absorbed 44 percent of this increase. Now the sluggishness of the present recovery, and the one in 1958-60, begins to look less mysterious. The tax structure, by absorbing 40-45 percent of the rise in private incomes, left a gain in incomes after taxes so moderate that (with no special elements of strength present) we could not get an expansion in private demand vigorous enough to carry the economy back to reasonably full employment.

If the neutral position of the budget (where revenues and outlays are equal) is at full employment, we should theoretically find it possible to avoid persistent unemployment—though a tax structure absorbing such a large proportion of

increments to national income would still have important adverse implications for economic growth. If, however, this neutral budgetary position is at a level of business activity considerably below what would constitute reasonably full employment, we have also a short-run problem. The fiscal drag would make full employment difficult to attain, which would cause a short fall in revenue, which would make the budget look bad, which might make us disinclined to take needed tax action, etc.

This is not an unfair characterization of the present situation. In their January report the Council of Economic Advisers estimated that at reasonably full employment the present tax structure would produce a surplus (on a national income accounts basis) of perhaps \$8 billion this year, with this full employment surplus approaching \$10 billion by the first half of calendar 1963. In short, the budget now moves from a neutral to a restrictive position substantially before the economy reaches reasonably full employment, and with government receipts siphoning off over 40 percent of additions to income, it has been very difficult to get the needed thrust of increased private demand.

## III

If this diagnosis is correct, what does it suggest for fiscal policy? It means, I think, three things. First, the tax structure should be lowered so that the budget does not begin to exert a brake on the economy quite so far below reasonably full employment. Second, the tax structure now absorbs too large a proportion of increases in the national income. Third, we must slow down the tendency for the Federal Government's receipts to absorb a growing proportion of the national income secularly.

Most of my time has been consumed in an endeavor to establish the case that the fiscal operations of Government are an important source of our present economic problem, and that vigorous fiscal action must play a major role in any program to deal with the problem. This leaves little time to spell out specifics. Even so, it may be useful to indicate briefly the nature of a fiscal program that might contribute to a stronger economy.

First, budgetary procedures should be modified so that we give more explicit attention to this question: How rapidly should Federal expenditures grow in the years ahead? The excellent work on expenditures at both ends of Pennsylvania Avenue does an effective and, I think, underappreciated job of sifting out waste and unessentiality in the technical sense. It is less well designed to tell us whether these individually well-considered programs add up to more than ought to be spent in the aggregate. The ratio of Federal budget cash outlays to GNP in fiscal 1962 was 2.1 percentage points above that of fiscal 1956. Thus, if the rate of increase of Federal outlays had been limited to the rate of increase of GNP, Federal cash outlays last year would have been \$12 billion less. This inevitably has reduced the scope for otherwise desirable incentive-promoting tax reductions. It is not unreasonable to expect from the administration an explicit declaration of its longer range policy with respect to total outlays; and the Congress should reexamine its own procedures to see if more explicit attention can be given to the total on the expenditure side of each year's budget.

TABLE VI.—Ratio of Federal cash budget outlays to gross national product

[In percent]

	Fiscal year 1956	Fiscal year 1960	Fiscal year 1962
National defense.....	10.9	9.3	9.5
Others.....	7.8	9.8	10.4
Total.....	17.8	19.1	19.9

Second, the economic situation would benefit from tax actions now that would reduce the level of the structure and move it in the direction of a better system. Fortunately, there is considerable agreement about what would constitute such a package—a reduction of three to five points in the corporate income tax; a cut-off of the personal income tax at around a 65-percent top rate, with reductions of perhaps two percentage points back down through the normal tax; and a rationalization of our motley array of excise taxes (which could be done with

no loss of revenue). The total package should be such that the resulting tax structure would produce enough revenues comfortably to cover expenditures at reasonably full employment. On this basis something like \$7 billion should probably be the outside limit of any tax reductions at this time. The action should not be "quickie" or temporary in character. We should capitalize on the substantial current consensus about what ought to be done to move toward a better basic pattern of Federal taxes.

Third, I would myself support the proposal that the President be given limited power to alter certain tax rates. This could be hedged with adequate safeguards—limited as to amount, and perhaps requiring that the President transmit to the Congress a full report setting forth reasons for his actions. Without this each recession produces inexorable pressures to "do something" on the expenditure side which, history suggests, will be moving expenditures to a substantially higher level. This proposal would, in short, be a step toward fiscal conservatism. In the long run it would make for a less rapid increase in expenditures and more "elbow room" on the tax side for further needed reforms.

#### IV

One further question: Would tax reduction and reform now be apt to worsen further the already somewhat nervous position of the dollar internationally? This is possible. If the resulting expansion sets in motion an accelerated rise in our cost-price level, and if we insist that the monetary authorities adhere to unrealistically low interest rates, and if needed improvement in profits were seemingly interpreted as evidence of entrepreneurial malevolence, the dollar could quickly be in real trouble. And, it must be stated flatly, such trouble would then be thoroughly deserved.

If, however, we manage our affairs carefully, there is good reason to think that the international position of the dollar would not be worsened by tax reform and reduction now, and it might well be strengthened. The resulting higher level of national income would, of course, tend to increase imports and that would enlarge the deficit in our international balance of payments. There are, however, forces that would work the other way. The more active demand for funds would produce higher interest rates in the U.S. capital markets. The invigorated pace of economic activity would enlarge the opportunities for more profitable investment of capital in the domestic economy, reducing incentives to seek investment outlets abroad. And the innovational activity that accompanies a more lively pace of economic expansion should in time have some favorable effect on U.S. exports. Since in the U.S. economy imports are relatively small and the international capital outflow is relatively large, there is at least an even chance that policies proposed here would help to narrow the balance-of-payments deficit.

There does remain the potentially adverse effect on confidence in the dollar, internationally and domestically, of tax action now. If, however, the tangible, concrete, objective forces can reasonably be expected to beat least neutral and probably favorable, and if we give evidence of capacity to manage sensibly such things as monetary and wage-cost-price policies, we can probably deal with the psychological aspects of the problem.

#### CONCLUSION

The becalmed state of the economy at present, coming on the heels of a particularly weak cyclical expansion superimposed on a protracted period of less than reasonably full employment, strongly suggests that the economy needs strengthening in a fundamental way; and it also suggests that within reasonable limits this can be done without courting the risk of a disorderly economic expansion. The basic problem is a shortage of income and purchasing power, but this deficiency must be remedied in ways that do not increase costs per unit of output and that do not produce monetary conditions which would further weaken the dollar. This calls for tax adjustments that lower and otherwise improve the structure. The magnitude of the reduction should still leave us with a tax structure whose revenues would cover expenditures when productive resources are being utilized reasonably fully.

Such action need not weaken the dollar internationally, and there is an even chance that it might strengthen it. In fact, we are fortunate that what is needed to step up the pace of job creation and economic expansion at home could also add strength to the dollar internationally—a more innovative, more prosperous, and more profitable economy.

Chairman PATMAN. Our next witness will be Dr. Joseph A. Pechman, director of economic studies at the Brookings Institution.

We are glad to have you, sir. You may proceed in your own way.

#### STATEMENT OF JOSEPH A. PECHMAN, DIRECTOR OF ECONOMIC STUDIES, THE BROOKINGS INSTITUTION

Dr. PECHMAN. Thank you, Mr. Chairman. I am happy to have this opportunity to appear before the Joint Economic Committee to discuss the economic situation and its fiscal policy implications. In this statement, I propose to review the economic outlook, try to explain why the expansion seems to be petering out, and suggest policies that might be adopted to restore our economic momentum. The views I shall express are my own and do not necessarily reflect those of the trustees, officers, or other staff members of the Brookings Institution. Since I agree with practically all of what my two friends said before me, you might call my statement "Variations on the Eckstein-McCracken Theme by Pechman."

#### THE ECONOMIC OUTLOOK

There is no question that the economic expansion which began early last year has been disappointing. Perhaps the most telling figure—certainly the one which should concern us most—is the rate of unemployment. In July, the unemployed were 5.3 percent of the labor force, after adjustment for seasonal variation. This is a much poorer performance than those of the first two postwar recoveries, and roughly similar to the unsatisfactory 1958-60 performance.

At the same stage in the cycle, unemployment was 3.4 percent in the 1949-53 expansion and 4 percent in the 1954-57; it was 5.6 percent in the same stage of the 1958-60 expansion, but this figure was unusually high at the time because of the prolonged steel strike. The distressing fact about the unemployment situation is that it will get worse if the economy rises by anything less than about \$7 billion per quarter at an annual rate.

It is not difficult to demonstrate that the expansion is not only disappointing, but also that it has lost most of its momentum. In the first place, the difference between actual GNP and potential GNP at an unemployment rate of 4 percent has remained at about \$30 billion during the past 9 months.

Second, GNP in real terms rose at an annual rate of 8.6 percent in the first three quarters of the expansion; in the last two quarters, the rise has been at the rate of 3.2 percent.

Third, gains in employment, personal income, and industrial production have slowed down almost to a creep. In June, employment rose only one-tenth of 1 percent; personal income, two-tenths of 1 percent; and industrial production, three-tenths of 1 percent.

Fourth, retail sales fell in May and June. The drop was particularly steep in June, perhaps reflecting the impact of the sharp break in the stock market. Although sales appear to have increased again in July, they will probably turn out to be lower than the peak reached in April.

Thus, none of the broad indicators of business activity suggests that the economy is going anywhere very fast. But the gloomy evi-

dence on the business outlook comes from the leading indicators. Manufacturers' sales have exceeded new orders since March. This means that order backlogs are going down and, unless the trend is reversed very soon, production is bound to fall.

Inventory investment declined sharply in the second quarter of the year, suggesting that businessmen are already anticipating a slowdown in demand. The decline in inventory investment is not all due to the unusual steel situation; other industries are also exhibiting the same tendency. Fortunately, fixed investment—particularly construction—has continued to rise, but new orders of firms manufacturing machinery and equipment have been sliding off since January. This implies a weakening of investment demand and is perhaps the most disturbing sign of all.

I am not trying to suggest that a downturn in business activity in the near future is a certainty. We have had slowdowns before without experiencing a recession. The two most recent cases were 1951 and 1956—but, in both cases, there were good reasons for the pickup.

In 1951, defense expenditures continued to rise rapidly as the Korean war continued. In 1956, private investment remained strong and defense orders rose sharply while industry generally was operating close to capacity. Today, Federal expenditures are still rising, but at a declining rate; excess capacity at current rates of output is widespread; and there are no signs of a strong upward movement anywhere in the private economy.

We have had a good year in autos and housing, but these industries are hardly likely to go much higher with personal incomes leveling off. Inventory investment will continue to decline unless retail sales pick up, and the latter is not likely to happen unless incomes go up faster.

Profits are already falling, even though some specific companies have reported record earnings for the first half of the year. With the large amount of excess capacity throughout industry, it is hard to believe that we are about to see a significant increase in investment demand. (The more liberal depreciation allowances will certainly be helpful and so would the investment credit if it were enacted, but their effect probably will not be immediate.)

In brief, the situation looks more like mid-1957 than 1951 or 1956. Then, as now, inventory accumulation was low, manufacturers' new orders were declining, and order backlogs were going down. Without implying a forecast for this year, I simply record the historical fact that the peak of that cycle was reached in July 1957.

#### WHAT WENT WRONG?

Since proper diagnosis is an essential prerequisite to prescription, it is important to explain the premature slowdown in the rate of expansion. Until the turn of the year, the recovery was going along on schedule. There were differences of opinion over the outlook, but practically all informed observers expected the rise to continue vigorously at least until midyear.

In this situation, the administration submitted a budget for fiscal year 1963 that would be roughly in balance if the 1962 GNP turned out to be \$570 billion. It is to be noted that the balanced budget was

expected to materialize only if, given the projected Government spending and taxing programs, demand in the private economy would be large enough to produce a total GNP of \$570 billion.

Developments in 1962 clearly indicate that Government fiscal policy is too restrictive to permit the economy to achieve the projected levels of output. The degree of restriction can perhaps be fully appreciated if the figures used in the budget are translated to a full employment basis (which is ordinarily defined as employment of 96 percent of the labor force.) At full employment and projected levels of Government spending, the administrative budget surplus would probably amount to about \$4 billion in fiscal year 1963. When translated into the more economically meaningful national income budget, this is equivalent to a surplus of about \$8 billion. Full employment will not be reached this year because private demand is not strong enough to permit the Government to drain off that amount from the private economy.

In fact, as events have turned out, private demand is not even strong enough to permit the Government to plan on a budget which would be barely balanced at a 1962 GNP \$15 to \$20 billion short of full employment.

It is noteworthy that the original budget estimates for every one of the past 5 years projected some surplus, yet deficits were actually realized in 4 out of these 5 years. As the following table shows, the original estimates for the 5 years aggregate to a cumulative surplus of \$8.1 billion, but the period ended with a cumulative net deficit of \$24.2 billion. This sad record was due primarily to the reduced receipts from levels of business activity that turned out to be substantially lower than those estimated.

(The table referred to follows:)

*Comparison of original budget estimates with actual results, fiscal years 1958-62*

[Billions of dollars]

Fiscal year	Administrative budget surplus (+) or deficit (-)	
	Original estimates	Actual
1958.....	+1.8	-2.8
1959.....	+6	-12.4
1960.....	+1	+1.2
1961.....	+4.2	-2.9
1962.....	+1.6	-6.3
<b>Total.....</b>	<b>+8.1</b>	<b>-24.2</b>

The so-called "squeeze" on corporate profits is principally a reflection of this lackluster performance of the economy. Recent research by econometricians has indicated that the brunt of a short fall in the gross national product below full employment potential is felt by corporate profits. The short fall of profits below the level it would reach at full employment will amount to at least \$8 billion in 1962 alone. Even larger amounts were lost in several recent years. We cannot allow this to continue much longer. A prolonged period of disappointing profits inevitably reduces investment incentives and retards the Nation's economic growth.

The United States cannot hope to approach the growth rates experienced in Europe and Japan during the last decade without a higher rate of investment, and we will not achieve a higher rate of investment unless businessmen expect growing markets for their products.

The lesson to be learned from the economic record of recent years in this country is that planning for a surplus, without regard to the strength of private demand, may very well produce unsatisfactory rates of employment and output and create deficits besides. When demand is strong and appears to be pressing hard on available resources, a surplus may be essential to insure balanced growth and stability in the general level of prices.

But when demand is recovering from a recession and when unemployment is still large and capacity still greatly underutilized, too vigorous a movement toward a surplus may repress the recovery and prevent the growth in output and income upon which the expansion of Government revenues was predicated.

In short, efforts to reduce the deficit too quickly are likely to be self-defeating.

Does this mean that the United States is doomed to have deficits for an indefinite period? The answer to this question cannot be given with any degree of certainty by responsible economists, simply because we do not know the strength of private demand out of the incomes that would be generated at full employment.

It is my own view that, at full employment, demand would be strong enough to require a surplus in order to prevent prices from rising, and that a full employment level of activity is likely to generate that surplus at the expenditure levels now contemplated, even with somewhat lower tax rates than those now in effect.

But to reach full employment, we must first remove the restraints under which the economy has been operating in recent years. Except for an easy money policy which is ruled out because of our balance-of-payments problem, no other policy is available to restore our economic momentum than fiscal policy.

#### POLICIES TO RESTORE ECONOMIC MOMENTUM

Private demand can be stimulated through fiscal policy either by increasing expenditures or by reducing taxes. Congress is now completing action on the President's expenditure requests for this year. These requests contemplate a rise in Federal expenditures (as measured by the national income accounts) amounting to \$5.8 billion in fiscal year 1963. Further expenditure increases of any substantial magnitude would require considerable advance planning as well as congressional action and would therefore not be effective soon enough. Expenditure policy should, in any case, be geared largely to the long-run needs of the economy and to the demand for public services.

Under the circumstances, tax reduction would be the best and most effective method of providing a strong and immediate stimulus to the economy. In the past, consumers have consistently spent about 92 or 93 percent of their disposable incomes. There is no reason to suppose that they would respond very differently to the added take-home pay from a tax cut than they would from a straight increase in their wages. (In fact, as a result of withholding, the additional take-

home pay from a tax cut is indistinguishable for the vast majority of wage earners from the additional take-home pay due to an increase in wages.)

This addition to consumer spending would increase employment and incomes, leading to further rounds of spending. Moreover, the improvement in sales expectations would have effects of its own on business expenditures. It would, in the first place, probably reverse the decline in inventory investment; second, it would also promote additional fixed investment. Together, the effects on consumer and business spending could well provide the stimulus needed for a rapid advance to full employment provided the tax cut is large enough.

I do not agree with the view that a tax cut should be delayed until after a recession has begun. The weakness of investment in the last few years is a reflection of the slow growth of demand and the continuation of excess capacity. There is substantial danger that businessmen will come to regard a slack economy as a normal state of affairs.

Under these circumstances, our economic recoveries will become even more disappointing than they have been in the last two cycles and our rate of growth will become chronically depressed. A prompt tax cut would very quickly be translated into higher business sales and break these bearish expectations.

Since the economy is already \$30 billion below potential and the prospects are that it will lose ground in the months ahead, strong medicine is needed to overcome the effect of the disappointing performance in recent years. Even if it is assumed that the tax reduction will have a substantial direct effect on business spending, a cut of at least \$10 billion would be required to close the gap between actual and potential output. In arriving at this judgment, I assume that the effect of the tax cut would not be offset in whole or in part by expenditure reduction. If expenditures were reduced, the size of the tax cut needed to reach full employment would increase by more than the cut in expenditure.

I believe that what the economy needs is a permanent reduction in tax rates, because it is now clear that the present rates choke off expansions long before high employment is reached. However, consideration of a permanent change in tax rates would trigger off a national debate that could not possibly be completed in this congressional session.

Moreover, any permanent revision in the rate structure should be carefully adapted to the tax reform program scheduled for congressional consideration next year. For this reason, I would suggest the enactment of an equal percentage-point cut in individual and corporate income tax rates effective October 1 for a year or 15 months, with the understanding that these rates would be superseded by a new rate structure which would be included in next year's tax reform bill.

A reduction of one point in all individual income tax rates would cost \$2 billion a year; the same reduction in the corporate rate would cost \$0.5 billion. Accordingly, a 4-point reduction in the individual and corporate rates would amount to a total reduction of \$10 billion at an annual rate; of this, \$8 billion would go to individuals and the remaining \$2 billion to corporations.

This package would meet the requirements of simplicity and size, and would have the added advantage of maintaining the present differential between top and bottom bracket individual income tax rates and between individual income tax rates generally and the corporate rates. It would also give the administration and the Congress the necessary flexibility to coordinate the proposed tax reform with permanent rate reduction.

The effect of this tax reduction on the budget for fiscal year 1963 would be much smaller than the full-year effect. I estimate that the deficit would be increased by approximately \$6 billion before taking into account any recoupment from the effect of the tax cut on business activity. It should be emphasized, however, that this increased deficit in fiscal year 1963 would lead to a smaller deficit, or perhaps even a surplus, in fiscal year 1964.

Although the case for an immediate tax cut is strong, I realize that the odds against the enactment of such legislation during this congressional session are very heavy indeed. If Congress does not cut taxes this year, an alternative program should be devised to give the administration sufficient power to cope with the problems that may arise before Congress is organized and ready for action next year. In my opinion, a minimum program would include the following:

First, the President should be given the authority he requested early this year to make a temporary reduction in individual income tax rates of up to 5 percentage points. The cut would take effect 30 days after submission, unless rejected by the Congress. If the Congress is not in session when the cut is proposed, it would take effect immediately but terminate 30 days after Congress convened.

If the Congress is reluctant to yield this authority to the President on a permanent basis, it might extend the authority until the end of February 1963, when it will be organized to act quickly if necessary.

Second, provision should be made for the use of Federal funds to extend unemployment compensation benefits for a limited period to workers who exhaust their benefit rights under the regular State unemployment compensation laws. Similar legislation has been enacted during the past two recessions, and has proved to be an effective countercyclical measure. Since it is too late to process a permanent law, the temporary law which expired in April of this year should be reenacted for another year, for humanitarian reasons alone, if not for reasons of purchasing power.

Third, the capital improvements program for distressed areas which has already passed the Senate and is now being considered in the House should be enacted before Congress adjourns. The legislation is designed to provide funds especially for relatively small local projects on which work can be started quickly. The amount of money involved is modest enough to insure that the funds would be spent on useful projects.

Finally, the administration should plan now to submit a budget for the coming year that would yield a much smaller surplus at full employment levels of income than the surplus implicit in the budget for fiscal year 1963. Although it has been reduced somewhat since 1960, the full employment surplus for the first half of calendar year 1963 which is implicit in the current budget is of the order of \$10 billion (on a national income basis).

The Economic Report stated that "if demand falls short on current expectations, more expansionary policies will be pursued." It is clear that the signs were set too high early this year and it is to be hoped that budget planning will be more realistic the next time around.

In closing, I should like to recall to the committee that, when I last appeared before you in December 1960, the economy was in a contraction that was already 6 months old. Nevertheless, many people denied that there was sufficient evidence to justify immediate action to stimulate demand.

It was also said that caution was necessary to avoid unbalancing a budget that was already becoming unbalanced because of the reduction in employment and incomes. And there was a great concern about the inflationary consequences of a vigorous fiscal policy at a time when there were large reserves of idle men and machines waiting to be productively employed.

Although the economy is not in a recession now, our rate of growth continues to be inadequate by any standard and there is very little, if any, steam left in the current expansion. But we are still told not to prejudge the situation; more concern is expressed about the condition of the budget than about the condition of the economy; and we are still warned of the dangers of inflation even though unemployment is high and inflation has long since subsided.

As an economist, I cannot explain the defensive attitude which has gripped the Nation in recent years. I can only express the hope that this committee, which has done such excellent educational work in economic affairs since it was established more than 15 years ago, will help alert the country to the needs of the times.

Chairman PATMAN. Thank you, sir.

I would like to know about the basic premise on which you reach conclusions as to the kind of tax cut which you think we should have. Of course, I know we want to raise the level of savings, the level of investment, the level of income, and the level of consumption, raise all levels, but my question specifically is this: Relative to consumption expenditures as defined in the national income account, are savings too low or too high? How would you, Dr. Eckstein, answer that? Would you say they are too low or too high?

Mr. ECKSTEIN. Sir, in the present short-run context they are obviously too high. Not in the long run.

Chairman PATMAN. What do you say, Dr. McCracken?

Mr. MCCRACKEN. The proportion of income being saved does not seem to me to be greatly out of line with our historical trends.

Chairman PATMAN. Do you consider it too low or too high? Which would you say, if you can answer it categorically.

Mr. MCCRACKEN. They are, I suppose, too low in the sense that obviously we need a step-up in the demand for output, though I do not think this gets very close to the heart of the present problem.

Chairman PATMAN. How would you answer?

Mr. PECHMAN. I agree with Professors Eckstein and McCracken.

Chairman PATMAN. I would like to call your attention to two charts prepared by Dr. Roy Moor of the committee staff. They show how the income which would be made available to individuals under the tax cut would be distributed among the various income brackets under

the different methods of reducing individual income taxes. The chart on the left is self-explanatory. It shows the average tax reductions. Can you read those figures from where you are? Looking at the additional money that would be made available to individuals having adjusted gross incomes of between nothing and \$5,000, the relatively low income class, we see that the different methods make quite a difference in the amount of money which would go to these individuals.

The figures show the distribution, by class of a \$6 billion overall reduction in taxes. If we split the first income tax bracket, setting up a bracket of between zero and \$1,000, and applied all the cut in that new first bracket, individuals with less than \$5,000 of income would on the average have a net gain of \$75. If we increase the personal income exemption from the present \$600 to \$800, individuals in this group would gain \$76. If we applied all of the tax cut in the present first bracket, individuals in this group would benefit by \$60. If we had an across-the-board cut such as has been frequently suggested, individuals in the lowest income group would benefit by only \$42.

Looking at the families with incomes of over \$5,000 you may notice that the different methods also give different results. If we increase the personal income exemption these individuals would receive an extra \$300 of disposable income, but if we had an across-the-board these individuals would receive an extra \$1,680 of disposable income.

But the chart on the right is probably more significant for our considerations of how a tax cut would affect the economic activity. This shows the percentage increase in the aggregate income of each income class which would be brought about by the different methods.

For example, if we increase the exemption the lowest income receivers would have their disposable incomes increased by 2.8 percent, while the aggregate income going to families with over \$50,000 of income would be increased by six-tenths of 1 percent. To take the other extreme, however, an across-the-board cut, we find that the aggregate incomes in the lowest income group would be increased by only 1½ percent, while aggregate incomes of the group of over \$50,000 would be increased by 3.3 percent—more than twice the rate of the lowest income families.

Would the members of the panel care to comment on whether these different methods of reducing taxes would have important differences in their effect on savings, investment, consumption and overall economic activity? Would you start, Dr. Eckstein?

Mr. ECKSTEIN. Of the points to be made in this connection, I think one very obvious point in this: That a \$6 billion tax cut will not accomplish miracles in any event because the increase in income accruing to anybody is only 3 percent, which is not exactly a revolution of the economy.

Second, in general, it is my belief that this kind of an issue—that is, the proper distribution of the tax burden—is largely a noneconomic issue and elected officials are the people properly to pass judgment of this sort. On the effect on saving, what studies have been done on this problem tend to suggest that people in the lower income brackets have somewhat higher spending propensities than the upper brackets, but the total impact of any change in the tax burden can at best make a small contribution to total expansionary policy.

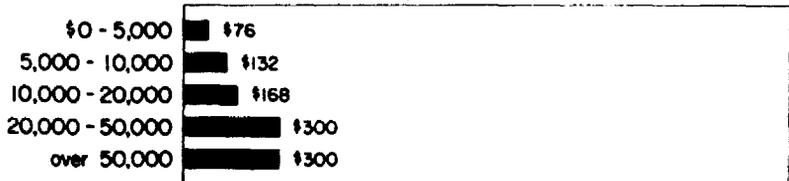
**Average Tax Savings per Individual  
Under Various Methods of Making a \$6 Billion Reduction  
in Individual Income Taxes\***

ADJUSTED GROSS  
INCOME CLASSES

**Reduce Rate in Half First Bracket 7.5 Percentage Points**



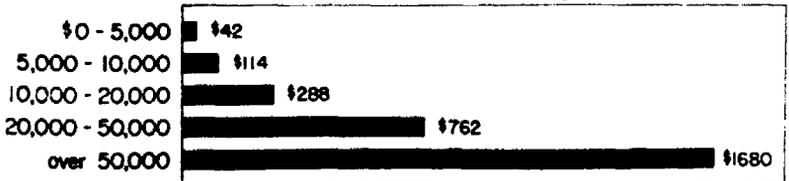
**Increase Personal Exemption \$200**



**Reduce First Bracket Rate 4.6 Percentage Points**

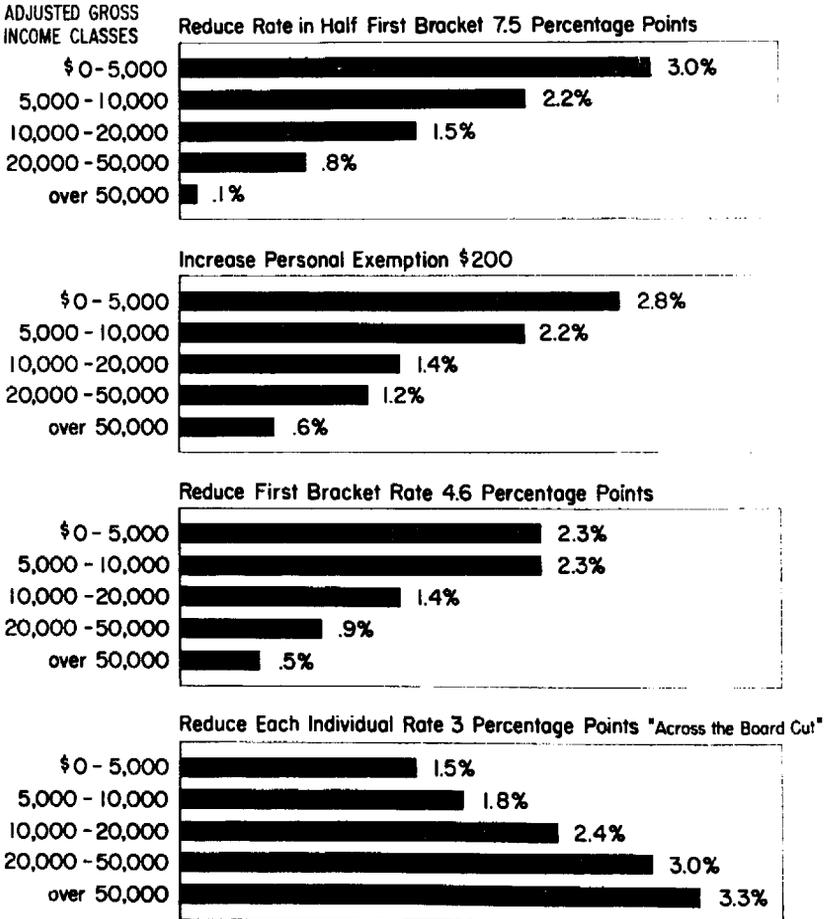


**Reduce Each Individual Rate 3 Percentage Points "Across the Board Cut"**



\* Estimated for 1962 on basis of 1960 data of Internal Revenue Service

Percentage Increase in Taxable Incomes, After Taxes,  
of the Different Income Classes Under Various Methods  
of Making a \$6 Billion Reduction in Individual Income Taxes\*



\*Estimated for 1962 on basis of 1960 data of Internal Revenue Service.

Chairman PATMAN. Thank you, sir.

I will not insist on answers to these at this time. I will put the questions in the record. I wish each one of you would comment on them when you review your transcript and extend your remarks, if you please, or insert anything else that you feel is germane. An across-the-board tax cut would increase disposable incomes of families in the high-income brackets a great deal more than it would for those at the lower end of the scale. If you felt that our basic problem is one of inadequate rate of savings, I could understand this kind of proposal. But if you think that the problem is underconsumption, then I should think you would want to give the largest cuts to the low-income groups, or at least keep things even. In other words, an across-the-board cut would tilt the income distribution in favor of the high-income families. Do you have any distribution by income classes of the percentage of family income going into consumption and the percentage going into savings? I will ask you to submit an answer when you review your transcript.

Next, have you experts made any estimates which would show how much reduction in taxes would be required to produce a given amount of stimuli under each of the alternative methods: raising the exemptions, making the cut in the first income tax bracket and making the cut across the board? This is a question that concerns me. If we had an across-the-board cut in taxes; that is, a cut which would change the income distribution in favor of the top bracket income receivers, would we not have a worse fiscal structure after the period of the deficit is over? In other words, would it not, in the long run, increase the troubles which the tax cut is intended to cure?

With reference to the economy of Western Europe, I think I can see that there are peculiarities in the situation which would enable these economies to operate at full employment even where a large share of income is going into savings and investment. A dynamic rebuilding or reconstructing of the whole European economy is going on. They are building modern plants to replace handicraft plants in anticipation of future consumer demand for the output of those plants. But I wonder, in a situation like ours, if we can have full employment with anything like the percentage of income going to capital in Europe; that is, the high profits and high interest rates of Western Europe.

Could you comment on that? I will ask you to do that when you look at your remarks. But I think those charts make out a convincing case for the tax savings going to the low-income groups. Certainly if our problem is underconsumption, the answer is obvious.

(Information submitted by Otto Eckstein, Harvard University, follows:)

The major studies of the effects of income distribution are the following: Harold Lubell, "Effects of Income Redistribution on Consumers' Expenditures," *American Economic Review*, XXXVII (March 1947), 157-70, XXXVII (December 1947), 930.

M. Bronfenbrenner, Taro Yamane, and C. H. Lee, "A Study in Redistribution and Consumption," *the Review of Economics and Statistics*, XXXVII (May 1955) 149-59.

Alfred H. Conrad, "The Multiplier Effects of Redistributive Public Budgets," *the Review of Economics and Statistics*, XXXVII (May 1955), 160-73.

Lubell and Bronfenbrenner do not attribute much expansionary effect to changing the income distribution; Conrad comes to a more optimistic conclusion.

As a first approximation, I would assume that all of a tax cut accruing to individuals with incomes below \$5,000 would be spent, and between one-half and three-fourths of a tax cut on incomes over \$15,000. Applying a multiplier of 2, every \$1 of low-income tax cut would raise GNP \$2; the figure for high-income tax cuts would be \$1 to \$1.50.

(Responses by Mr. Pechman to the questions raised by the chairman:)

1. I would rank the four illustrative tax cuts in the following order as regards their effect on personal consumption expenditures: (a) an increase in the personal exemptions; (b) a reduction in the rate in the first half of the first bracket; (c) a reduction in the rate applying to all of the first bracket; and (d) an across-the-board cut of equal percentage points. However, the difference would not be very large. Although average consumption is a higher proportion of income in the lower income brackets than in the high-income brackets, differences in consumption out of increments to income are probably much smaller.

2. There are no current estimates of the consumption-saving patterns of families in different income classes. But earlier studies have all indicated that consumption declines relative to income as income rises. There are no data on the proportions of additions to income that might be consumed at various levels of income.

3. I do not agree that the fiscal structure would be distorted in any way as a result of an equal percentage-point tax cut. As I indicated in my statement, such a cut preserves the rate of progression and might therefore be more acceptable as an interim measure than a reduction in taxes applying mainly to one part of the income distribution. Since the consumption effect would be substantial in any case, I would support an across-the-board cut under present circumstances.

Chairman PATMAN. I have probably taken up my time, and I will yield to Mr. Curtis for questioning.

Representative CURTIS. Thank you, Mr. Chairman.

I find myself in a difficult position to ask questions because all three presentations start on a premise with which I disagree, a very fundamental premise, that our economy is stagnant. The very symptoms that I think you all use to substantiate your view that the economy is stagnant are what I would interpret as growing pains. We have had this argument before, Dr. Eckstein and I. I think it comes to two things. One is a question of whether or not we feel that an economy does move forward through business cycles, as we call them. Do we agree it does, that that is normal, to go forward in periods of expansion and then contractions like the peristaltic action, if I can be a little earthy? Is that a natural thing? If it is a natural thing what are we trying to do—interfere with a natural process? Rather should not we be understanding it and working with it? Could I ask that question?

Is it a natural process, or is it something that you want to eliminate? Do we want an economy moving like that and so we feel it moves up and down?

Mr. ECKSTEIN. Congressman, I doubt a little bit whether this is in my statement. Actually, the business cycle itself has been becoming milder of its own accord. The 1960–61 recession was a very mild one, more so than 1958. Even that was very small by prewar standards. I think our concern is that the little ups and downs have so preoccupied us, especially with the immense amount of statistics and figures which come out every single day, that we have tended to lose sight of the longer run trend.

Representative CURTIS. Do we agree, is it a natural thing? Is this the way an economy moves forward, through contraction and ex-

pansion? Again, to use the earthy illustration, of the peristaltic action, in actual life so many things move forward in that way. Do you think that is a natural state? If it is, we should not be trying to destroy it, should we?

Mr. ECKSTEIN. Our economy has always grown with cycles.

Representative CURTIS. It has, but is it natural and is it the way it should be, that is the question? I think some of you economic theorists are treating something that is natural as if it were a disease.

Mr. PECHMAN. I will try. What I do not like is your use of the term "natural." You use it in a way which suggests that, once you have said it, that is all there is to be said about the cycle.

Representative CURTIS. No.

Mr. PECHMAN. You said that 2 years ago, Mr. Curtis, when you were talking about growing pains, about business cycles. We never got back to high employment then. The real question is not—

Representative CURTIS. I will get to that because I happen to think, and this was the next question—maybe I better interject this—you see in your concept of this gap theory that Dr. Eckstein and Dr. Heller and apparently most economists, and your paper seems to buy, is on the assumption that there is failure to have full utilization of our productive resources which includes the labor force, which includes plant capacity. What I suggest that you are failing to realize is part of this natural thing, particularly in a dynamic economy which is innovation—and that to me is the real reason—

Mr. PECHMAN. Are you satisfied with the economy as it is today?

Representative CURTIS. On innovation?

Mr. PECHMAN. Yes.

Representative CURTIS. I am never completely satisfied but let me say this, that the innovation as near as we can figure reveals that 25 percent of the goods and services now on the market were not even known 5 years ago. There is a test of innovation. How much money is going into research and development? How much is going into retraining? Here is what I wanted to say. Part of the natural process, as I see it, is retooling, actually junking obsolete equipment. That applies to human beings, to taking skills that have become obsolete and retraining for new skills in demand. So a lot of what you people, I am afraid, call unemployment and unused capacity is part of a natural process of dealing with obsolescence.

Mr. PECHMAN. I must confess I have heard you say this a number of times, Mr. Curtis, and I would like to understand your position. Particularly the position that everything is going along all right.

Representative CURTIS. I did not say that. Because I am critical. If I had time, and I do not here, but I will come around in the second round, to point out where I am critical.

Incidentally, we all agree on one thing, the need for tax reform, and the fact that our budgetary process and fiscal policy is interfering with this natural, I say, process. You all for other reasons advocate the same approach. No, I am not satisfied with our economy. I never am. I do feel it is a basically sound situation and what we have got to do, in my judgment, is understand it a little better.

Mr. PECHMAN. There is no question about that. The problem, it seems to me, is that in recent years we have not utilized the tremendous resources of this country to the fullest advantage. For the last 5

years our rate of growth has been falling farther and farther behind the rate of growth in other industrialized economies. We are now taking a back seat to some of the smaller and less advanced countries. If this continues over a period of years, I do not think we will be able to survive the competition that we will be subjected to.

Representative CURTIS. Your statement in my judgment begs the question that is at issue. You are measuring growth in terms of gross national product which I have tried to point out is not an accurate measure of growth. You have to dig into the component parts, such as innovation and new goods and services to test whether there is real growth. As I have tried to point out, the shift we have seen in our economy from the manufacturing sector to distribution and services, the amount of increased leisure time, the percentage of time spent by an individual human being in education; those are measures of real growth, not gross national product, which is simply a measure of economic activity in a given year.

Mr. PECHMAN. Do any of the measures that you suggest indicate that we are doing better now than we did in 1960?

Representative CURTIS. Certainly so.

Mr. PECHMAN. Would you suggest some?

Representative CURTIS. Yes, one is measurement of school construction. Incidentally, one of the most glaring inadequacies of this administration is the fact that the school bonds in 1961—new school bonds voted—went down from \$2.2 billion to less than \$1 billion. It went down to \$850 million. But take the cycle from 1950 to the present, President Kennedy said we had to double the amount we are spending on education in the next 10 years. My comment was, "Why slow down?" It has been more than two and a half times from 1950 to 1960. That is what I regard as significant growth.

Mr. PECHMAN. I agree we need more schools.

Representative CURTIS. I am talking of a sample of measurement.

Mr. PECHMAN. We could afford to build more schools if we had higher GNP, the measure you do not like.

Representative CURTIS. I disagree with you. We are building them and the local districts are doing this because one of the essential sound things in our economy has been the real estate tax, the property tax.

Mr. PECHMAN. Every time they build a school it goes into the GNP.

Representative CURTIS. My time is up.

Chairman PATMAN. You mentioned the bonds not being offered for sale for school purposes. Do you not think that the people concerned have refused to vote them because the interest rates were too high?

Representative CURTIS. No, as a matter of fact, let us get our indicators here and let us know what we are talking about. These are the Health, Education, and Welfare indicators of July 1962. The charts here are very interesting, and I think need to be followed. The first chart on page 25 is public educational construction, bond elections, bond sales and contract awards, and shows first bonds voted upon in public school election bonds, and then the number passed.

Chairman PATMAN. What percent?

Representative CURTIS. The percent passed ranges, beginning in 1957, 74 percent, 78 in 1958, 62 in 1959, 83 percent in 1960, and then dropped to 69 in 1961, and it is ranging around there. But here is the point. The amounts of bond issues voted start out 1.3 billion, go up to 2.2 in 1960, and then drop down to 851 in 1961.

Chairman PATMAN. I urge you to look that over more carefully and evaluate it more carefully with this in view: that the people turned down these bond issues because the interest rates were too high. More of the local people pay taxes on what they owe than what they own because of the ad valorem system. They are very careful about levying these extra costs on themselves.

Representative CURTIS. I might say to the gentleman that an examination reveals that is not so. I think I can tell you why this drop. It is because they are waiting for a Federal program.

Chairman PATMAN. What year was that? That was during the preceding administration.

Representative CURTIS. 1961. The other figure on this thing, if we go on to the next page, you get your public education construction, interest, cost of bonds, and educational construction put in place.

Chairman PATMAN. Senator Douglas, we are intruding on your time.

Senator DOUGLAS. Not at all. We have the interest rate on long-term bonds, Federals; the movement of the State and municipals is very similar; in 1953 the rate was around 2½ percent, and it has been rising to 4 percent more or less as of the present time, or a relative increase of 60 percent during this period. Dr. McCracken, in your statement you state that the reserve position of the banks has been easing. You mention this as an indication that monetary policy has not impeded economic expansion. I wonder what evidence you have for the statement that the reserve position of the banks has been easy.

Mr. McCracken. I would make two or three points here. First of all, there is the simple fact that the net free reserve position has continued at a very substantial level. Even with recent changes free reserves are still in excess of \$300 million.

Senator DOUGLAS. May I stop you right there. Dr. William Moor of the committee staff has charted the free reserves for a number of years. The chart shows, in brief, that in 1961 the average free reserves for the year were above \$500 million; probably a closer figure for the year as a whole would be \$550 million. The average free reserves for the year thus far have been around \$375 million.

Mr. McCracken. That is right.

Senator DOUGLAS. Or a decrease of some \$150-\$175 million. A further analysis indicates that almost the entire amount of these free reserves is in the country banks where only a small proportion of the demand for lending actually takes place. For instance, in the figures for the end of June, the free reserves in the country banks amounted to \$371 million. In the Reserve city banks, there was a minus \$5 million. In Chicago, a reserve of minus \$3 million. In New York, a minus \$12 million. The actual "free reserves" were thus entirely in the country banks, where, as I have said, a very small fraction of the total loans originate.

We should also remember that a few years ago we made vault cash a part of the reserves. You have to have cash for cashing checks and so forth and so on. So it would seem to me that in practice free reserves are virtually nonexistent. It puzzles me, therefore, when I read these statements—and yours is not the only one—that the reserve position of the banks has been easy because free reserves are plentiful, when they have declined absolutely and as a matter of fact are con-

concentrated almost exclusively in the country banks and consist almost exclusively of vault cash.

Mr. McCracken. Nonetheless, the evidence supports the conclusion which I stated in my testimony.

Senator Douglas. Are my figures erroneous?

Mr. McCracken. This is what I want to comment on. In the first place excess reserves historically tend to be concentrated in the country banks. This is not new. Larger banks keep even temporarily surplus funds quite fully employed in such things as bills or the sale of Federal funds.

In the second place, while the net free reserve figure, like any other simple figure, is subject to limitations, it is a useful quick way of getting some indication or some impression of the pressure on the banking system. It indicates at present a condition of relative ease, an impression confirmed by collateral evidence. I happen to be a director of a bank and spend some time in banking circles. There is a vast amount of difference in the sentiment of the bankers so far as their lending policies are concerned, or particularly so far as their interest in building up their loans, relative to that in 1957 or 1959. There is not the loaned up sentiment that there was in those years. Moreover, there has been an 8½ percent increase in bank credit during the past year. That is double the normal needed gain to support vigorous economic growth. So, as I look at the evidence, I do not see it supporting the position that the major problem that we face at the present time is in the area of monetary policy.

Senator Douglas. I wish you would take another look at these figures, because it may indicate that free reserves are virtually nonexistent. The second question I want to ask perhaps applies to all three of you, although I came in late and did not hear Dr. Eckstein's statement. Dr. McCracken and Mr. Pechman seem to believe that the balance-of-payments problem requires relatively high interest rates. Yesterday, we brought forward facts indicating that so far as the short-time rate is concerned that the American rate is above the Swiss rate, which is only 2 percent. It is above the French rate which is about 2½ percent. It is above the Dutch rate, which is just about 2½ percent. It is below the French, British, and Canadian rates.

But, if you take the arbitrage costs into account, it is approximately equal to the French rate, and the British rate, and I think there are charts here to demonstrate that. It is below the Canadian rate, but I can hardly believe that people would transfer American dollars to Canada in view of the shaky situation in Canada which has caused them to devalue their dollar.

Now, then, just what is it that you are afraid of as far as the situation is concerned? Is it the fact that our balance of payments is against us? Is that the point?

Mr. Pechman. I would be concerned about substantially lowering the interest rate, particularly the short-term interest rate.

Senator Douglas. How about the long-term rate?

Mr. Pechman. I would like to keep the long-term rate at the present level, or even lower it a bit. The short-term rate controls short-term capital flows, which are particularly sensitive to interest rates. I think we have to keep short-term rates at a higher level than we kept them during the early postwar period.

Senator DOUGLAS. Is there a drain from Switzerland?

Mr. PECHMAN. No, but I am afraid that, if we pushed the rates substantially lower than they are today, it might stimulate a large flow of liquid funds abroad.

Senator DOUGLAS. Don't we have a real margin of safety on this and need we be concerned with speculative outflows of gold in search of higher interest rates abroad? That is what I am trying to say. What are you afraid of: that the balance of payments is against us and Europe may not be content with leaving their balance on deposit in dollars?

Mr. PECHMAN. Both factors are involved. I do not want you to misunderstand me, Senator. I do not want a higher level of interest rates.

Senator DOUGLAS. I understand. But you do not want a lower rate.

Mr. PECHMAN. That is right. In other words, I am saying that we have done fairly well in monetary policy up until recently. I am a little concerned about the noises being made on monetary policy, though I cannot say that the action has been as bad as the noises. If these noises are followed up by action, I would be terribly concerned, as you would.

Senator DOUGLAS. Here is the point. Recently the Federal Reserve sold Government securities and depressed the price and consequently raised the yields. The result has been a rise in the short-term rates and a lesser rise, but some rise, in long-term rates.

On the question of the unfavorable balance of payments, must we accept eternally those inadvisable items which turn a favorable balance of trade into an unfavorable balance of payments, which turn \$3 billion surplus in commodities to a  $1\frac{1}{2}$  to 3 or 4 billion unfavorable balance because of the so-called inadvisable items. Are we committed indefinitely to continue maintaining military divisions in Europe? Are we committed indefinitely to the attendant costs of expenditures of dependents? Are we committed indefinitely to the existing level of foreign aid if the other countries do not contribute? Are we committed indefinitely to the present flow of capital abroad when virtually every other country imposes some controls upon the export of capital. I mention all these things. Can we take the existing unfavorable balance as something we cannot do anything about?

Mr. PECHMAN. I agree with the implications of what you said. A great many of these things have already been done and a lot more perhaps should be done. Certainly we should not have a domestic policy that would prevent us from getting back to high employment merely because of the balance of payments. I think that is the important lesson of your remarks.

Senator DOUGLAS. That is the point I was making. My time is up, but if any of you wish, you may volunteer a reply.

Mr. McCracken. May I make just one comment, Senator Douglas.

The point of that part of my testimony where I commented on the balance of payments problem was simply this. We hear a great deal of discussion that the nature of our rather precarious balance of payments problem makes it impossible for us to consider expansionist fiscal policy action. Precisely the point that I was trying to develop here was that if we manage an expansionist economic policy correctly, there is reason to think that this kind of action at least would be

neutral in its effect, and I think personally there is at least an even chance that it might improve our balance of payments.

Senator DOUGLAS. You say "correctly," what do you mean?

Mr. McCracken. If the expansion of business activity that we got sets off a very substantial rise in the price level, or if we gave the economy a surfeit of liquidity, then this would probably work out to have adverse effects. But in the technical sense, the adverse effect on our balance of payments of a higher level of business activity because of the higher imports, would, I suspect, be largely offset by favorable effects on the large capital outflow—and ultimately even a strengthening of U.S. exports.

Senator DOUGLAS. I was not speaking of commodities.

Mr. McCracken. I understand.

Senator DOUGLAS. I was speaking of the military and dependents' expenditures, foreign aid, capital investment abroad.

Mr. McCracken. All of that would help. Some reduction in these is an essential part of the solution.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Gentlemen, I notice an interesting consensus among all three with respect to a tax cut which is very interesting in view of the fact that the press and public and Mr. Heller all assume the matter is decided and that there will be none. Therefore, I notice, also, an interesting consensus among you—certainly two of you explicitly, and perhaps I missed it in the third, suggest that we give the President the authority to make a tax cut. Suppose I should tell you, just for the sake of this argument, that is equally impossible. Just as the President can decide that he would not ask the Congress for a tax cut, the Congress can decide that it would not give him authority to make one. I have little doubt, and I state this unilaterally, that is just as sure by now as the fact that he is not going to ask for one.

Representative CURTIS. Surely.

Senator JAVITS. I think the Congressman is right. Where does that leave us in view of the fact that your recommendations, Dr. Pechman, are directed essentially toward governmental action? I notice at pages 7 and 8 where you say that what we should do, if we cannot get a tax cut, is to give the President authority. I tell you unilaterally, and I think it is sound, that is just as unlikely and impossible as the other.

Then really you boil down to recommendations to extend unemployment compensation benefits, and to deal with the capital improvements program already passed by the Senate. I do not think you put that very high on your list, or that the administration submit a new budget. Again it is not too decisive a form of action. So really we get down to extending unemployment compensation benefits for a year. I could not agree with you more. I thoroughly agree with you.

Now I would like to ask you all this question: Are there not many other things which could be very helpful—assuming now that notwithstanding your view and mine, as you know widely advertised, that there should be a tax cut, that it should be now and it can be now and it makes a lot of sense, and the fact that we are not going to give the President this authority, which I asked you to postulate, and the fact that perhaps we would not even do this unemployment thing much as I agree with you. Are there any things which the Presi-

dent could do other than that which would help our situation, not necessarily only in the governmental line? For example, do you think that some effort should be made to deal with the business problems in making the transition to automation and in financing that transition—something which the President might very well generate through his Labor-Management Advisory Committee? Do you think that some action on the part of the Congress concerning the rash of big strikes that seem to be imminent on the railroads, to deal more effectively than we do under the Taft-Hartley law, with the problem of national interest strikes might be something to which we ought to direct our attention? Do you think that some declaration by the Department of Justice as to its policy in respect of the antitrust laws might be an important factor?

Somebody here suggested that the President ought to make a decisive statement of the view of the country on business profits, and their desirability and importance. In short, do you have any suggestions which go to the only clue to this proposition I find in your statements, that of Professor McCracken's paper which at page 5 says that businessmen were alarmed by the inferences they drew from the administration's handling of the steel price dispute? Then he says on page 6, consumer attitudes have never regained the levels of buoyancy they reached in 1955, and there has been some deterioration since events of April and May, which I would imagine refers to the same events. What do you say about that, gentlemen?

My time is up and I have asked you a long question, because I am a lawyer.

Mr. ECKSTEIN. I think this country has many problems and accomplishments and there are lots of things the Government might do and lots of things the Government might stop doing. One thing the Government might well do is to create a more certain business environment with regard to areas of regulation, antitrust and so on. Even if policy is tough, business is better off knowing it is going to be tough than not knowing at all and having to deal with a rather erratic kind of situation. Other than that, I do not think a little bit of action on these longrun structural problems, such as depressed areas and automation, is any kind of a substitute for the kind of massive fiscal action which is called for. I will even go so far as to say that in some way it distracts us from the main problem.

These structural programs, which I agree are very much needed to ease the introduction of technological progress into the economy, will be much more successful if the overall situation is healthier.

Senator JAVITS. Thank you very much.

Mr. McCracken. May I make one comment?

Senator JAVITS. I would like to have you all comment, if you would.

Mr. McCracken. I do not think any reasonable estimate of the magnitude of the economic effect of action in these other areas would be equal to the kind of stimulus we could get from tax reform and reduction. Now, if these are ruled out, however, then the question becomes: Do we just sit on our hands, or are there other things to do? There is no question in my mind but that something constructive could be done along the lines you have indicated in your question. It would be very helpful to try. It certainly would not hurt to try.

Senator JAVITS. Thank you.

Mr. PECHMAN. I agree that the longrun problems that you suggested ought to be tackled and it would be helpful from the standpoint of business and consumer confidence to know that they are being thought about constructively. But I also think that the point made by Professors Eckstein and McCracken is quite right. I know of nothing that would equal the potency of a very substantial tax cut. But I have worried about your question and that is why I have a program at the end of my paper.

Since you foreclose the possibility of Congress giving even temporary authority to the President to cut tax rates, I am sure that when you have your hearings next February on the Economic Report you will find that unemployment is no lower than it is today. It may even be higher. And you will be lamenting the fact that we wasted another 6 months, and that the rate of growth of the economy will have been further reduced; in other words that we will still be where we were 2 or 4 years ago. I think the quicker we start solving these long-run problems, the better.

Senator JAVITZ. Gentlemen, you have given me encouragement and fortitude to continue my campaign for an incentive tax cut. Thank you.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. A question first of my colleague, Mr. Curtis. Did I hear you right—you attribute the fact that a smaller total of local school bond issues was voted in 1961 than in the period, 1958-60, to President Kennedy's advocacy of Federal aid for education?

Representative CURTIS. It was the unsettled condition, yes. The school districts thought they might get it free or get it from the Federal Government.

Representative REUSS. Then I did hear you right.

Representative CURTIS. That is correct.

Representative REUSS. How do you account for the fact that school districts voted larger amounts for local school bonds in the period 1958-60, when President Eisenhower was advocating aid for school construction? Was that because they did not believe him?

Representative CURTIS. I guess so.

Representative REUSS. A question for the panel—

Representative CURTIS. If the gentleman would yield. You made a wisecrack.

Representative REUSS. How long do you want me to yield?

Representative CURTIS. Just to comment. I would say it could be that. I do not know. It certainly deserves explanation or contemplation. I merely suggested that this could be the reason. I think it probably is.

Representative REUSS. A question for the panel: Leaving aside, for the moment, the politics of tax cuts, monetary policy, and other methods for dealing with our economic lag, what is the difference in economic effect of a tax cut of, say, \$6 billion and increased Federal expenditure of \$6 billion? The increases in Federal spending in my example would be for schools, hospitals, urban rapid transit, urban redevelopment, antipollution work, and other necessary public works. Is there, in your opinion, anything different economically between one method and the other? They would both increase the deficit by \$6 billion in the period immediately ahead. Would one method give more impetus to the economy than the other?

Let us also leave to one side, the point that the construction work required by a public works program takes a bit longer to translate into actual expenditure.

Would you each give me your opinion?

Mr. McCracken. Certainly I would not take any Procrustean view with regard to Federal expenditures or taxes that one is all evil and one is all virtue. It would seem to me that on the "first round" the rise, in Federal expenditures might very well have a slightly more expansive immediate effect than a decline in taxes. With a tax reduction some part of the resulting increase in income would presumably be saved. On the other hand it is not easy to effect an immediate, large upward displacement in the trend of Federal spending.

Representative Reuss. I assume you are comparing the average saving by consumers of 7 to 8 percent of their disposable income with the fact that a million dollars spent in building a school is by definition spent.

Mr. McCracken. In the first round, yes. On the other hand at this stage of the game the evidence is quite clear, to me, that the time has come when we do need some action on the tax side in order to start moving toward a level and structure of taxes that would be somewhat less of a drag on economic expansion and growth secularly, quite apart from the very immediate period.

Mr. Eckstein. Congressman, the total Federal purchases of goods and services outside of defense in 1960 were \$8.6 billion. Of that, a very substantial fraction is agriculture. The rest was defense.

Representative Curris. Federal?

Mr. Eckstein. Federal goods and services. Only \$8.6 is nonmilitary. And that includes space. To effect a substantial increase in that would be very difficult. The Federal Government simply does not buy that many civilian goods and services to make it an instrument of the same magnitude as a tax change.

Representative Reuss. I suggested some areas of public expenditure where the needs today are very great. However, I am putting to one side the question of whether increased expenditures are politically feasible, socially just, or economically desirable in terms of resource allocation. What I want to know is, would you get the same economic impetus by spending \$6 billion more as you would by taxing \$6 billion less?

Mr. Pechman. I want to agree with the point you are making. The ratio of taxes to expenditures that is too high. You can reduce this ratio either by reducing taxes or increasing expenditures. If we got businessmen and consumers to spend as much as is necessary to get us to high employment, today's tax structure would not greatly impede the rate of growth.

I think there are things that can be done to improve our rate of growth, but the rate of growth that we can achieve at high employment is awfully tough to budge. We would have to make many changes to increase the growth rate. One of them would be to reform the tax structure to the extent that it impedes incentives.

Representative Reuss. Then, what you three gentlemen contend is not that we need a tax cut as such but that we need a budget imbalance at the present time for various reasons. In economic terms, am I not right that it is not the level of taxes alone, but the level of taxes in

relationship to Federal spending which chokes off the economy before full employment is reached? If the budget tends to balance before full employment is reached, the ailment could be cured by either of two methods.

Dr. McCracken says, "Cut taxes." Galbraith might say that public expenditures should be increased.

Mr. PECHMAN. I agree.

Representative REUSS. I have used your names rather freely. I hope I have not misinterpreted your positions.

Mr. McCracken. No. Clearly the two sides of the budget must be taken into account. I would agree with this. A tax cut would temporarily mean an enlarged deficit. If, however, tax reforms will really strengthen the economy (as I think they can) we can be ahead of the game in the long run on renewals of the deficit.

Representative REUSS. There has been much talk recently about a tax cut as though it were the only way out. Actually, budgetary balance seems to me to be the real problem. I am not suggesting what fiscal policy mix we should have, except to say that the best mix is one which combines relatively easy money and low interest rates, a tax cut and spending for the Nation's needs. An aggressive trade policy would also help.

Representative REUSS. Dr. Eckstein, in your statement on page 8, you refer to the argument which says,

Why cut taxes now, since this will cause interest rates to rise and to cancel the benefit of the tax cut? The growth rate will not increase, but we will have a larger deficit.

Your reply is that, although the monetary authorities actually shrank the money supply and increased interest rates in the 1958-59 recession, they will now allow the money supply to increase at some modest rate. Why do you think this will be the case, particularly in view of Mr. Martin's recent testimony that he would not permit any of the deficit resulting from a tax increase to be financed by the banks.

Mr. ECKSTEIN. It would certainly be far beyond my capabilities to analyze why our central bank does what it does when it does. However, what I am really trying to say is this: The tightness of money and the level of interest rates in 1963 will be largely determined by the policy choices made by the Federal Reserve and the Treasury. I do not know whether they will do the right thing or the wrong thing, but the extra few billion of deficit which will have to be financed, I doubt will be the decisive considerations. It would obviously raise interest rates somewhat. But I do not believe that additional financing alone would reverse the basic tone of the capital markets.

Could I also take another moment while I have the floor? When I read my statement I also made a quick comment on the possibility of lowering withholding schedules effective January 1. I stand corrected on that. It would take congressional action to lower the withholding rates.

Representative REUSS. I am glad you made that point because I was about to ask you. More administrative flexibility in the withholding provision might be desirable, but it does not now exist.

Senator PROXMIRE. I would like to ask Mr. Eckstein, Senator Javits indicated there is not much prospect of a tax cut. Yet Senator Javits

advocated a tax cut the other day which he said would be a \$7 billion tax cut. He included in that the \$1½ billion reduction in tax burden the administration has already achieved because of the adjustment of the depreciation. Now, as he pointed out, it appears that the Finance Committee with that monster they are about to report out, is going to further reduce taxes, and as far as the investment credit would seem to provide an additional \$1 billion tax cut.

FOR BUSINESS SPECIFICALLY IN CASH FLOW

So is it not true that during this year of 1962 if Congress takes no further action, there is likely to be, in effect, a tax cut for business of about \$2½ billion?

Mr. ECKSTEIN. That is correct.

Senator PROXMIRE. Since you advocated a \$6 billion tax cut, this is 40 percent of the way.

Mr. ECKSTEIN. No. Our analyses took those for granted.

Senator PROXMIRE. You are really advocating \$8½ billion tax cut if we want to include everything?

Mr. ECKSTEIN. If you want to include all the previous relief, yes. The Treasury is supposed to get a little bit of the investment credit back in revenues from loophole closing. They are not to get all of it.

Senator PROXMIRE. Very little the first year—A net cut of a billion dollars in taxes.

Mr. PECHMAN. May I just interpose that I am distressed to see so much pessimism about some of the things that were not included in the Finance Committee bill. I should hope for example that an effort would be made to restore withholding on the floor.

Senator PROXMIRE. It will be made but it does not have much chance.

Mr. ECKSTEIN. To answer your question more to the point, the additional savings that will be made available by these measures will certainly have to be considered in making up the next tax package. It is a fact that the cash flow of corporations will have been augmented by between \$2½ and \$4 billion. I do not think anybody knows where in that range. And for any tax bill in the future, it would not make any sense to keep pouring more and more money into that area alone.

Senator PROXMIRE. That is right. From what you say I take it this is one area where we are probably less in need of a tax cut. This relates to a vote that we may be about to take on the floor of the Senate in the next few weeks, whether or not we should have an investment credit. I am inclined to feel that the cash flow increased before the improvement in the depreciation policy of the administration. Now the cash flow is going to be abundant, and perhaps superabundant.

There is an additional loophole in this investment credit to permit for the first time a depreciation exceeding a hundred percent which would seem to have some equity disadvantage. I am wondering whether in your judgment, Dr. Eckstein, if this is a sensible proposal now under the present circumstances.

Mr. ECKSTEIN. I am still an optimist that even if not now within the reasonable future we will get the short-run problem straightened out. Maybe that is foolish, but I believe we can, and there is a reasonable prospect we will. If you really look at it as a long-term question,

I do believe that we have something to learn from the experience of Western Europe and Japan, and that tax devices will raise the total rate of investment.

Senator PROXMIRE. Yes; but is this the right kind of tax device? In the first place, business has not indicated any enthusiasm. McGraw-Hill said this will have the result of increasing investment by \$300 million although the Federal Government will lose a billion dollars. A survey by the Wall Street Journal, with 68 big firms queried, only 1 said they would change their investment policy. It is a nice windfall, but one they do not expect to influence policy and do not want it.

Mr. ECKSTEIN. This will not be very effective as long as the aggregate rate of activity does not lead to anything like optimal utilization of capacity. I would not attach too much significance to the immediate answers of businessmen. I think most of them did not understand what the credit was about. I have explained it to a few small businessmen and in some cases they very clearly told me, that it certainly would help them quite a bit.

Senator PROXMIRE. These were the biggest firms in the country and people who had very distinct ability, and understanding in this area. They have sufficient specialists so they should be competent on something of this kind. Let me ask Dr. McCracken, you assumed the same thing Dr. Heller did yesterday: That the supply of money should include time deposits. We did not have a chance to pursue it on this, but I want to take the few minutes I have left to pursue it with you.

Dr. Heller seemed to ignore his own indicators which show on page 26, money supply, total, and under total it does not include time deposits. It does include currency and demand deposits which have been the traditional definition of money supply. Then it shows related deposits or time deposits separately. On this basis, and I think you can make a good argument that time deposits are not money, it is clear that money supply has been dropping very rapidly in relationship to the gross national product, whereas in 1953, it was 35 percent; 1958, 31 percent; a year ago, 27 percent; now it is down to 26 percent. This does seem to represent a real squeeze which is being directly reflected in rising interest rates, as Senator Douglas demonstrated so well, and by the drop in free reserves.

Mr. McCracken. I would define the money supply differently from the Federal Reserve or the concept as included in the Economic Indicators. There is no one definition which is uniquely and clearly and unambiguously vastly superior to another. The assets that people hold are really a continuum, ranging all the way from currency, the most liquid asset, to demand deposits and time deposits and for corporation short-term securities, which serve for them a function virtually the same as cash. One important function of money is to serve as a reserve of purchasing power for unforeseen contingencies. Certainly time deposits serve this function well, and practically are immediately convertible into demand deposits. In any event one can say this. In the last year total bank credit has increased over 8 percent, half of which has occurred since the turn of the year. Perhaps that is a better measure of the monetary influence on economic activity. As a matter of fact, in my opening statement I used the figures on bank credit, rather than the money supply, because it was not until after my

prepared statement had been mimeographed that I got the July Federal Bulletin with the new seasonally adjusted data.

Senator PROXMIRE. To follow up on this, would you not all agree that if the Federal Reserve Board and the Treasury continued to follow a tight money policy, if they continue to push up interest rates, if they continue to shrink reserves, and the Chairman of the Federal Reserve has indicated he might very likely adopt such a policy, and action on the part of the Treasury has indicated they are moving in the same kind of direction, then we are going to need a bigger tax cut to get the same stimulation in the economy? Furthermore would you agree that it is conceivable that if we have a relatively modest and small tax cut with a substantial increase in interest rates, that the economy might not move at all. It might stand still or even retrogress.

Mr. PECHMAN. I would agree that, to the extent interest rates are raised, a larger tax cut would be necessary. However, I would hope that, if we had a substantial tax cut, it would not be accompanied by higher interest rates.

I certainly do not think that we ought to permit long-term interest rates to rise and to reduce investment at the same time that we are trying to promote investment. That would be ill-advised policy under present circumstances.

Senator PROXMIRE. I would like to ask Drs. Eckstein and McCracken one more question:

In reply to what Mr. Reuss said about cutting taxes and increasing expenditures, you indicated that the expenditure side of the budget, Dr. Eckstein, was pretty difficult to expand. In Dr. McCracken's presentation he said on page 14, this proposal for a tax cut would be, in short, a step toward fiscal conservation. In the long run it would make for a less rapid increase in expenditures and more spacing on the tax side for further needed reforms. I know that Dr. Eckstein said that a reduction in tax rates will force the Government to scrutinize expenditures more closely in the coming budget.

I believe in economy in Government. I wish I could subscribe to your view that taxcutting will lead to expenditure reduction. But I feel when economists are talking about deficits and asserting that we need bigger deficits, this destroys the discipline Government has. You can make a strong argument if you accept your basic assumptions for almost unlimited spending. Services are needed and wanted. There is a lot of pressure for them. What is a poor Senator or Congressman going to do when he gets that kind of pressure and when the economists say it will be greater for economy if you cut taxes and increase spending? It is wonderful for the politician if he accepts that viewpoint. When you do that you get in the position where you could have a very bad misallocation of resources, and where you have no real discipline to exercise prudence in Government spending. This directly contradicts what both of you gentlemen said in your statement. Does not this concern you at all?

Mr. ECKSTEIN. I think you would agree with us, would you not, sir, that in general a tax cut would lead to less spending than no tax cut.

Senator PROXMIRE. In old days, yes. But now when a tax cut is justified not because spending has been reduced or spending can be reduced, but although spending is increasing and has been increasing,

the argument is made we need a deficit to move employment up. I say under these circumstances the tax cut will not restrain expenditures.

Mr. ECKSTEIN. Historically, in recent years has it not been like this? The Budget Bureau and the President have been very tough when there was no recession. When there was a recession the lid was off, so to speak, and new programs began. Everybody got a little bit more money in all fields.

Senator PROXMIRE. Now there is no recession and believe me nobody is very tough and Congress is spending money with record rapidity.

Mr. ECKSTEIN. There are a lot of structural issues both in taxation and expenditures. Obviously, there are some tax cuts that would be worse than some expenditure increases and vice versa. A lot of people, including, I think, the three up here this morning presently favor a tax cut, because they really feel it is impossible to prepare a high quality expenditure program of the requisite magnitude within the time schedule in which events are occurring.

Mr. McCracken. The importance of maintaining the concept of fiscal discipline, to which you have alluded, seems to me to be exceedingly important. While clearly the advocacy of a tax cut is suggesting a program that would make the deficit larger, I prefer to put this in terms of getting toward the kind of tax structure which would seem to me to be more consistent with increasing the vitality of the economy.

Now, how does one reconcile these two? I would reconcile them on a basis that has received substantial attention recently. The important thing is always to compare the relationship between our expenditures and the volume of taxes which the present tax structure would produce at reasonably full employment. I would be very reluctant, under any circumstances short of a real emergency, to suggest a tax cut which would leave the tax structure not comfortably covering expenditures at full employment. If this is our approach to the budget problem we do not surrender concern about fiscal discipline. So our tax action should leave us with a tax structure that will always comfortably cover expenditures, assuming that we have reasonably full employment of our productive resources.

Senator PROXMIRE. My time is up, but I would like to say that is an awfully theoretical goal as compared to balancing the budget, which is precise and with all its weaknesses you can still arrive at some arithmetic precision. To talk about a full employment balance—you can argue on vague generalities a long time.

Mr. McCracken. There is no question about this. I suppose to some extent the function of a professor is to be theoretical and explore things that may not have immediate applicability. But it does seem to me that there is validity to this way of looking at the budget problem, and I suspect that we shall hear more about it.

Mr. PECHMAN. I just want to agree with what Professors Eckstein and McCracken said, although I did not make this point explicitly in my statement. In reply to your question, I believe that expenditures would be lower if we had a tax system that next year produced \$90 billion rather than \$95 or \$98 billion. In other words, I do think that the prospective level of the tax receipts exercises a restraint on spending. The existence of a large deficit, which is your alternative hypothesis may relax restraints.

As a matter of fact people do not understand that a deficit indicates one of two things; either the economy is not operating up to full capacity or expenditures are wasteful and too high. We have had deficits during the past 5 years because we have not reached full employment.

Representative CURTIS. I want to get into another question, but first I want to lead into this. The thing I have not understood and I have asked all the witnesses before the Ways and Means Committee, and this committee, is this: How does this theory of a tax cut in a period of a deficit already relate to the economic problems it creates in the debt-management area?

As a member of the Ways and Means Committee I have always had to be concerned about how we market our bonds. If you take \$5 billion, let us say, and give it or transfer it from the governmental sector to the private sector in the nature of a tax cut and then market \$5 billion of bonds in the private sector, why do people suppose that stimulates the economy? Maybe there are some reasons. Occasionally I have gotten answers to the effect that the transfers involve different people. I say let us go into that. But we have not had very much discussion on that subject.

Dr. Heller yesterday had only one little paragraph on the problems of debt management in his prepared statement—simply to say they are great and very difficult, and we have to be very careful about whether we market the bonds to the consumer or whether we use the Federal Reserve System. I said if you are going to use the Federal Reserve System and simply create more money, in effect you are not talking so much of the tax cut effect as you are talking about the fact that inflationary forces of this nature would stimulate the economy. Would any of you care to comment on that?

Mr. ECKSTEIN. It is certainly an extremely difficult question on which economists have pondered and reach no definitive conclusions. There are some things you can say. First, if economic activity expands as a result of the tax cut, some normal increase in the money supply should go along with it.

Representative CURTIS. Let me stop you there, if I may, Doctor. You say, "If it does." To me that begs the question. What we are talking about—does it? Will it?

Mr. ECKSTEIN. Let us take that question first. I take that for granted. Would that tax cut be spent? That is the first question.

Representative CURTIS. That is correct, but nothing should be taken for granted.

Mr. ECKSTEIN. The evidence on that, and there is some disagreement among the experts, I would say it would be fair to summarize it this way. As far as consumers are concerned you would find—and there is an immense amount of statistical work done—people would say somewhere between 60 and 80 cents of every dollar would be spent within a year.

Representative CURTIS. We have never done this. This has always been theory, as I understand. There is no place we can look where we have cut taxes for the purpose of this kind of economic stimulation. I am just taking your aggregate. You take \$5 billion here in tax cuts and then you take it back in bonds. Dealing in aggregates I do not see what you have done, unless there is something about the mix in here.

Suppose you sold it in E-bonds. The purchasers then are the consumers. Then they would not have \$5 billion to spend. You have taken it right back from them. Suppose some goes to investors, as some would, then they do not have that to invest. The Government has taken it.

Mr. ECKSTEIN. Sticking to the tax side, a tax cut on business, I think most people who have tried to make studies of it tend to say in the long run the larger part of additional cash flow would be spent. Then you get to the other side of the question—to what extent is spending reduced by the bond financing? Mortgage money and other long-run money is presently not terribly scarce. It is not rationed even though interest rates have moved up. It seems to me that it is up to policy whether long-term investible funds other than internally generated funds are going to be made very scarce or not. That is a question of Federal Reserve policy.

So we have that side of the coin under somebody's control to some extent also. Of course, the Federal Reserve could run a policy which is so tough that they could completely undo the effect of the tax cut.

Representative CURTIS. Particularly with the balance-of-payment problem. To me these are the issues we should have been discussing in the Ways and Means Committee. Yet the witnesses who appeared before us were unprepared to discuss it. It was improvising, instead of the prepared papers being on that point. I thought that everyone was begging the question. The question is, Will a tax cut which increases deficit financing and puts an added burden on debt management in the condition we are now in, balance of payments and so forth, stimulate the economy, even if it would work at other times under different circumstances? This is an untested theory at best. At any rate I wanted to pose that.

The one thing I particularly wanted to ask a question on here is this: I have just recently got my ducks in a row on it. I know you are all interested in new economic phenomena. I think we have a beauty here. To me it is an amazing thing and one that requires real study and explanation. That is the fact that the civilian labor force, and I have the figures back to 1929, has continually increased each year except for war years. With the total labor force which includes the Armed Forces it continued to increase. But for the first time since 1929, in the year 1962, the civilian labor force actually has not increased and yet our population figures would indicate that there would be an increase of around 1 million.

I average out the figures from 1929 to 1959; we increased on an average about 700,000 a year. In the figures that we have here from 1955 to 1961, we increased almost a million a year. We were able to ask questions on this. Dr. Ewen Clague sent in a letter to the committee saying his statistics were right. I had raised the question whether the phenomena could be explained as statistical errors. Secretary of Labor Goldberg yesterday said that this is a phenomenon to which they just do not know the answer. I have been trying to fit it into my theory of what I think is the test of real economic growth and my belief that we are not stagnant and it does make sense to me that we are having people withdraw from the labor market because they do not want that extra income or balancing in their minds whether they would rather have the leisure time or the income. People did go into the

labor force apparently, women, so that their family could get another car or downpayment on homes, and so on. Maybe that is it. I do not know.

Certainly this gap theory, if you apply this million group, you must put it into the unemployed area, and so the gap has widened. I do not adhere to the gap theory, but to those of you who do, I would think this would be very worrisome because then your gap is increasing.

Mr. ECKSTEIN. I have tried to make a little bit of inquiry on this problem. I gather that the lack of growth of labor force is not concentrated in any one group. I think originally the thought was it might be earlier retirements because of the improved social security benefits.

Representative CURTIS. The figures showed it to be in all age groups and not by men or women, either.

Mr. ECKSTEIN. There are a lot of different phenomena and so far nobody is in a position to put them together. Certainly one thing that does happen in a depressed area, you do slowly over the years evolve a new way of life in which people drift out of the labor force and draw relief and make a living without working. It takes several years of not much prospect for employment where you are located before you get this kind of effect of people just sort of drifting out of the labor force and finding some other way of getting along.

Representative CURTIS. Even in the depression years of the thirties, the civilian labor force increased each year. I did want to point that up. The final thing, and I just want to get this more or less on the record; to me the places that we have to get into in reforming our tax structure are not just rates. Yes, I am very much interested in rate reform. I want to point up some of the specific things in our tax laws I think are impeding economic growth. They seem small, but I do not think they are in economic effect, only in revenue. One is a tax law which works against labor mobility. The law as it presently is says that a man's residence is where his job is. This may have been true in the 1920's and even 1930's. As a matter of fact, our laboring group now, 80 percent of them own their own homes. So their residence is where their home is. This archaic law has an effect on the tax of those individuals if they have to follow a job. If they are technicians, like from McDonnell Aircraft, men going down with their missiles, from St. Louis to New Mexico, and they are in New Mexico over a period of some months, what is a per diem allowance becomes taxable income according to the Federal tax laws. Likewise, when you shift a plant, like Chrysler did from Evansville to St. Louis, the workers cannot immediately sell their homes. They follow their jobs and they are commuting back and forth. They cannot deduct the cost of maintaining two residences from their taxable income. This is a reform badly needed. In my estimation, one of the greatest problems in our dynamic economy is matching skills with jobs and encouraging labor mobility, to bring this about. This tax law encourages labor immobility.

The second point, our tax laws work against training and retraining. Another great problem in a dynamic economy going places, as ours is, is in upgrading skills, training, and retraining. The tax law says if you study to hold your job you can deduct the cost from

your taxable income. But if you go to improve yourself by training for a better job, you cannot. Yet the process today is such, if my interpretation of this dynamic economy is right, that if you have a skill, it can become obsolete in 5 years. Formerly, in father's time, you could have a skill that would last you a lifetime. Really, to maintain yourself you have to be in a position of upgrading your skill, retraining constantly, and yet our tax laws work against this process. Third, our tax laws on research and development are out of date and working against economic growth.

You have to tie the actual research and development into a marketed product to get a tax deduction. Yet today pure research which is not tied to a product must be conducted if we are to move forward, and our tax laws work against that. Our tax laws work against equity financing, giving an undue preference to retained earnings and debt financing. We started to reform that in 1954, one step out of three was taken. But even this modest reform was so hit on the head, I would say, in a demagogic fashion, by people who refused to look at the problem, saying we were giving tax cuts to rich people, that we have been hard put to hold the little progress we made, let alone take the next two desirable steps. The purpose of the stock dividend tax credit was to try to relieve the double tax burden on new equity financing of growth on the theory that new equity financing was a more effective way to promote economic growth, than retained earning and debt financing. This reform actually works against the rich investor in favor of the smaller investor and encourages the noninvestor to become an investor.

And then finally I must mention the burdensome taxation we impose on profits which has had a lot of discussion here. This is an out-and-out tax on incentive, the well spring of human progress, economic or otherwise. I simply want to put those matters on the record. So much talk has been spent on economic aggregates that we tend to forget the components where we will find the source of our problems. You call them structural when I refer to them in this way. I think if we would get to work on these structural things which mean little as far as the revenue is concerned, we would move forward. It would mean a great deal to economic growth because we would be removing some of these impediments to economic growth. We would help to match up the unused labor force with the jobs that are going begging. I am convinced there are more jobs going begging today, than there are unemployed, which is traditional, not unusual, in America. In other words, we have a labor shortage. We have not matched the human beings with the jobs that are going begging.

Thank you.

Senator DOUGLAS. There very well may be a tax cut, if not in 1962, in 1963. In connection with that, the chairman asked me to read certain sentences from the report of the commission on money and credit set up by the CED, which certainly is not charged with being a radical commission. These are from pages 134 and 135:

As in the proposal for formula flexibility—  
said the commission—

the most appropriate choice for shortrun discretionary changes in taxes is the first-bracket rate of the personal income tax. They are least likely to open

up controversial questions of income tax structure. The legislative and administrative problems in making such changes would be relatively simple. No uncertainty would be encountered in complying with such changes.

That is the end of the first quotation.

Then the second quotation was the italicized summary on page 135:

The commission, therefore, concludes that when discretionary tax adjustments are used to promote shortrun economic stabilization, they should consist of variations in the first-bracket rate of the personal income tax.

Thank you very much, gentlemen.

The committee will reconvene at 2 o'clock.

(Whereupon, at 12:30 p.m., the hearing in the above-entitled matter was recessed, to reconvene at 2 p.m. the same day.)

#### AFTERNOON SESSION

Chairman PATMAN. The committee will please come to order.

We have as our first witness this afternoon Mr. Leon H. Keyserling, economic consultant, Washington, D.C. Mr. Keyserling is well known. He has been around Washington a long time. He has been a witness many, many times before this committee, before the Banking and Currency Committees of the House and Senate, and others.

Mr. Keyserling, we are glad to have you, sir, and I notice you have a prepared statement. You may proceed in your own way. After you finish we will have Mr. Saulnier and then after he finishes we would like to have the panel interrogate both of you.

We will interrogate you together instead of separately, if that is all right. You may proceed.

#### **STATEMENT OF LEON H. KEYSERLING, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ECONOMIC CONSULTANT, AND PRESIDENT, CONFERENCE ON ECONOMIC PROGRESS, WASHINGTON, D.C.**

Mr. KEYSERLING. Mr. Chairman and members of the committee, I think the most expeditious method would be for me first to read some brief highlights of my conclusions, which will take only a relatively few minutes, and then I have some supporting materials in the form of charts which I would talk from orally.

Chairman PATMAN. All right.

Mr. KEYSERLING. Beginning with my prepared statement, I have been asked to speak about fiscal policy. But naturally, fiscal policy derives from the condition of the economy, and ties in with other economic policies. So, while I shall concentrate on fiscal policy, I shall try to relate it to the matters which determine what it is and what it ought to be.

I think the members of the committee are familiar with the method I use, which is to prepare over the years a rather complete description of the economy in action, and also what I call my model of an economy operating consistent with maximum employment, production, and purchasing power under the Employment Act of 1946.

Then, I constantly test the actual condition of the economy against the model, and try to discern where relationships went wrong and where the difficulties appeared. This has given me a rather full view,

and I think has helped me to arrive at some forecasts which have turned out to be moderately accurate.

I want to call attention to just a few of these before this committee, only for the reason that this has a bearing upon what I shall say about the future now.

In 1954, before this committee and elsewhere, I forecast an average annual economic growth rate of  $2\frac{1}{2}$  percent from 1953 through 1960, which turned out to be accurate, and also forecast the growing levels of unemployed plant and manpower which would result. This, also, turned out to be reasonably accurate and, therefore, more or less vindicated my assumed needed growth rates, because if my assumed needed growth rates had been too high, the actual unemployment of plant and manpower would have been lower than my forecasts.

Second, in 1957, before this committee and elsewhere, when people were generally concerned about inflation, I was very concerned about the oncoming recession, which very shortly thereafter appeared, and similarly in early 1960. In early 1961, before this committee and elsewhere, and in a publication in May 1961, and in a meeting with about 150 Members of the Congress, I said that I thought that, with the policies then in being, the economic growth rate under the new administration would be no better than under the old one, for the simple reason that in my nonpolitical view you could not change an economy much without changing policies much. I said that I thought that the economic growth rate in 1961 and in 1962 would be only about half as high as what we would need to get back to reasonably full employment and production; that it would probably be the shortest recovery of all; and that it would probably convert into stagnation and recession more quickly than the others because of the cumulative effect of the uncured imbalances. Unfortunately, this has come to pass to date, though the recession still lies ahead.

Senator BUSH. You are speaking of the current recovery?

Mr. KEYSERLING. I am saying that the current recovery is the weakest since World War II.

Senator BUSH. You are not indicating that you think it is finished, are you?

Mr. KEYSERLING. I will deal with that specifically in my statement, Senator.

Senator BUSH. All right.

Mr. KEYSERLING. In support of my feeling that we need immediate and extensive changes in national economic policies—this is my first point—U.S. economic performance has been highly unsatisfactory since early 1953. Since then to date, our average annual growth rate has been only about 60 percent of the needed rate; we have at no time had maximum employment and production; and, through a recurrent pattern of inadequate upturns, recessions, and stagnations, we have moved inexorably in the long run toward rising levels of idle manpower and plant.

In second quarter 1962, the true level of unemployment averaged about 6.5 million, or almost 9 percent of the civilian labor force, taking into account full-time unemployment, the full-time equivalent of part-time unemployment, and the concealed unemployment representing inadequate growth in the labor force due to scarcity of job opportunity. I will demonstrate that in detail with my charts.

Similarly in second quarter 1962, total national production was about \$73 billion or almost 12 percent below maximum production. Let me say, parenthetically, that Chairman Heller in his statement yesterday said that national production was about \$30 billion below the true level. He obtains this figure by projecting a 3½-percent growth rate from 1957 or 1955 as being consistent with maximum employment and production. I have shown before this committee, on other occasions, and will show again, that this is a very much lower growth rate than can possibly absorb the new technology and the growing labor force.

As a matter of fact, the reason why the recovery in the first three quarters of 1961 came so far short of getting us back to full employment, and why the economy has done so much worse since then than was anticipated by many of the forecasters, including the Council of Economic Advisers, is that they have persisted in understating the growth rate needed to regain and maintain maximum employment and production.

In other words, the underestimate of the size of the problem is the first step toward taking inadequate remedies.

Since late 1961, we have been in still another period of economic stagnation, with an annual growth rate of only 3.5 percent from fourth quarter 1961 to first quarter 1962, and only 2.8 percent from first quarter 1962 to second quarter 1962. Of course, those figures cannot be related to the 5-percent growth rate that I think is needed in the long run, because you need a much higher growth rate than 5 percent when you are in a recovery period. That rate would merely hold you where you are with respect to unemployed plant and manpower.

And many indexes of activity tend to reveal an overall growth rate even lower if not negligible or negative in June and July. All signs now are that this latest stagnation will end up in the fourth recession since 1953, and trying to guess—let me underscore this—trying to guess whether this will happen later this year or in 1963 is a sad and fruitless misdirection of energy.

In view of the dismally consistent long-term record since early 1953, we are closing our eyes to reality and playing with fire when we ask for another few weeks, and then still another few weeks, to see where we are going, or when we look at every little ripple from week to week in order to squeeze consolation out of the inconsequential. We have done very badly for long enough; the time to start reversing the course is now.

I do not share CEA Chairman Heller's apparent view, expressed in his testimony yesterday, that the fast rate of upturn during the first three quarters of 1961, or how much better we have done in recent years than in the 1930's, may have some bearing upon where we are now and what we should do.

With reference to my analysis of the causes of our chronic economic difficulty, which is my second point, the central cause of this difficulty is that ultimate demand, composed both of private consumer outlays and public outlays for goods and services, has failed consistently to keep up with our increasing power to produce, as generated by business investment, improvements in technology and automation, and enlarged worker and managerial skills. In second quarter 1962, measured as an annual rate, a deficiency of about \$56 billion in private consumer

outlays, and some deficiency in public outlays, were the dominant factors in the deficiency of about 73 billion in total national production at an annual rate.

While there was also a deficiency in gross private domestic investment, and in investment in plant and equipment, during second quarter 1962 and during the period 1953 to mid-1962 as a whole, this deficiency was caused by the deficiencies in ultimate demand which led to vast idle plant capacities and therefore dissuaded private investment.

During the upturn or boom periods which have occurred since 1953, investment in plant and equipment has tended to race forward at a nonsustainable rate when measured against ultimate demand and unused plant capacities. Throughout the whole period, prices and profits and other funds available for investment have been ample or excessive, in that they have always been adequate to spark a level of investment as high or higher than justified by ultimate demand. This is true even today, despite the exaggerated talk about the "profit squeeze"; most profits now are very rewarding, and where they are inadequate it is only because of deficient ultimate demand and the extraordinarily high level of unused plant capacities. Profit-sales ratios indicate clearly that what business really needs is more sales.

CEA Chairman Heller's testimony of yesterday, in its citation of facts and indeed in its general analysis, powerfully reinforces what I have just said; that is, that profits are good and in many instances advancing; that funds available for investment are ample or even redundant, especially when cash flow is taken into account; and that only unused capacities and deficient ultimate demand stand in the way of more ebullient investment.

Under these circumstances, I might fairly construe Dr. Heller's continued support of still more tax concessions for investors as evidence of his proper responsibility to keep in step with existing administration policies. Meanwhile, I cannot understand fully why the administration is still debating what kind of tax cuts we need, or even leaning toward a composition of tax cuts which would exacerbate the imbalances between investment in the means of production and ultimate demand by favoring corporations and high-income individuals unduly, at the expense of those middle- and low-income consumers who spend for consumption a larger part of their aftertax incomes.

My third point is with respect to tax policy—and let me say that my discussion follows the very penetrating questions in the statement which the chairman of this committee put out in announcing the hearings—dawdling or delaying with respect to tax reduction has no justification, in the face of a chronic economic ailment which is now being confirmed rather than alleviated. And in view of the central reasons for the chronic economic ailment, the proper nature of the immediately needed reductions in taxes is clear as day. Tax policy since 1953 has aggravated the imbalances in the relationship between investment in the means of production and ultimate demand; recent Treasury revisions in tax regulations move in the same direction; and passage of the 7-percent tax credit would move still further in the same direction.

To restore a better balance throughout the economy, large and immediate tax reduction should concentrate upon increasing the after-tax incomes of low- and middle-income consumers, who have a propensity to spend a much larger proportion of their disposable incomes than higher income families.

Senator BUSH. May I just ask parenthetically how do you define the middle-income group?

Mr. KEYSERLING. There is no one definitive definition. In my recent studies, it is indicated that the middle-income group are those, let us say, with family incomes from \$4,000 to about \$8,000 a year.

Senator, I would be very glad to provide you with a study which shows the exact compositions of the number of families falling within the different sectors.

Senator BUSH. I just wanted to get what you meant. You spoke of the low-income group and then the middle-income group. I am not quite sure what you meant by middle.

Mr. KEYSERLING. For a multiple-person family, I would say below \$4,000, at least in urban areas, is low and from \$4,000 to \$8,000 or thereabouts is middle.

Senator BUSH. I see.

Mr. KEYSERLING. These tax cuts should have an annual value of about \$7 billion in fiscal 1963. Let me emphasize what I am saying now. These kinds of tax cuts would be good, not only for the short run, but also for the long run; they would be sound long-term reforms, in addition to their immediately stimulative effects; and thus the claim that we should wait until next year in order to develop systematic "reforms" in the tax structure is in my view specious.

In other words, once you accept my basic proposition, which I think to be sound, that we have a chronic economic problem of 9½ years duration, then it follows that the situation really hasn't changed fundamentally, and looking at all the little or short ups and downs and saying that each one is a change in the situation is, as I have said before, looking at a man whose head is bobbing up and down in the water, and every time his head comes up, saying he is up again. The economic trouble is chronic.

We should be particularly on guard against adopting, in the name of "reform," revisions in the tax structure which would aggravate rather than remedy the fundamental imbalances in the economy which have existed since 1953 and still exist. Such tax reforms as closing loopholes, while ultimately desirable, should be deferred, because efforts to enact them now would forestall the top priority tax action which is needed now.

I have noticed the very interesting article in the New Republic this week by Senator Douglas. I wish that he were here. There is no man in Congress for whom I have a higher regard, and I have not yet recovered from a debate which I had with him in 1952. Nonetheless, I do differ with him in this particular instance.

I agree that we should wait for tax reduction until we "see the whites of their eyes," but I have been seeing the whites of the eyes of the chronic economic trouble for many years. It depends on what you define as the whites of their eyes. If you are concerned only in an antirecessionary policy after the event of recession, then you should wait for tax reduction until you have a recession. But if you are

concerned with the fundamental, long-range problem of an inadequate growth performance, of chronic economic stagnation, of our competition with the rest of the world, of all the matters about which the President so eloquently has spoken on so many occasions, then the whites of their eyes are right up at the crest of the hill now.

With respect to Federal spending policies, I have this point to make. The proposition that any immediate cuts in tax rates should be counterbalanced by comparable cuts in Federal spending is so obviously wrong in the context of our whole economic problem that it should require no analysis. We are so far short of maximum employment and production and have such a long and difficult road to travel to get there and then to stay there, that we need both tax cuts and increased spending now. We also need increased spending, because of the grave neglect of many priorities of national need.

The current and prospective economic situation, in my view, calls for Federal spending in fiscal 1963 about \$3 billion higher than the administration proposes. Thus, my proposed tax cuts and spending increases would have a combined annual value in fiscal 1963 of about \$10 billion. This would provide total stimulation to the economy, including indirect effects, of about \$25 to \$30 billion. Of course, various economists will suggest a different product mix between the tax cuts and the spending increases. I would like to call your attention to the number of economists whose overall figure converges pretty close to the \$10 billion that I suggest.

Some of them suggest it all in tax cuts. I personally can't see how, as a great nation, we can concern ourselves only—

Senator BUSH. You say it would provide a stimulus to the economy, including indirect effects of about \$25 to \$30 billion. In what would that be reflected? The gross national product, or the gross national income?

Mr. KEYSERLING. This is the gross national product, Senator. This is merely the so-called multiplier effect of the changes in fiscal policy.

Senator BUSH. Thank you.

Mr. KEYSERLING. On the subject of balancing of the Federal budget, I make this point, which is my fifth.

Let me say clearly here that it is a complete misconception to think that I am in favor of an unbalanced budget. I am in favor of a balanced budget in a balanced economy.

We now have, and since 1953 have had, a spending and tax policy which is grossly erroneous and self-defeating, because it attempts to balance the Federal budget at levels of economic activity woefully short of maximum employment and production. In consequence, despite constant declarations of intent to balance the Federal budget, we have run an aggregate Federal deficit of \$30.7 billion from the beginning of 1953 through the middle of 1962. In vivid contrast, and I will demonstrate more clearly with my charts, if the expenditure side of the Federal budget during this period had been enough higher to fulfill its appropriate share of the task of maintaining maximum employment and production, the application of actually existing tax rates to an economy functioning at maximum levels of activity would have yielded an aggregate budget surplus estimated at \$14.3 billion from the beginning of 1953 through the middle of 1962. In other words, the net difference between the deficit of \$30.7 billion and the

\$14.3 billion surplus which I estimate would be about \$45 billion. This implies that we should have had lower tax rates, as well as higher spending, during this period as a whole, and indeed both would in fact have been necessary for maximum prosperity.

Under the Federal budget for fiscal year 1963 as now officially proposed, I estimate that our total national production during fiscal year 1963 will be at the very deficient level of not more than \$565 billion, and might well be only \$555 billion or still lower. At this particular point, most of the other estimates are about the same.

This would mean a Federal deficit of \$4 to \$7 billion, or even higher. The changes in tax and expenditure policy which I recommend would result, according to my estimates, in total national production close to \$600 billion for fiscal year 1963 and a Federal deficit of \$6.5 to \$7 billion. Thus, the true alternative is between choosing a planned deficit that will be highly beneficial to employment and production, and stumbling once again into a deficit through neglect of the needs of the economy, just as we stumbled into a \$12 billion deficit in one year recently, and I think about \$6.3 billion during the fiscal year just ended. Some people seem to think if you stumble into a \$6.3 billion deficit it has the same accelerating effect upon the economy as if you plan a \$6.3 billion deficit. This, of course, is not correct. In one event you are starting out at the beginning of the year with a fiscal policy that is stimulatory to the economy. In the other event you are starting out at the beginning of the year with a fiscal policy that is repressive of the economy and you stumble into the deficit because the economy suffers. It is not the same thing at all.

Moreover, the program which I recommend would offer a realistic prospect of reasonably full production and employment by 1964. This condition, along with the closing of some tax loopholes when the time is more propitious than now, and this is what some people call a practical consideration or a political consideration, would yield enough revenues to balance the budget even with the reduced tax rates and increased spending which I propose.

As a matter of fact, on this matter of tax reform, I have said above that I think that the kind of tax reduction which I propose is really the most basic, and long-range, and fundamental kind of tax reform, and that, so far as the tax reform of closing loopholes, such as depreciation allowances and so forth, I would like to do some of that but it is entirely secondary now. It isn't going to stimulate the economy if you do it. It may give some people a sense of moral fervor. I would like to see it done ultimately. It may be important, when we are wedded to the concept of getting as close as we can to a budget balance, but such kinds of tax reforms in my mind are entirely secondary, and I think that they should be put aside so that with less acrimony and more dispatch we can get down to the job of the kind of tax reform that we really need now in the interest of the whole economy.

**Mr. RRUSS.** Mr. Keyserling, when you say 1964, do you mean fiscal year 1964?

**Mr. KEYSERLING.** I would say calendar year 1964. I don't believe that, where we are now, we can get to full employment by fiscal year 1964, except by changing my \$10 billion compound to \$15 billion, and for what I call practical reasons I have held it a bit below that.

Senator JAVITS. Mr. Chairman.

Chairman PATMAN. Senator Javits?

Senator JAVITS. If the chairman would allow me—I may not be able to stay but a few minutes as I have a bill on the floor and I have to go back—I didn't quite get, Mr. Keyserling, your point about taxes when you talked. Would you mind making your point again?

Mr. KEYSERLING. My point about taxes is that I think we need an immediate tax reduction, and I want to commend the Senator on what he said about that, although we don't agree on the exact composition.

I think, also, that his statement about the lack of vigor in pressing for this now is correct. I say that we need an immediate reduction in taxes because we have been suffering from a chronic economic ailment for 9½ years and that, therefore, waiting another 2 weeks, or 4 weeks, or 6 weeks for another little inconsequential ripple has little to do with the case.

Such delay bespeaks a continual attention only to very short-range developments, which negates the very concept of the chronic ailment.

Senator BUSH. Tell him also about your schedule of reduction.

Mr. KEYSERLING. Then I say, and here the Senator and I do not have exactly the same program, that the program should concentrate very heavily, if not entirely, upon the reduction of consumer taxes in the middle and lower income brackets, on the ground that this would provide the most immediate stimulus to consumption, and in other parts of my testimony I analyze why the other forms of tax reduction are not needed now.

Senator JAVITS. I thank my colleague and I am very grateful to the chairman.

Mr. KEYSERLING. On the subject of rates of saving and family incomes, which is one of the other questions raised by the committee chairman, I say this: Federal tax and expenditure policy since 1953 to date, along with other developments in the economy, have resulted generally in too high a rate of personal saving, and too low a rate of consumer expenditures, measured against total personal incomes after taxes.

May I say here that I do not measure the appropriate rate of personal saving, and here I differ from some economists, primarily by historic records in the past. I measure it primarily by looking at the economy and seeing whether as a matter of pragmatic observation investment and consumption have been kept in balance or whether one has outrun the other, and since the function of savings is to spark investment or to feed investment and the function of consumer spending is to add to ultimate demand, I derive the conclusion that the rate of savings has been too high from the fact that, generally speaking, investment has outrun ultimate demand and resulted in vast unused capacities.

I might call this the functional approach, or the real wealth approach, or the ultimate performance of the economy approach. This condition is the natural counterpart of the imbalance between investment in the means of production and that portion of ultimate demand which is represented by consumer spending.

The appropriate remedy is to reverse the regressive trends in income distribution which have been persistent in recent years. May I point out that, since I put out my income study a few months ago,

there have been two very good books on the subject, one by Robert Lampman and one by Professor Kelso, which support what I have been saying all along: under conditions of low economic growth and high unemployment, we have had a regressive redistribution of national income in recent years.

The appropriate remedy is to reverse the regressive trends in income distribution which have been persistent in recent years, and which cause too much saving relative to consumer spending because higher income families save more while lower income families spend more relative to the size of their incomes.

I am not talking here about a share-the-wealth program or equalitarian program, but I think it is always the function of national policy to improve the equity of income distribution. This has been part of our long-range progress, and whether this is the purpose or not, every tax policy, every monetary policy, and every other basic economic policy, does affect income distribution, so we might as well look at what we are doing. The kind of tax cuts which I propose would be part of this appropriate remedy. Increased Federal spending would also be part of the remedy, because many of the public programs which need enlargement, such as in the fields of education, health, housing, and social security, improve the absolute and relative incomes of low-income and middle-income families. They also provide a great new mass market for business.

A vigorous trend in this direction would also be highly desirable on social grounds, which I have never regarded as outside the scope of national economic policy, in view of the fact that about two-fifths of all Americans now live in poverty or in some lesser degree of deprivation.

On the subject of monetary and credit policies, I would say this: I agree entirely, I may say here, with the very eloquent statement made by Senator Douglas in the New Republic this week, excoriating, if I judge him correctly, the recent and current monetary policy. It has been very much too tight. It has been wrong, all along.

I do not believe, however, that monetary policy is a substitute for fiscal policy. Also, monetary policy can be used much more easily to repress the economy rather than to expand it, because it is easier to pull a string than to push it. If you don't have the fundamental levels of demand about which I have talked, the mere amplitude of credit and money doesn't expand investment much and does not expand the economy much. I get to that in my analysis of the profit question.

Monetary and credit policies, since 1953 to date, have been too stringent to float an adequate rate of economic growth and, therefore, have contributed substantially to the chronic rise of idle manpower and plant. As an avowed brake upon inflation, when inflation was actually in process, the stringent monetary and credit policies have been a failure, because the structure and behavior pattern of the modern U.S. economy is such that tightening up on money and credit translates into repressed or reduced levels of employment and production long before it impacts upon the price structure.

For example, during the period of reasonably adequate economic growth, 1952-55, the average annual growth in total national production was 3.5 percent, the average annual growth in the nonfederally

held money supply was 3.6 percent, consumer and wholesale prices were virtually stable, and the average annual increase in industrial prices was only 1.1 percent. But during the period of economic stagnation, 1955-57, the average annual increase in total national production was only 1.7 percent, induced substantially by an average annual increase in the nonfederally held money supply of only 2.5 percent, while there was an average annual increase of 2.5 percent in consumer prices, 3.1 percent in wholesale prices, and 3.6 percent in industrial prices. This whole analysis, which defies some of the conventional economic analysis, is based upon the simple proposition that you may have inefficiency resulting from too high a rate of economic growth or from too low a rate of economic growth. You may have inefficiencies resulting from an economy that is excessively taxed—I don't mean taxed in the technical sense—I mean has excessive pressures on it, or from an economy that is insufficiently pressured, just like a car going too fast or too slow burns too much gas per mile.

Most economists have only lately come to realize increasingly this point that I have been making, that an economy that is constantly moving up and down, that has a high level of unemployment and a high level of unused plant, tends thereby to be more inflationary than under fuller utilization, aside from the fact that you lose scores of billions of dollars of national product.

Moreover, the tight money policy and rising interest rates contribute mightily to the regressive redistribution of national income, repress desirable lines of activity far more than they affect the relatively excessive periodic booms in investment relative to ultimate demand, reduce the funds available to governments at all levels for essential public purposes by increasing the interest charges and by making it impossible for States and localities to borrow, and therefore contribute to all of the chronic imbalances in the economy.

The open declaration in recent weeks by spokesmen for the Federal Reserve System that they will tighten up on monetary and credit policies, especially if immediate tax cuts are undertaken to stimulate the economy, is an open declaration of war upon the programs which the Nation needs, and represents an almost unbelievably gross inconsistency in national economic thinking. This declaration of war, by the Federal Reserve System, while it does not say so openly, is tantamount to continued adherence to the indefensible proposition that large volumes of idle plant and manpower are indicia of economic health and are necessary to fight inflation.

I find it difficult in this connection to follow the logic of CEA Chairman Heller's discussion of monetary policy in his testimony yesterday. I understand he improved it some in response to questioning. He says this:

Fiscal policy and monetary policy are tightly interwoven, indeed are in part substitutes for one another. A given stimulus to the economy can be achieved by a relatively easier fiscal policy coupled with a relatively tighter monetary policy, or vice versa.

Let me try to translate that into simple language. It is like saying that, if you take four steps forward and two steps backward, you are still taking two steps forward. But it is nonetheless true that the two steps backward cancel out two of the steps forward, and if you reduce taxes by \$20 billion and tighten up on the monetary policy,

you may still have a net forward of \$10 billion, but why should you cancel out the effect of one with the effect of the other, and if you have a relatively smaller reduction in taxes, the tight money policy can cancel it out entirely.

Representative REUSS. Did you underline the "vice versa" because you want to emphasize it?

Mr. KEYSERLING. I underlined the "vice versa" because it is underlined in Dr. Heller's direct testimony. In other words, I would have to ask him.

Representative REUSS. Is the policy combination implied in the "vice versa" more offensive to you than the alternative?

Mr. KEYSERLING. They are both offensive.

I believe it far more pertinent to point out that fiscal and monetary policies should in general reinforce each other; they should in general be complements, not substitutes. When general inflation threatens, both should be relatively tight or tightened; when there is very large economic slack, both should be loose or loosened. I have great respect for Dr. Heller, but in this instance I think that, instead of attempting to rationalize the perverse and damaging policies of the Federal Reserve System, he might well have called upon that System to bring its policies into line with the real economic situation as he understands it so well and with the policy implications thereof which he comprehends so fully.

Here I want to commend many members of this committee, including Senator Douglas, as I have said before, for their full realization of this point. The Federal Reserve System does not need a pat on the back; it needs a good jolting.

Fundamental conflict between fiscal and monetary policy, recurrent in recent years, is an anachronism. Indeed, at another point in his testimony, Dr. Heller admits that "monetary \* \* \* policy must continue [sic] to aim at providing ample credit and liquidity to support needed recovery and growth." But Dr. Heller then delimits the force of this valid observation by saying that all this must be "consistent with the requirements of balance-of-payments policy." This brings me to the subject of the balance of payments and gold problem.

Senator PROXMIRE. I am sorry that you didn't hear all of the things that I said about the pernicious uses of a tight money policy to cancel out the effects of tax reductions.

On the balance of payments and gold problem, which is the final question raised in the chairman's announcement: I am sorry I can't analyze this one in more detail, because I don't know anything on which there is more national confusion. Our balance of payments and gold problem, while a real one, has been exaggerated and misused and subject to the wrong remedies, very analogous to the way in which the inflationary problem was exaggerated and misused and subjected to the wrong remedies in earlier years since 1953. The central reason for our unfavorable balance of payments and gold problem is not to be found in the record of our international exchange of goods. In this category, we have been averaging a very favorable excess of exports over imports, and our record in this category might be even better if we achieved the real improvements in productivity and costs which are frustrated by large economic slack and encouraged by fuller utilization of production resources.

A main reason for our balance of payments and gold problem has been the perhaps excessive movement of American capital to Western Europe (although I think this too is exaggerated) I am not quite sure that I am absolutely clear as to why we should move toward a philosophy of free exchange of goods based upon marginal efficiency but not allow capital to flow where the manager of the capital, so long as we believe in a free system, thinks it will be most efficient. I think we are a little mixed up on this score, but I haven't got time to get into this in detail.

A main reason for our balance of payments and gold problem has been the perhaps excessive movement of American capital to Western Europe, and the excessive withdrawal of foreign funds from the United States. Both of these trends are to be explained mainly by the higher rate of economic growth, the lower levels of unemployment, the freedom from economic recessions, and consequently the more favorable opportunities for sustained investment and profits, in some countries of Western Europe contrasted with the United States.

It follows inescapably that those of our national economic policies are absolutely upside down which attempt to cure our balance of payments and gold problem by repressing economic growth, employment, and production in the United States. Variations in interest rates, comparing here with overseas, are a relatively inconsequential factor. And in any event, it shows a fantastic lack of perspective to saddle the whole \$550 billion American economy with the incubus of rising interest rates in order thereby to effectuate some slight changes in our balance of payments and gold position.

In addition to the main remedy of restoring and maintaining maximum prosperity in the United States, we need to improve the development of international mechanisms which would serve as a clearinghouse and set off short-range against long-range claims. In long-range terms, our balance-of-payments position has in general been satisfactory.

Now, Chairman Heller, in his testimony, and others have brought up the point that maybe we should try to hold down the long-term interest rates because of our domestic needs, and let or help the short-term interest rates go up in order to take care of the capital flow problem. I have been trying to convince committees of Congress for a long time, and I think unfolding developments have helped me a little bit, that it is absolutely impossible as a basic proposition to do these two things at the same time because interest rates interrelate. Most interest rates are fixed by other interest rates, and that is why I went before the Senate Finance Committee in 1957, when they were talking about raising the interest rates on savings bonds because other interest rates were going up. I said, "You have created a mess. You start raising some and you have to raise others, and you are on an escalator that will never come to an end."

It is absolutely impossible to do these two things at the same time. One of the reasons why the recent effort of the Treasury to float long-term bonds, at even what I consider a rather high coupon interest rate of  $4\frac{1}{4}$  percent, didn't work out very well is because we are getting into a situation where you are going to have to pay 5 or 6 percent interest to borrow anything, even on the supreme credit of the Government of the United States.

Anyway, why should we be freeing such high interest rates into long-term borrowings?

Coming to the needed changes in the national policy, which is my last point, during the 9½-year period from the beginning of 1953 to the middle of 1962, we forfeited about \$387 billion in total national production—measured in 1961 dollars—compared with what we would have achieved at the maximum rates of economic growth called for by the Employment Act of 1946. I don't say we could have done that well. But for goodness sakes, we should have done at least half that well. Over the same span of years, the true level of unemployment aggregated about 24 million man-years higher; in other words, well over 2½ million higher annually on the average, than it would have been under conditions of sustained maximum employment.

The record during the past year and a half indicates no fundamental change in the chronic ailment, although fortuitously we have been in upward movement during most of this short period. In fact, I think it is getting worse because of the uniquely weak character of this recovery and the fact that we are already in stagnation.

We are now in another stagnation, and confronted with the ominous threat of another recession later this year or next year. If our average annual growth rate 1963-66 averages no better than during the past 9½ years, and I do not think that it will average appreciably better without drastic changes in national economic policies, and I think it could even average worse because these imbalances feed on themselves, we could forfeit another \$290 billion of total national production, and suffer another 17 million man-years of excessive unemployment, while we talk about the great worldwide contest in which we are engaged and about the needs of our own people and about the need for economic growth.

Neither domestic nor worldwide conditions permit us to countenance even the possibility of such development. We must act, and act at once.

In one sense, Mr. Chairman, and members of the committee, there is never an "immediate" need for anything, except carrying somebody to the hospital who has been hit by an automobile. You may quibble about whether we should act now or wait until next winter, but once you analyze this problem correctly, we are 5 or 6 years late now, and it is getting later every minute.

We won't know any more a few months from now, unless we have a catastrophe. I don't expect a catastrophe within the next few months. I don't see any obstacle in the way of action now that will disappear a few months from now, and this whole business of looking at a few weeks at a time, or a few months at a time, or at the little upturns and downturns, is the greatest manifestation, in my view, of the immature nature of our economic policy and our national purposes in times when we should be thinking over the long-range.

This completes my summary answers to the policy questions that the chairman has raised. I would appreciate a little chance to document this with some of my pictures, which I think I can do rather quickly now that I have laid the contours of the argument before you.

**Chairman PATMAN.** You may go ahead and present the charts that you have. I suggest that you confine it to probably 10 or 15 minutes if you can.

**Mr. KEYSERLING.** Yes, I certainly believe that we can, because the questions will come later. I think I can do it very quickly. My first chart simply shows the long-term record from 1953 through 1962 estimated, the recurrent series of booms, recessions, and upturns. The first sector shows the record by years.

The second sector of the chart shows the short-term record quarter by quarter, 1961 and 1962, showing a high rate of upturn during the first three quarters of 1961, and the progressive deterioration since.

The third sector of the chart measures this on an annual basis from first quarter 1961, to first quarter, 1962, and so forth, and finally from fourth quarter 1961 to fourth quarter 1962, estimated.

In other words, we are experiencing a progressive shrinking in the rate of the upturn, more ominously than during previous upturns since World War II.

**Senator BUSH.** What are those figures in the bottom chart?

**Mr. KEYSERLING.** The figures on the bottom sector of the chart are yearly rates of change from first quarter 1961 to first quarter 1962, actual.

**Senator BUSH.** In gross national product?

**Mr. KEYSERLING.** In gross national product; second quarter 1961 to second quarter 1962, actual, third quarter 1961 to third quarter 1962 estimated, and fourth quarter 1961 to the fourth quarter 1962 estimated.

My second chart shows the three types of unemployment. The bottom part of each bar shows full-time unemployment. The middle part shows the full-time equivalent of part-time unemployment. The top part factors in what I call the concealed unemployment resulting from the phenomenally low growth of the labor force in recent years. In other words, people aren't looking for jobs because the jobs are not there, and I was very interested that Senator Douglas stressed this in his recent article.

The top sector of this chart shows the rising level of true unemployment. The second sector shows this unemployment as a percentage of the civilian labor force. Just by glancing at the chart, you can see how much more massive the bars are in the later years than in the earlier years. In first half 1962, which is a stagnation period, and not a recession period, the true level of unemployment was almost 9 percent of the civilian labor force, compared with only 5 percent in 1953, although you had a recession occurring in the middle of 1953, and this shows the prolonged and pronounced upward trend.

My third chart shows the high volume of idle plant and machines. The lower half of the chart shows that, in first quarter 1962, which are the latest figures I have, 18 percent of steel capacity was idle, and about 17 percent of manufacturing capacity was idle. The top part of the chart shows, as of the end of 1961, the tremendously high volume of idle capacity in a wide range of major industries.

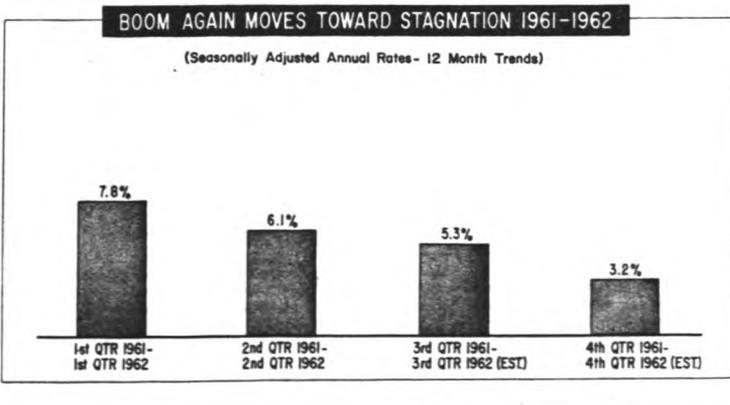
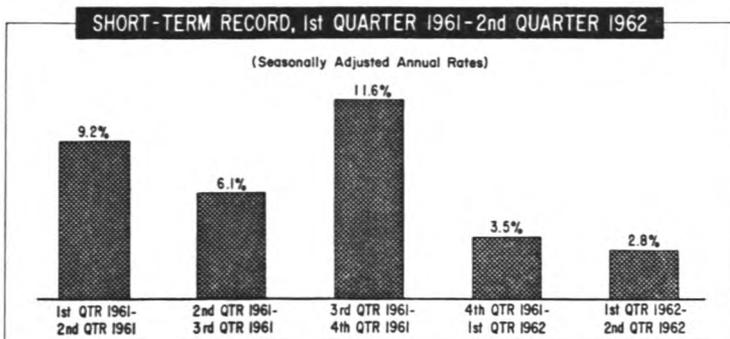
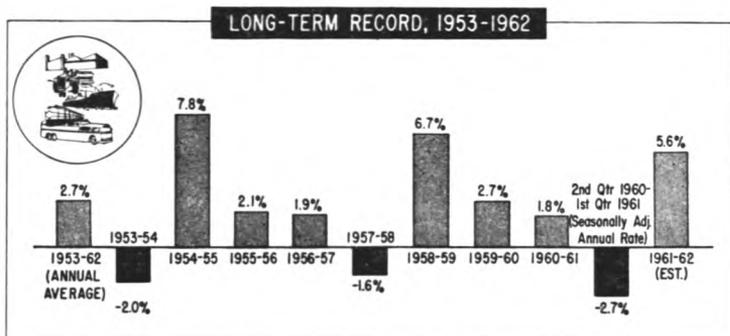
**Senator BUSH.** Where do you get those figures?

**Mr. KEYSERLING.** The sources are cited below, McGraw-Hill, and Steel Institute. All the sources are at the bottom of the charts.

**Chairman PATMAN.** Without objection the charts will be put in the record.

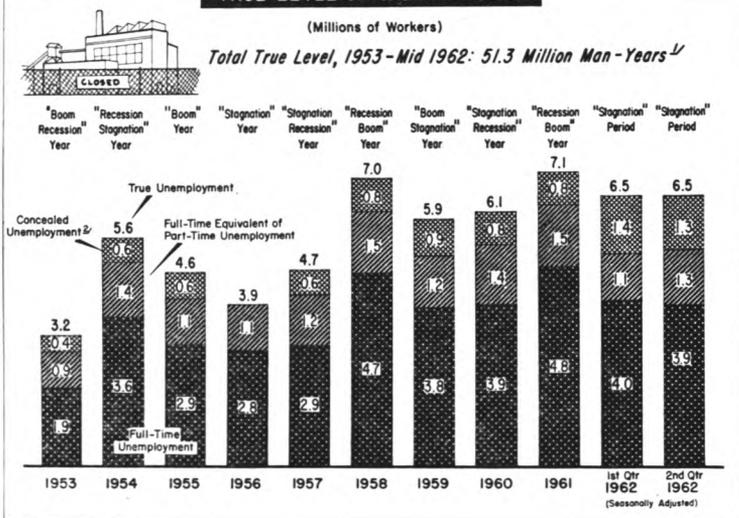
# RECESSIONS, BOOMS, STAGNATIONS, 1953-'62: RATES OF CHANGE IN G. N. P.

In 1961 Dollars

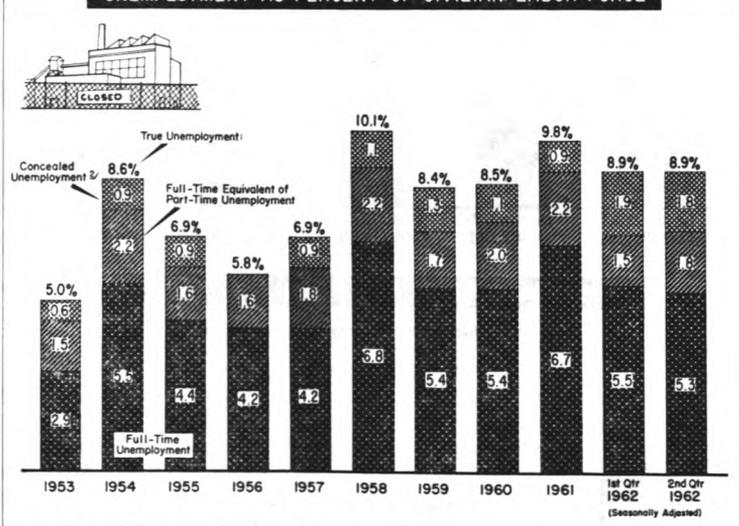


# CHRONIC RISE OF UNEMPLOYMENT, 1953-1962

## TRUE LEVEL OF UNEMPLOYMENT



## UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE<sup>2/</sup>

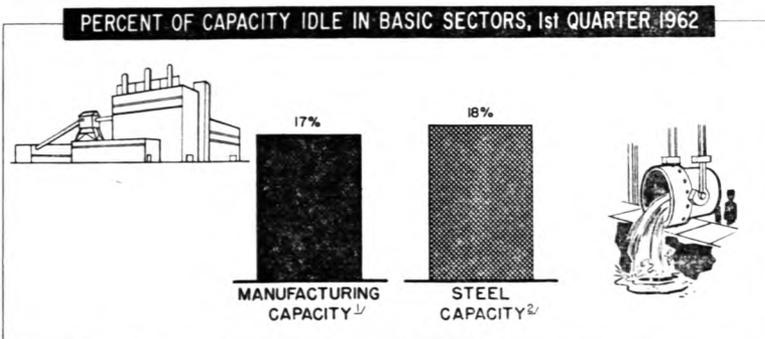
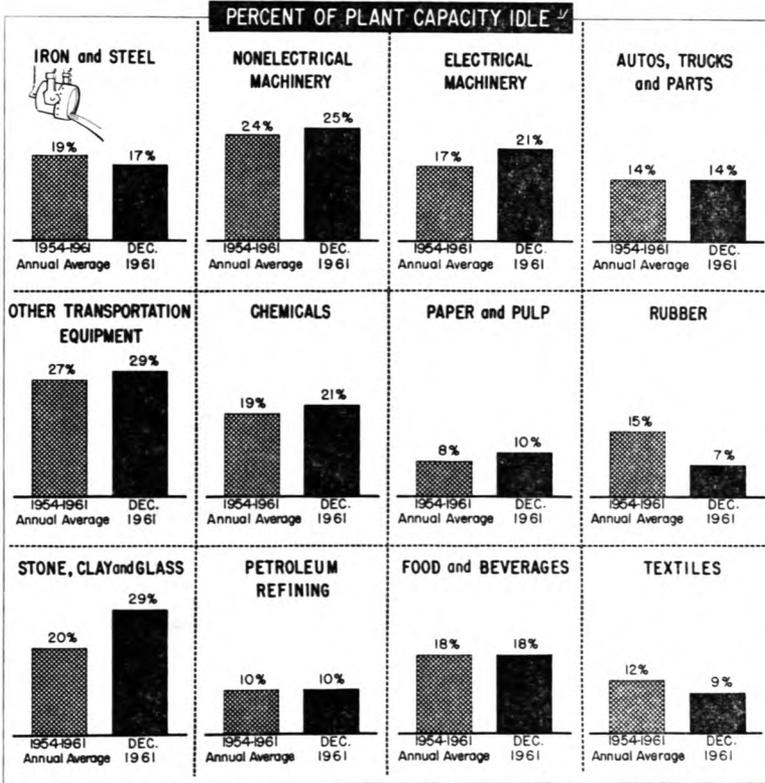


<sup>1/</sup> The man-year figure for first half 1962 is one half the figures shown for the half year. About 27 million man-years of unemployment (true level) would have been consistent with maximum employment.

<sup>2/</sup> Estimated as the difference between the officially reported civilian labor force and its likely size under conditions of maximum employment.

<sup>3/</sup> In deriving these percentages, the civilian labor force is estimated as the officially reported civilian labor force plus concealed unemployment.

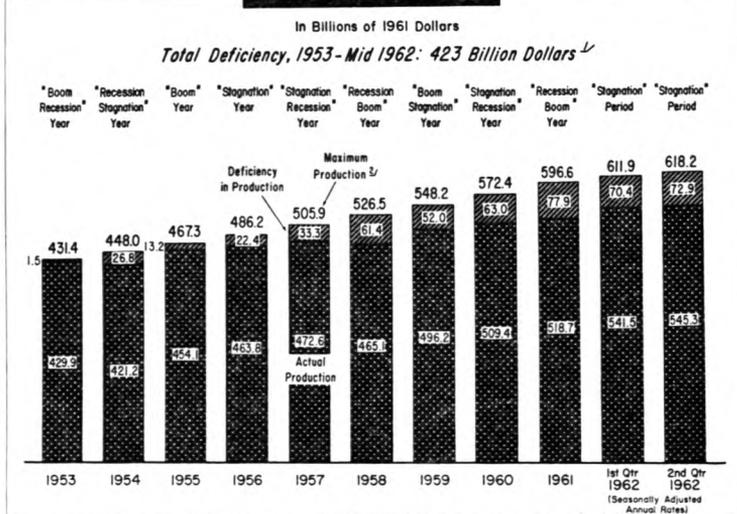
## THE HIGH VOLUME OF IDLE PLANT AND MACHINES — 1954 — 1962



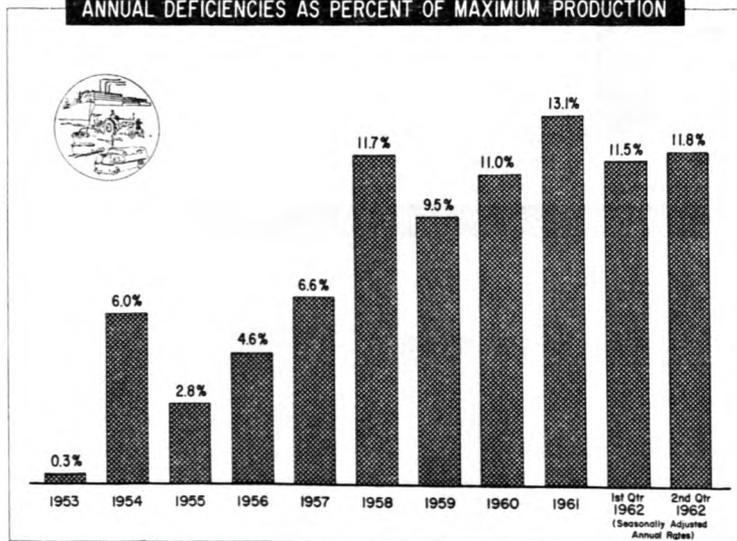
Source of Basic Data: McGraw Hill Annual Surveys, Est. based on Am. Iron and Steel Inst. data.

## CHRONIC RISE OF OUR UNUSED PRODUCTIVE POWERS (G.N.P.), 1953-1962

### ANNUAL DEFICIENCIES



### ANNUAL DEFICIENCIES AS PERCENT OF MAXIMUM PRODUCTION



<sup>1/</sup> The deficiency for first half 1962 is one half the figures shown for the half year.

<sup>2/</sup> Based upon sufficient annual rate of growth in G.N.P. to provide full use of growth in labor force, plant and productivity under conditions of maximum employment and production.

Mr. KEYSERLING. My chart five, taking into account unused plant and unused manpower, estimates the size of the deficits in total national production. The chart shows a deficit, as I have said, of about \$73 billion, annual rate, by the second quarter of 1962, coming to almost 12 percent of maximum production capacity. These are really underestimates, because I have no way of estimating the underutilization of manpower in the plants when they are running at 50 or 60 percent of capacity.

I have no way of estimating the accelerated technology and productivity which would result from full use, so these are very conservative estimates.

Now I come to an analysis of the basic reasons for the trouble, and this gets very closely into the matter of tax policy. My view is that the deficiencies in total national production have occurred mostly because of deficient private consumer demand. The three parts of the economy which make up total national production are consumer demand, public outlays, and investment.

Taking consumer outlays first, my fifth chart shows in the bar on the far left in the job sector, the needed rate of growth in consumer outlays, and in the following bars the actual rate which, as you see, has been very much lower. In the bottom sector, I attempt to show the portion of the total deficiency in national production which is made up of the deficiency in consumer outlays. For example, in the second quarter of 1962, the deficiency of about \$73 billion in total national production includes a deficiency of about \$56 billion in consumer outlays. If necessary, I will develop these figures more on questioning.

Moving over to my sixth chart, some people think that consumers aren't spending because they don't want to. Indeed, the rate of saving is too high. But nonetheless, the basic reason is income deficiency. The top sector of this chart compares the actual levels of consumer spending and income. The bottom sector makes an estimate that, for the 9½ year period as a whole, the deficiency of over \$250 billion in consumer outlays correlated roughly with the deficiency of about \$337 billion in consumer incomes before taxes, allowing for taxes and allowing for savings.

My seventh chart shows that there has also been some deficiency in public outlays, mostly at the Federal level. The top sector of the chart shows the declining size of the Federal budget, relative to the size of the national economy. The second sector of the chart shows in uniform dollars the declining level of per capita outlays.

The first is a measure of the economic problem. The second is a measure of the national need.

Coming to my eighth chart, the Federal budget reflects national economic deficiencies, and I brought this out earlier in my testimony. The top sector of the chart shows the annual deficiencies in national production over the years. The middle sector of the chart shows the actual condition of the Federal budget, and, as you see, it was generally in surplus very early in the period and generally in deficit later in the period.

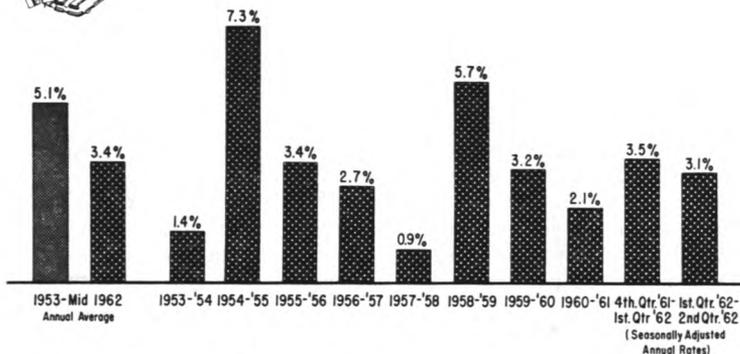
The third sector of the chart compares the size of the deficits in national production with the condition of the Federal budget, and shows obviously that as the national production deficit has increased, the Federal budgetary deficits have become larger.

## DEFICIENT RATE OF GROWTH IN PRIVATE CONSUMER SPENDING, 1953-MID '62

Rates of Change in 1961 Dollars

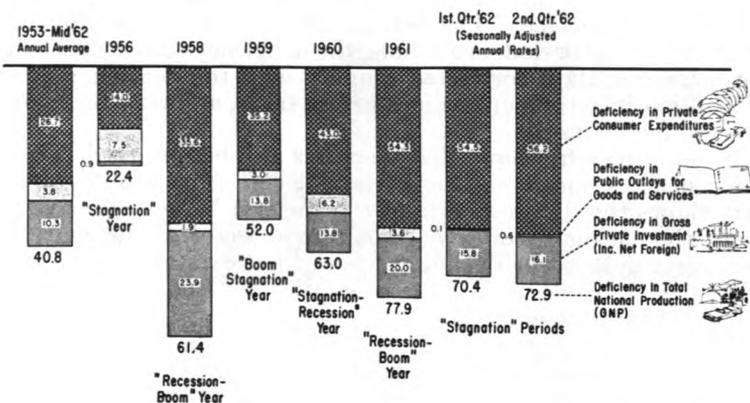


■ Needed Rate of Growth    ■ Actual Rate of Growth



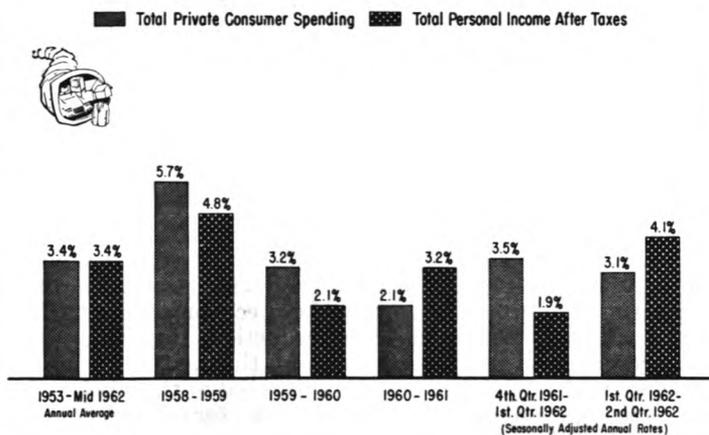
## THE PRIVATE CONSUMPTION DEFICITS DOMINATE THE DEFICITS IN THE TOTAL ECONOMY

Billions of 1961 Dollars



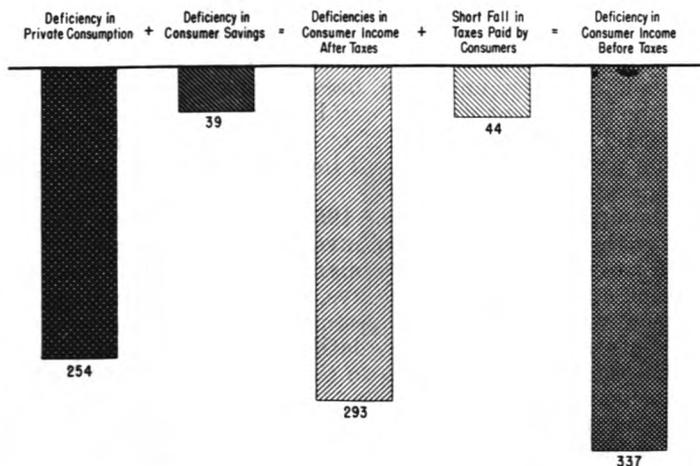
## LOW GROWTH IN PRIVATE CONSUMPTION REFLECTS LOW GROWTH IN INCOMES

Rates of Change in 1961 Dollars



## THE PRIVATE CONSUMPTION DEFICIENCY OF \$254 BILLION, 1953-MID 1962, REFLECTED A \$337 BILLION INCOME DEFICIENCY

Billions of 1961 Dollars



The last period is 1958—mid-1962, with an annual average deficit of \$64.5 billion in national production, and an annual average deficit of \$4.3 billion in the Federal budget, both cash and conventional.

My ninth chart illustrates what I said earlier in my testimony. The first sector of the chart is the actual Federal budget over the years, showing the predominance of the deficits. In the second sector of the chart, to show that my notion is not taken out of thin air, I have plotted the level of Federal expenditures appearing in my model maximum prosperity budget, somewhat higher each year than the actual, because I think they were too low. Then I have calculated carefully what actually existing tax rates would have yielded at maximum production and it shows, of course, a surplus during most of the period, with a deficit in 1953-54, due mostly to the high level of expenditures during the Korean war.

Now, coming over to my 10th chart, this brings me to the matter of private investment. This has a great deal to do with tax policy. I am for private investment. I am for private profit. I wish they were higher. They would be higher if our economy were performing better, and I have no objections to tax reductions for private investors and for corporations when there is room for them.

I do object to throwing billions of dollars out of the window for this purpose, when our narrow margin of capacity for tax reductions could be used to much better purposes and when we are wedded for one reason or another to trying to keep the budget somewhere near balanced.

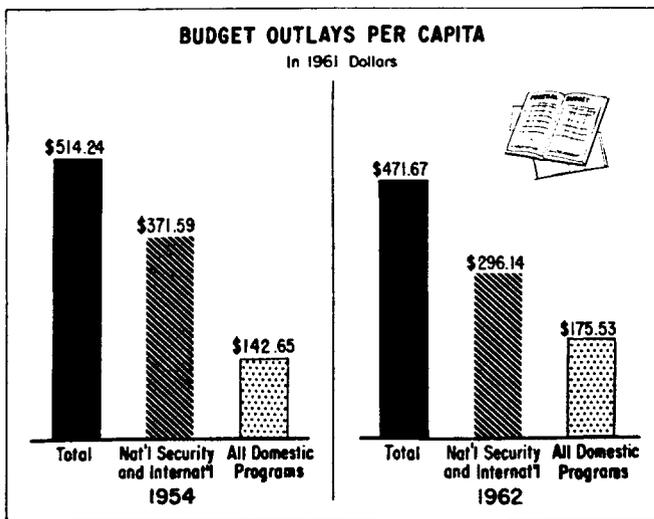
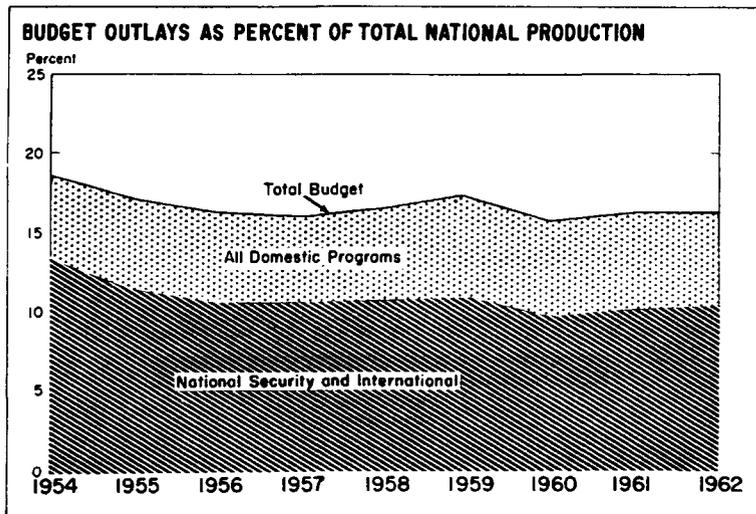
In my 10th chart, I show in the top sector that, during the 9½-year period as a whole, there was a deficit in gross private investment and there was a deficit in plant and equipment investment. In fact, the deficit averaged \$10.3 billion a year in the case of gross private investment and about \$7 billion a year in the case of plant and equipment investment. But how did this occur? It did not occur in anything like a straight line. It occurred in a succession of very rapid upturns when private investment far outran ultimate demand and led to large unused plant capacity, and then, because of the large unused plant capacity, the investment was cut way back so there was a low average for the period as a whole. But if one who wants to understand the equilibrium problem, to understand how this happens, one must look at these separate periods.

From the first three quarters of 1955 to the first three quarters of 1957, before the 1957-58 recession, investment in plant and equipment went up 9 percent and ultimate demand, in the form of both private consumption and Government outlays, went up less than 3 percent.

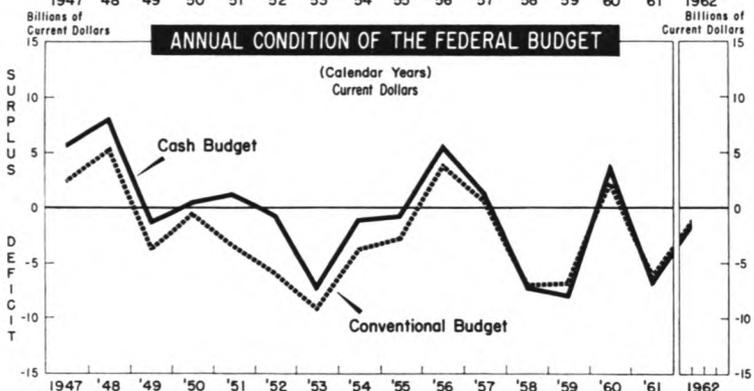
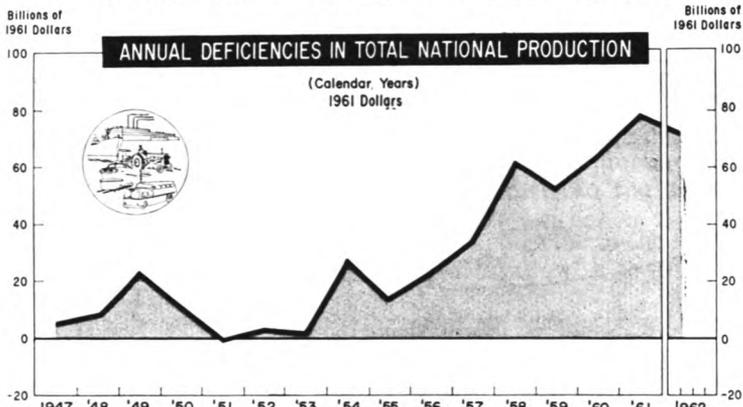
Then there was a very sharp investment cutback in the recessionary period. Naturally, being more volatile, investment went way down. Then, from the first half of 1959 to the first half of 1960, before the 1960 downturn, investment went up 11.6 percent and ultimate demand only 2.6 percent. Then there was another recession and another big cutback. I haven't chosen these periods arbitrarily. I have chosen these periods carefully on the basis of when the changes in the trends actually started to occur. From the first quarter 1961 to the first quarter 1962, there was a slowdown in the rate of investment increase during the upturn period, due to the cumulative effects of all the unused plant capacity. This means that, most recently, we have been

# FEDERAL BUDGET HAS SHRUNK RELATIVE TO TOTAL OUTPUT AND NEEDS, 1954-1962

Fiscal Years

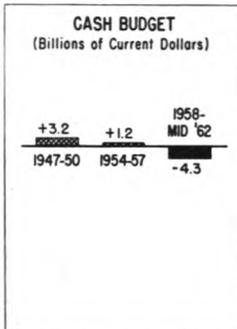
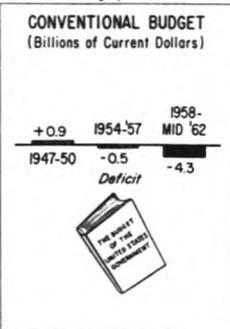
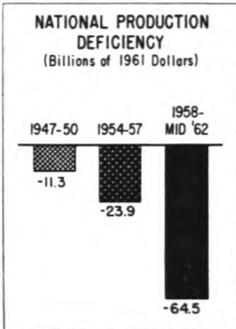


## THE FEDERAL BUDGET REFLECTS NATIONAL ECONOMIC DEFICIENCIES

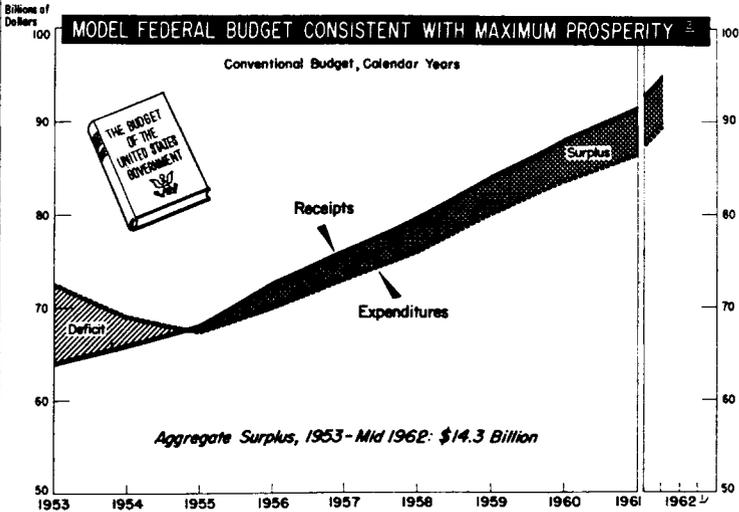
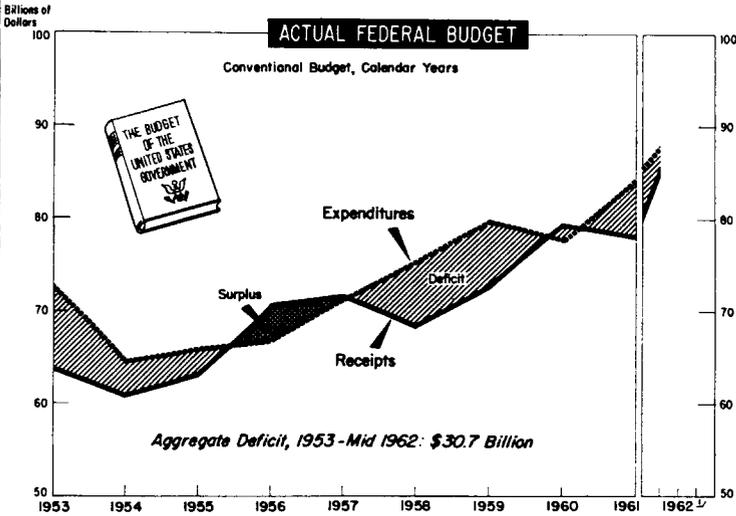


**FEDERAL DEFICITS GROW WITH NATIONAL ECONOMIC DEFICIENCIES**

(Annual Averages, Calendar Years)



# A BALANCED FEDERAL BUDGET DEPENDS UPON A MAXIMUM PROSPERITY ECONOMY



1/ First half year 1962 shown at annual rate, seasonally adjusted.

2/ Expenditures are shown as actual expenditures plus estimated deficiencies in expenditures during the period. Receipts are estimated by applying actual tax rates to maximum prosperity levels of economic activity.

getting a lower rate of investment expansion, even in the upturn period, and Dr. Heller pointed this out, because finally business says: "My goodness, how much more are we going to increase excess plant capacity?" This slowdown in the rate of investment increase is very serious, and it is one of the reasons why this most recent upturn is shorter and less satisfactory than earlier ones, because due to the cumulative effect of excess plant capacity and inadequate demand there is less propulsion in the investment upturn. But to deduce from this that the factor militating against investment is the tax policy or the profit rate doesn't comport with analysis of actual developments.

My 11th chart shows these actual developments. It shows the trends before the 1957-58 recession, as to prices, profit, and investment. We see prices rising, profit rising substantially, and investment in plant and equipment rising enormously more in various key industries.

Coming to my chart 12, before the 1960-61 recession, although prices were generally down slightly and although profits were generally down, nonetheless there was a tremendous investment splurge because of the appraisal of business that the potential markets were there to justify this level of investment. This indicates that the downturn in prices, the downturn in profits, was on the basis of a more than adequate profit margin to stimulate investment when the other enviroing conditions were there, and probably indicated that the prices and the profits had been much too high in the previous period. But be that as it may, the investment boom again occurred, and, as I showed on my 10th chart, it very far outran ultimate demand.

Coming to my 13th chart, here is the situation from first quarter 1961 to first quarter 1962. Here you have a somewhat downward trend in prices generally. In the case of the iron and steel industry you also had a downward trend in investment, because of the enormous unused capacity. Generally speaking, though, and in steel also, there was a rather pronounced upturn in profits. And generally, there were upturns in investment, though not as large as in the previous upturn periods for the reasons I have given.

This leads me to the conclusion that the conditioning factor, with respect to investment, is neither the tax structure nor the profit position, but rather the condition of ultimate demand and the amount of unused plant capacity. Let me say, Chairman Heller in his testimony yesterday supported this absolutely and completely. He talked about the fact that profits in the first quarter of 1962 were higher than in the first quarter 1961. He talked about the effect of cash flow. He said the only thing that they need in order to have a still more rewarding level of profits, is more markets, and until they get that they are not going to invest sufficiently.

In fact, he said they are overcashd and undermarketed. That is a paraphrase of exactly what he said.

Of course, I don't understand why, after saying this, he shifts over to the proposition that, having given one and a half billion dollars in the form of tax credits through Treasury regulations, and moving toward giving another billion in the form of the 7 percent credit, there is need to move on to give another large portion of any future tax reduction to the same investors. I don't understand the apparent

dichotomy between the analysis of the facts and the policy conclusions.

Representative REUSS. Before you leave this chart, I thought I heard you say in this period steel profits went down. It was steel investment that went down, not profits, was it not?

Mr. KEYSERLING. Yes. As the chart shows, steel investment went down.

Representative REUSS. Profits went up.

Mr. KEYSERLING. Yes. In the first quarter of 1962 they went up.

Representative REUSS. I thought I heard you say they went down.

Mr. KEYSERLING. I may have misspoken.

The next series of charts relate to the wage question. As wages are a basic factor in consumption, and investment is a basic factor in enlarging our productive capacities, I want to show for these periods the relative trends of wages and investment.

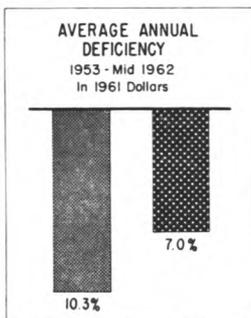
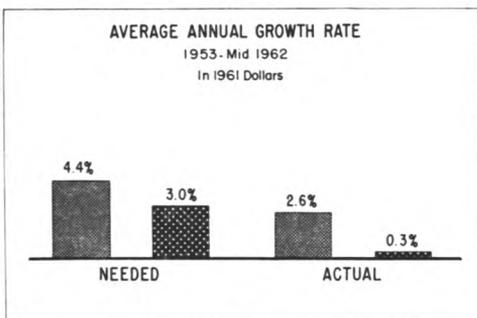
As you will see on my chart, before the 1957-58 recession, wage rate changes lagged generally far behind profits and phenomenally behind investment. What this means very simply is that, as corroboration of my earlier charts, the power to consume was not increasing anything like as fast as the power to produce, and I think that this is very important to stress, because of the widespread misimpressions about wage trends in recent years.

My 15th chart shows how the rate of increase in plant and equipment outran the rate of increase in wage rates during the period from the first half of 1959 to the first half of 1960, before the 1960-61 recession. And my 16th chart shows how again, from the first quarter of 1961 to the first quarter of 1962, the rate of increases in profits and in investment in plant and equipment generally outran the rate of increases in wage rates.

I also have another few charts, which analyze wage trends in the perspective of the whole economy. My 17th chart shows in the top sector the deficient rate of growth in wages and salaries for the 9½-year period as a whole. The lower sector of this chart shows that the deficiencies in wages and salaries have constituted the dominant portion of the deficiencies in total consumer income before taxes. My 18th and 19th charts show that, for the period 1947 to mid-1962 as a whole, with respect both to the entire nonfarm economy and manufacturing, wage rate increases and productivity increases were about in balance, and that during the most recent 5 years, wage rate increases in both cases have lagged very seriously behind productivity increases. These data lend no support to the popular impression, and the impression of many economists, that wage rate increases have outrun productivity increases and therefore forced up prices. The truth of the matter is that profit margins per unit have been too high, after allowing for all business costs including wage costs, which means that prices have been too high. The inadequacy of profits at times, as I have already demonstrated, relates entirely to the low level of operations and the high amount of unused plant capacities, which in turn are attributable to the deficiency in ultimate demand caused in large measure by the deficiencies in total wages and even in wage rate increases.

## GROSS PRIVATE DOMESTIC INVESTMENT WAS DEFICIENT DURING 1953-MID 1962 AS A WHOLE

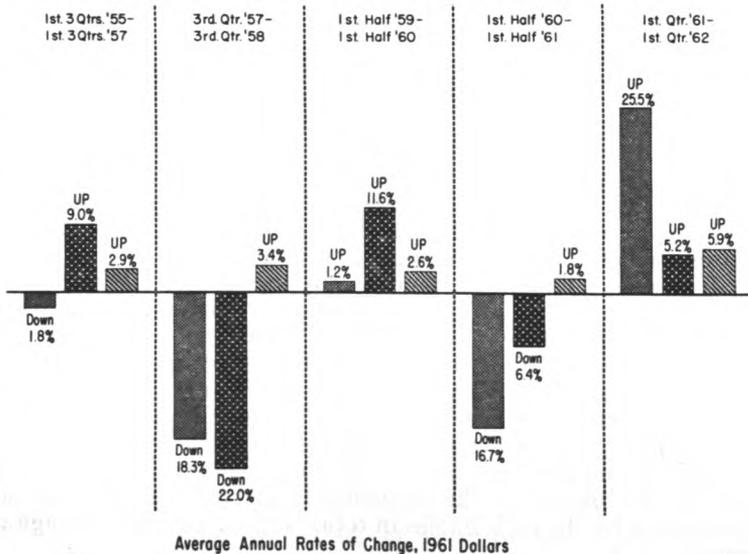
■ Gross Private Domestic Investment    ▨ Investment in Plant and Equipment



## BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN ULTIMATE DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS

■ Gross Private Domestic Investment    ▨ Investment in Plant and Equipment  
▩ Ultimate Demand: Total Private Consumption Expenditures

Plus Total Public Outlays (Federal, State and Local) for Goods and Services

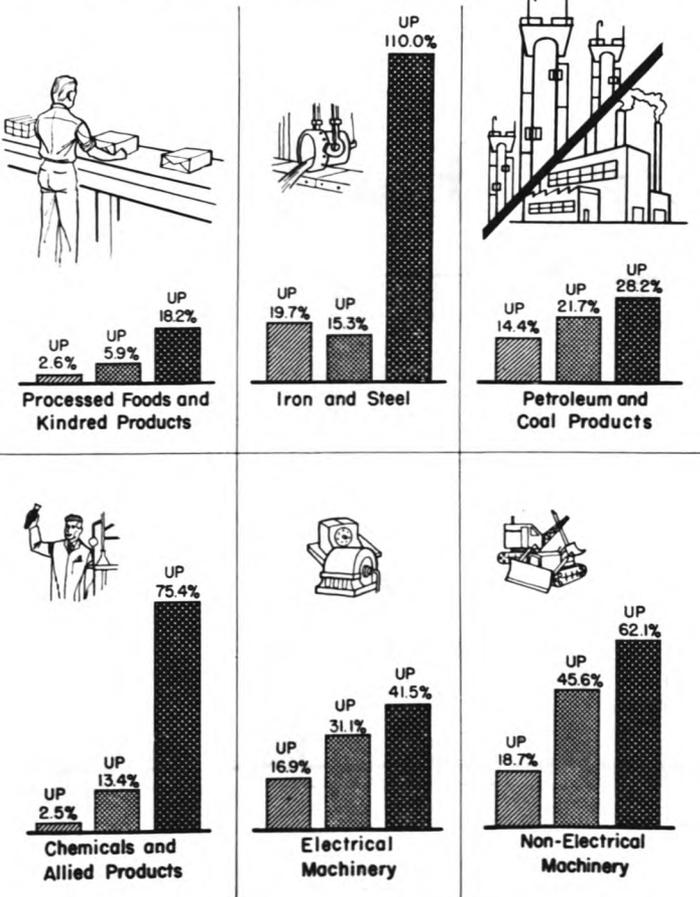


## RISING PRICES, PROFITS, AND INVESTMENT BEFORE THE 1957 - 1958 RECESSION

### The Investment Boom Before the 1957-1958 Recession

First Three Quarters 1955 - First Three Quarters 1957

Prices, <sup>1/</sup> Profits after Taxes, <sup>2/</sup> Investment in Plant and Equipment <sup>3/</sup>



<sup>1/</sup> Bureau of Labor Statistics, (U.S. Dept. of Labor), Commodity Wholesale Price Indexes.

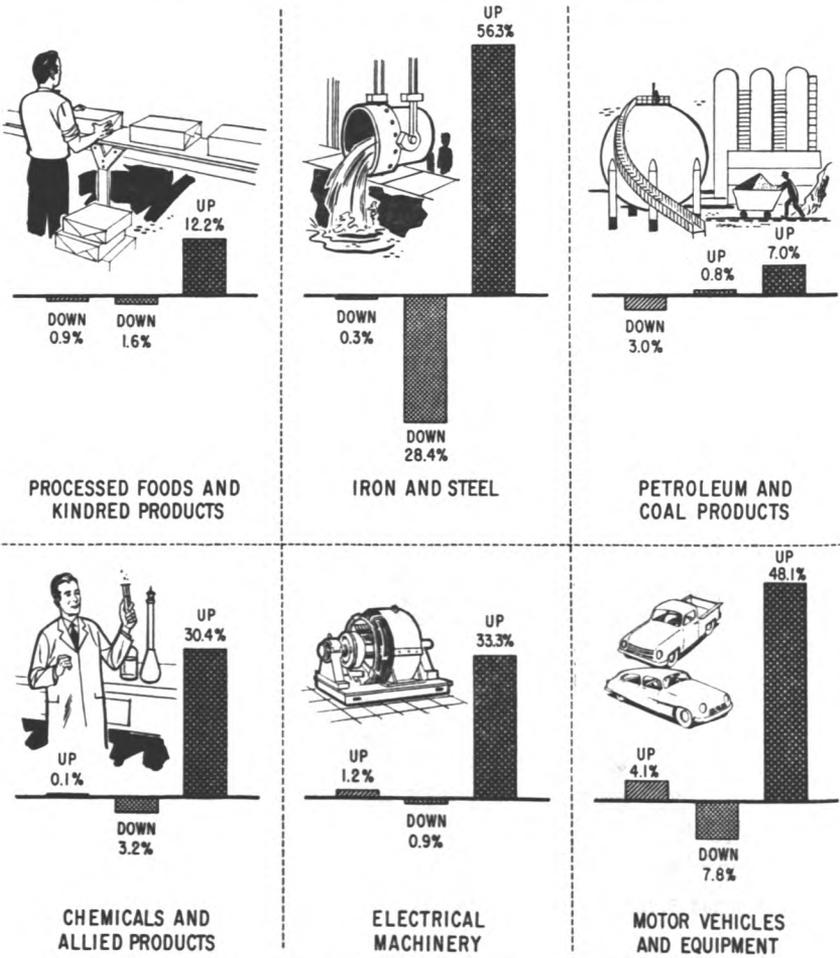
<sup>2/</sup> Securities and Exchange Commission, Profit Estimates.

<sup>3/</sup> Securities and Exchange Commission estimates of expenditures for plant and equipment.

## INVESTMENT BOOM OCCURRED AGAIN BEFORE THE 1960-1961 RECESSION DESPITE REDUCED PRICES AND PROFITS

First Half 1959 - First Half 1960

Prices,<sup>1/</sup>
 Profits after Taxes,<sup>2/</sup>
 Investment in Plant and Equipment<sup>3/</sup>



<sup>1/</sup> U.S. Dept. of Labor, Bureau of Labor Statistics, commodity wholesale price indexes.

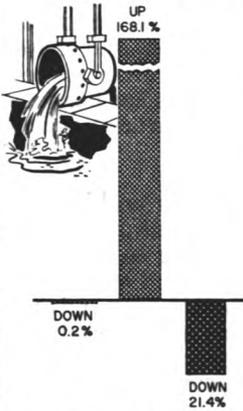
<sup>2/</sup> Securities and Exchange Commission, profit estimates.

<sup>3/</sup> Securities and Exchange Commission, estimates of expenditures for plant and equipment.

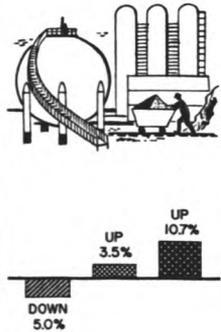
# PRICE, PROFIT AND INVESTMENT TRENDS DURING CURRENT ECONOMIC UPTURN

1st Quarter 1961-1st Quarter 1962

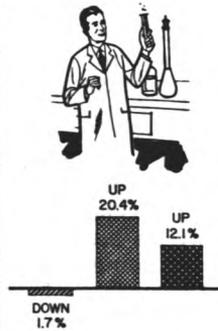
▨ Prices ▩ Profits ▪ Investment



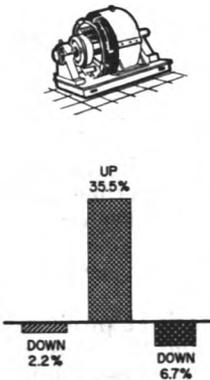
**IRON and STEEL**



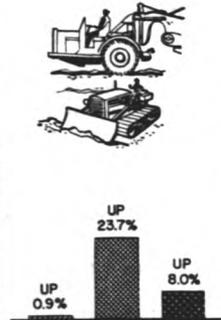
**PETROLEUM and COAL PRODUCTS**



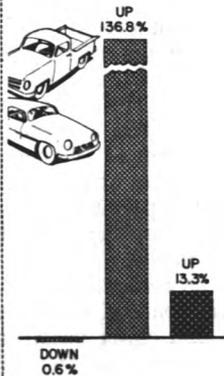
**CHEMICALS and ALLIED PRODUCTS**



**ELECTRICAL MACHINERY**



**NON-ELECTRICAL MACHINERY**



**MOTOR VEHICLES and EQUIPMENT**

▨ Data: U.S. Dept. of Labor, wholesale commodity price indexes.

▩ Data: Securities and Exchange Commission.

▪ Data: U.S. Dept. of Commerce and Securities and Exchange Commission.

On top of all this, the material which I have thus far presented measures actual wage rate increases against actual increases in productivity. But the actual increases in productivity have been repressed by the large economic slack and consequent inefficient use of plant and manpower. Wage rate increases, to fulfill their proper consumption function, should be related to the technological changes in productivity, which means the changes in productivity which would occur under conditions of reasonably full utilization. My chart 20 demonstrates this proposition by comparing rates of actual productivity growth under varying degrees of economic utilization, and therefore substantiates my conclusion that the lag of wage rate increases behind technological change has been severe indeed, and thus has been one of the main factors in the poor character of our overall economic performance.

Chairman PATMAN. They will all be in the record.

Mr. KEYSERLING. The main point is that there is nothing wrong with our productivity, whenever there is adequate ultimate demand. One day we hear that our productivity is increasing so fast that we are never going to be able to expand ultimate demand enough to use all the labor force because technology and automation are advancing so fast. The next day we hear from the same people that productivity and technology are increasing so slowly that we are at a competitive disadvantage all around the world. Both statements can't be generally true.

The fact of the matter is that productivity and technology are increasing faster than we dare to realize, both in the factory and on the farm, and the great problem is to expand distribution apace. There is nothing wrong with American productivity, or American inventiveness, or American managerial skills. This is an economic problem and not a technological problem.

This brings me back to the question about profits that Congressman Reuss asked. My 21st chart shows profits in some key industries, showing in the final bar of each box the first quarter of 1962. This does show iron and steel profits, up again in the first quarter of 1962, although not above the alltime peaks of some of the earlier years.

In the case of motor vehicles, as we have all read in the papers recently, the profits are enormously above any previous time, and in the case of other key industries they are either at or above or very near alltime peaks.

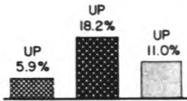
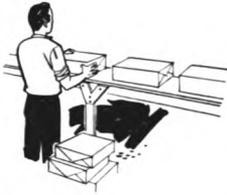
Let us remember that there is at the same time a very low utilization of capacity, as I showed.

My 22d chart bears upon this. When you look at profit sales ratios, you see that they have held up very well, and that most of them have increased, which simply means that, if there were a higher level of operations, if there were a higher level of ultimate demand, profits would soar, and quite properly would soar, far above their recent levels, which in themselves have been very rewarding and quite high.

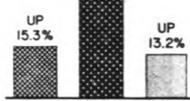
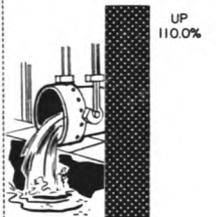
## BEFORE THE 1957-1958 RECESSION, PROFITS AND INVESTMENT OUTRAN WAGES—BASIC TO CONSUMPTION

First Three Quarters 1955—First Three Quarters 1957

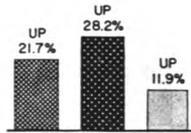
Profits <sup>1/</sup>    
  Investment <sup>2/</sup>    
  Wage Rates <sup>3/</sup>



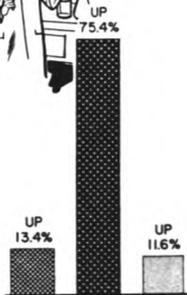
**PROCESSED FOODS  
and KINDRED PRODUCTS**



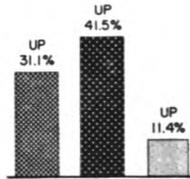
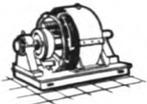
**IRON and STEEL**



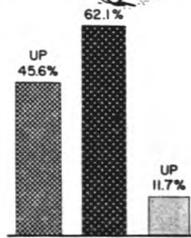
**PETROLEUM  
and COAL PRODUCTS**



**CHEMICALS  
and ALLIED PRODUCTS**



**ELECTRICAL  
MACHINERY**



**NON-ELECTRICAL  
MACHINERY**

<sup>1/</sup> Data: Securities and Exchange Commission.

<sup>2/</sup> Investment in plant and equipment. Data: U.S. Dept. of Commerce and Securities and Exchange Commission.

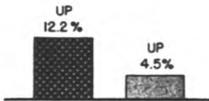
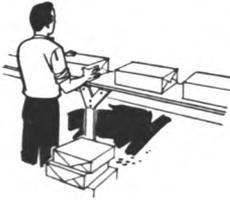
<sup>3/</sup> Average hourly earnings of production workers. Data: U.S. Dept. of Labor.

# BEFORE THE 1960-1961 RECESSION INVESTMENT AGAIN OUTRUN WAGES-BASIC TO CONSUMPTION

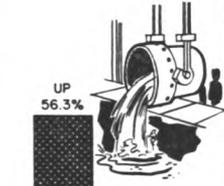
First Half 1959-First Half 1960

Investment ↙

Wage Rates ↘



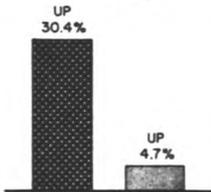
**PROCESSED FOODS  
and KINDRED PRODUCTS**



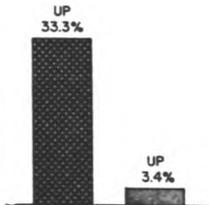
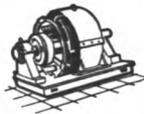
**IRON and STEEL**



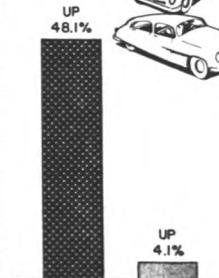
**PETROLEUM  
and COAL PRODUCTS**



**CHEMICALS  
and ALLIED PRODUCTS**



**ELECTRICAL  
MACHINERY**



**MOTOR VEHICLES  
and EQUIPMENT**

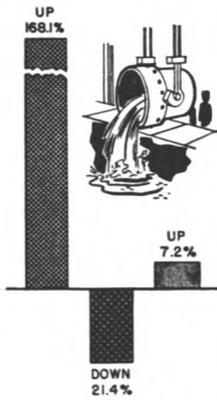
↙ Investment in plant and equipment. Data: U.S. Dept of Commerce and Securities and Exchange Commission.

↘ Average hourly earnings of production workers. Data: U.S. Dept. of Labor.

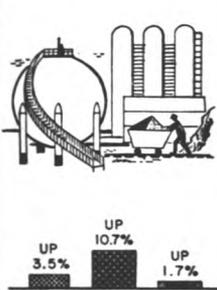
# PROFITS AND INVESTMENT DURING CURRENT ECONOMIC UPTURN OUTRUN WAGES-BASIC TO CONSUMPTION

1st Quarter 1961-1st Quarter 1962

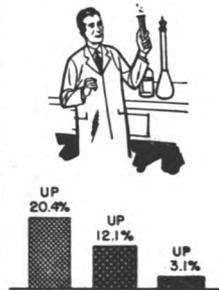
Profits<sup>1/</sup> Investment<sup>2/</sup> Wage Rates<sup>3/</sup>



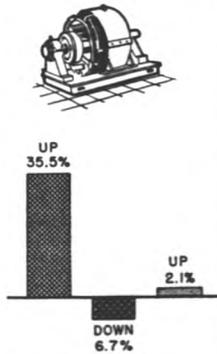
IRON and STEEL



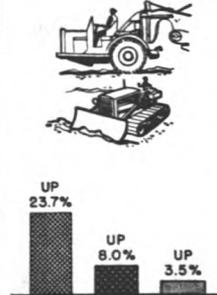
PETROLEUM and COAL PRODUCTS



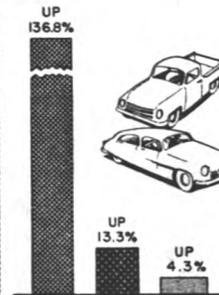
CHEMICALS and ALLIED PRODUCTS



ELECTRICAL MACHINERY



NON-ELECTRICAL MACHINERY



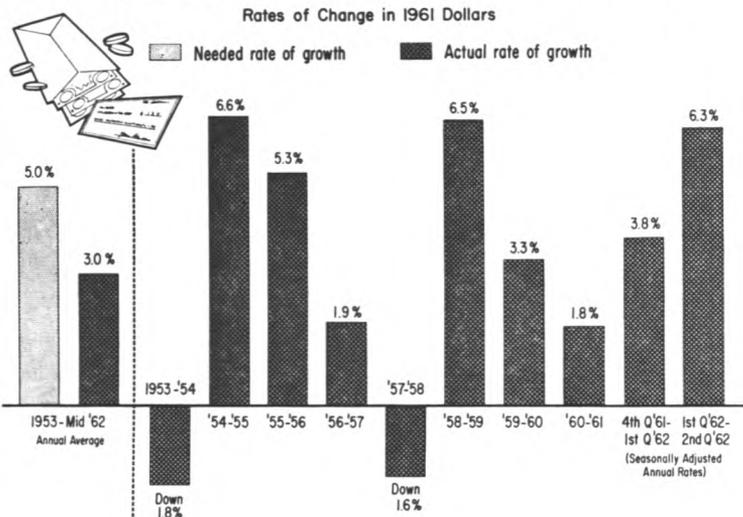
MOTOR VEHICLES and EQUIPMENT

<sup>1/</sup> Data: Securities and Exchange Commission.

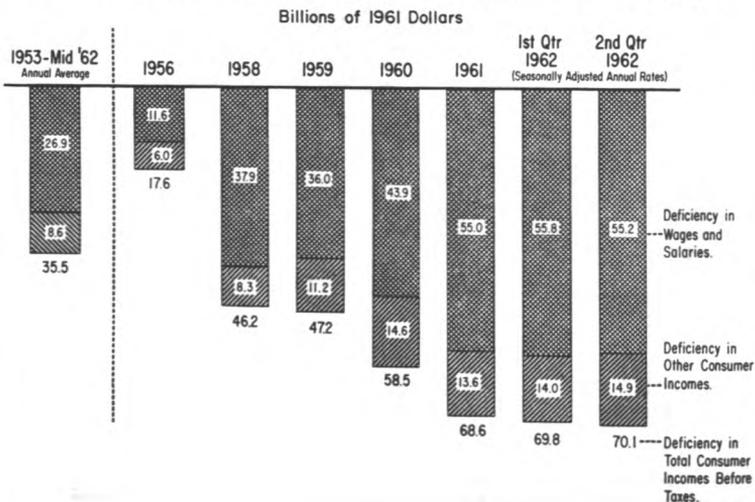
<sup>2/</sup> Investment in plant and equipment. Data: U.S. Dept. of Commerce and Securities and Exchange Commission.

<sup>3/</sup> Average hourly earnings of production workers. Data: U.S. Dept. of Labor.

## DEFICIENT RATE OF GROWTH IN WAGES AND SALARIES, 1953-MID 1962

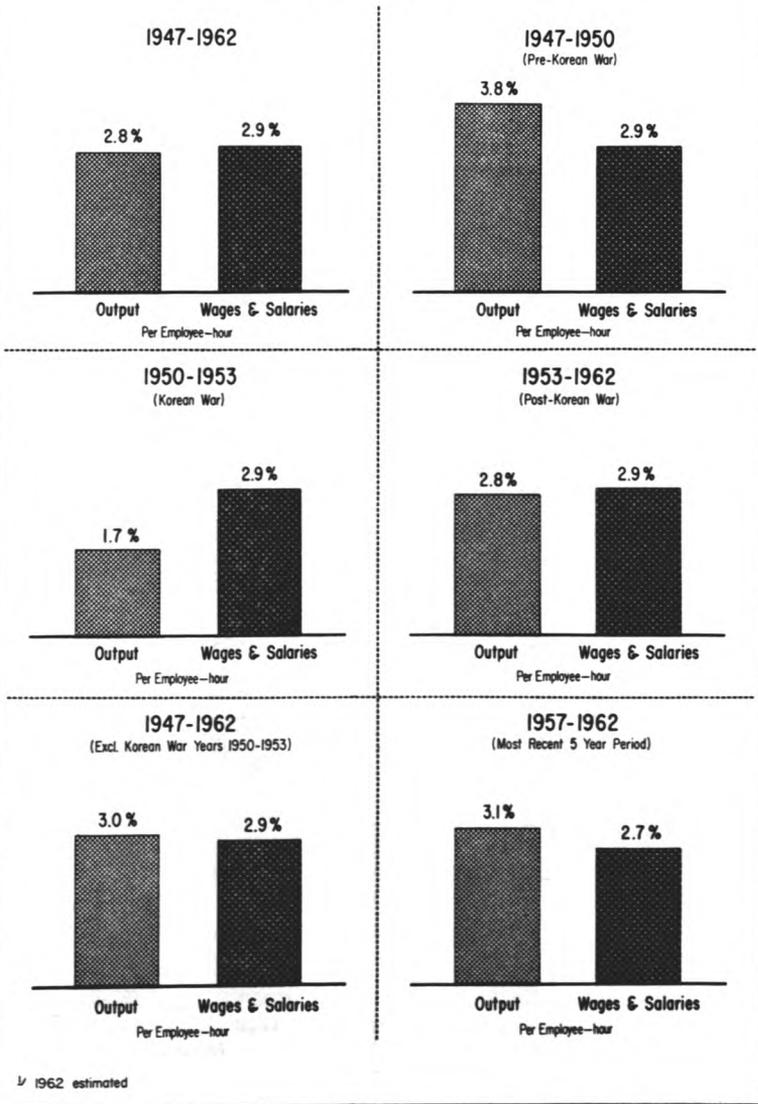


## DEFICIENCIES IN WAGES AND SALARIES ARE LARGE SHARE OF DEFICIENCIES IN TOTAL CONSUMER INCOMES BEFORE TAXES



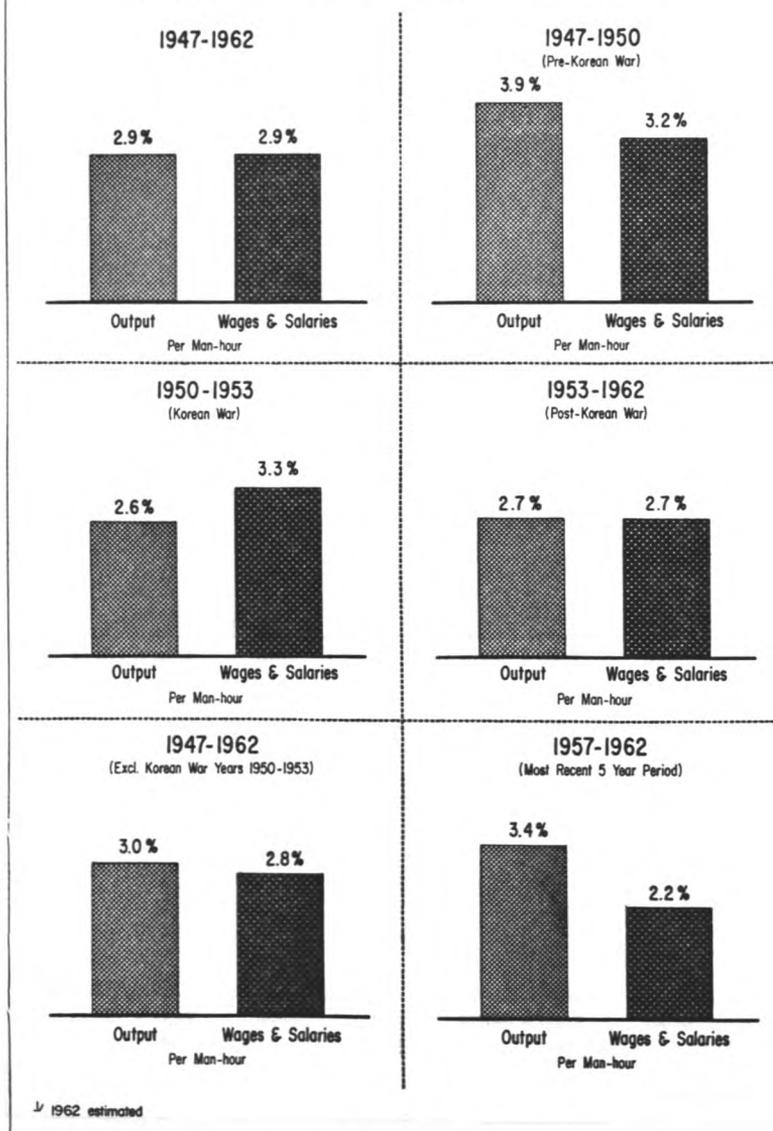
## RATES OF CHANGE IN NONFARM OUTPUT, AND IN NONFARM WAGES AND SALARIES, PER EMPLOYEE-HOUR, 1947-1962 <sup>1/</sup>

Annual Average Rates of Change, Measured in Uniform Dollars



## RATES OF CHANGE IN MANUFACTURING OUTPUT, AND IN WAGES AND SALARIES, PER MAN-HOUR, 1947-1962 <sup>J</sup>

Average Annual Rates of Change, Measured in Uniform Dollars

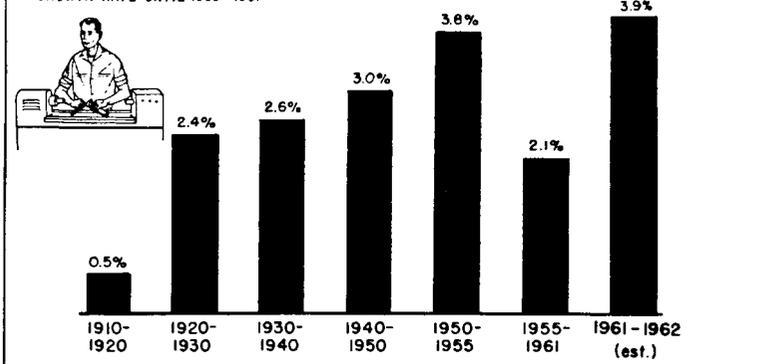


# TRENDS IN OUTPUT PER MAN-HOUR -OR PRODUCTIVITY-1910-1962

Average Annual Rate of Productivity Growth  
for the Entire Private Economy

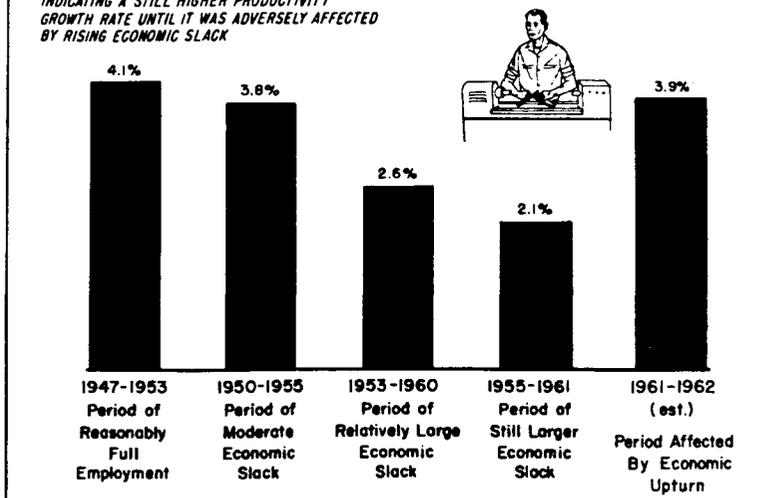
## THE RECORD 1910-1962

INDICATING AN ACCELERATING PRODUCTIVITY  
GROWTH RATE UNTIL 1955-1961



## THE RECORD SINCE WORLD WAR II AND RECONVERSION

INDICATING A STILL HIGHER PRODUCTIVITY  
GROWTH RATE UNTIL IT WAS ADVERSELY AFFECTED  
BY RISING ECONOMIC SLACK



Note: Based on U.S. Department of Labor estimates, relating to man-hours worked.

Let's now look at my 23d chart. This shows that, in addition to the profit factor, there is the cash flow factor. In other words, even the high profit figures under conditions of low capacity utilization do not represent the real availability of funds for corporations. Here I analyze the organization of financing from internal sources, which is done through various types of internal sources, including depreciation, amortization, retained profits, and depletion allowances, so that what is actually happening is that even in some of the cases where there seems to be a profit squeeze, the Federal tax policy has been so liberal that really, for all practical purposes, there have been more investment funds available than at some earlier times when the figures were showing a better profit picture.

I have had an opportunity to analyze this difficulty for the railroad industry, and the difference between the figures when you just look at the profit trends for the railroads and the figures when you look at their true financial position, is fantastic in the case of some of these very large rail companies which are seeking merger on the ground that they are on the way to bankruptcy.

My final series of charts indicate the magnitude of the economic task confronting us. My 24th chart shows the needed increases in total national production, in various components of national production and income, and in employment. The goals for 1964 bring home how far current programs, and programs under active discussion, are short of the minimum requirements for restoring maximum employment and production even by 1964. My 25th chart shows the difference, 1953-56, between the high and the low growth rates. My 26th and 27th charts portray the nature of a Federal budget which would exert its appropriate role in an effective nationwide effort to restore and maintain maximum employment and production, and in helping to meet the great priorities of our public needs.

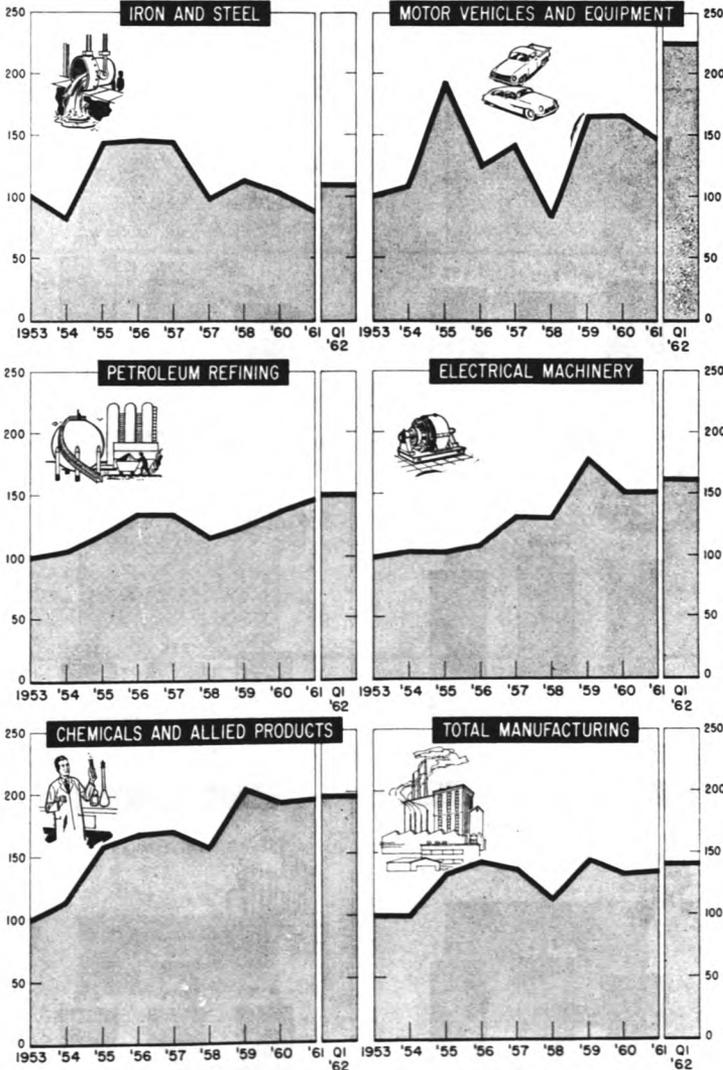
Now, what do all these charts show in substance, as I see them, as they bear upon fiscal policy? As they bear upon fiscal policy, they show first, that the problem in the American economy since 1953 has been the age-old problem of not being able to distribute what we can produce. It is an anomaly that almost everybody agreed to this a few years ago, and almost everybody has forgotten it now.

Businessmen, conservatives, liberals, economists, were all saying the American economy has a genius for production, but doesn't know how to distribute what it could produce. Ultimately and basically, this is what unused plant and manpower mean, that we don't distribute what we can produce, and it certainly isn't because we are an affluent society. It certainly isn't because we don't have poverty in our midst.

Even since the great depression, we haven't learned to distribute what we currently can produce, and yet our economic policies during the last 9½ years, if I may say so, under Republican and Democratic administrations almost alike, have been wedded to a monetary policy, a tax policy, an interest-rate policy, and other policies which have aggravated rather than remedied these basic imbalances in our economy.

## KEY PROFITS AFTER TAXES ARE HIGH DESPITE LARGE UNUSED CAPACITIES

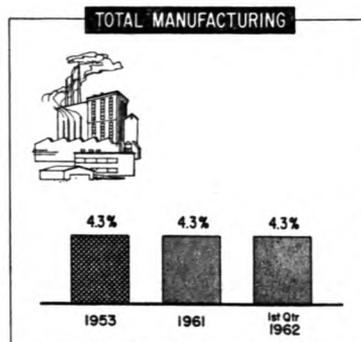
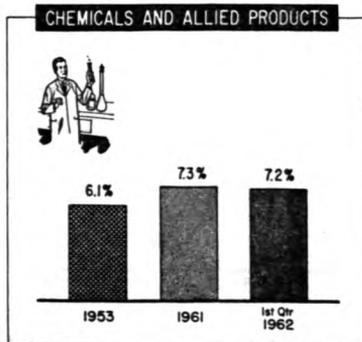
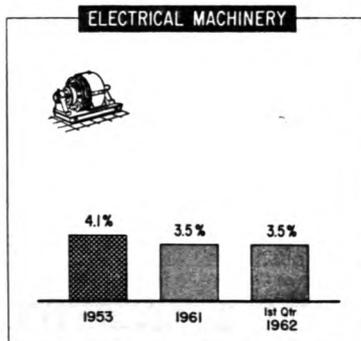
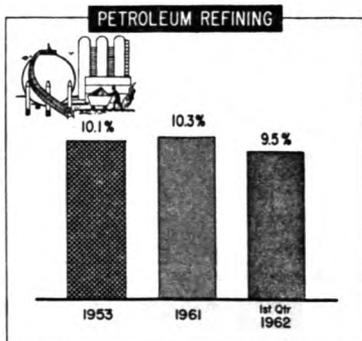
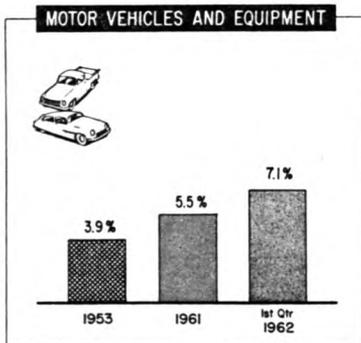
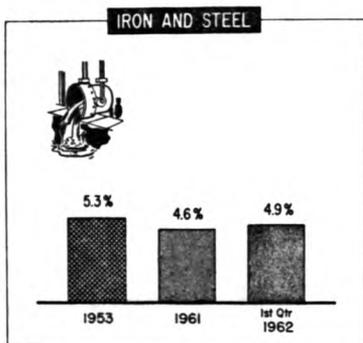
1953=100



Note: First quarter 1962 figures shown at annual rate, not seasonally adjusted.  
Data: Federal Trade Commission-Securities and Exchange Commission.

## PROFITS-SALES RATIOS INDICATE STILL HIGHER PROFITS WILL RESULT WHEN CAPACITIES ARE MORE FULLY USED

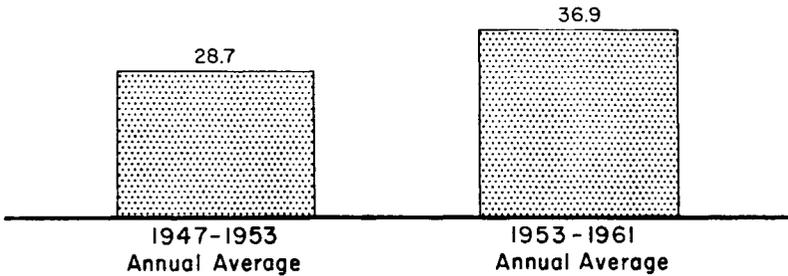
Manufacturing Corporations' Profits after Taxes, as Percent of Net Sales



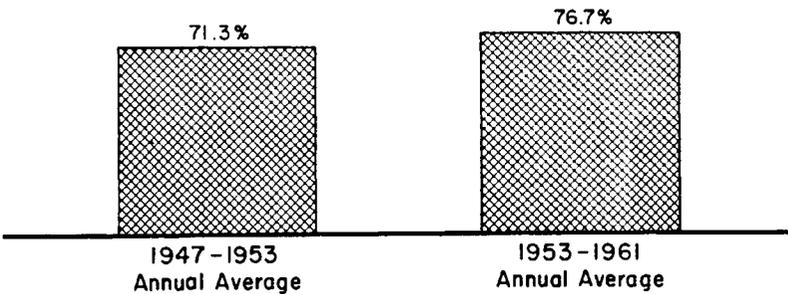
Data: Federal Trade Commission, Securities and Exchange Commission.

### TOTAL FUNDS USED BY CORPORATIONS HAVE INCREASED

Billions of Current Dollars

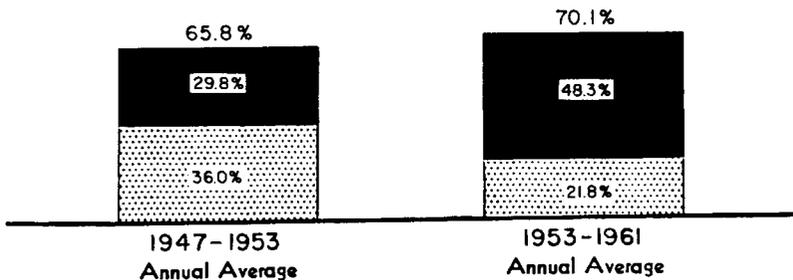


### PORTION OF THESE FUNDS USED FOR PLANT AND EQUIPMENT HAS GROWN



### PORTION OF CORPORATE FUNDS DRAWN FROM INTERNAL SOURCES HAS RISEN

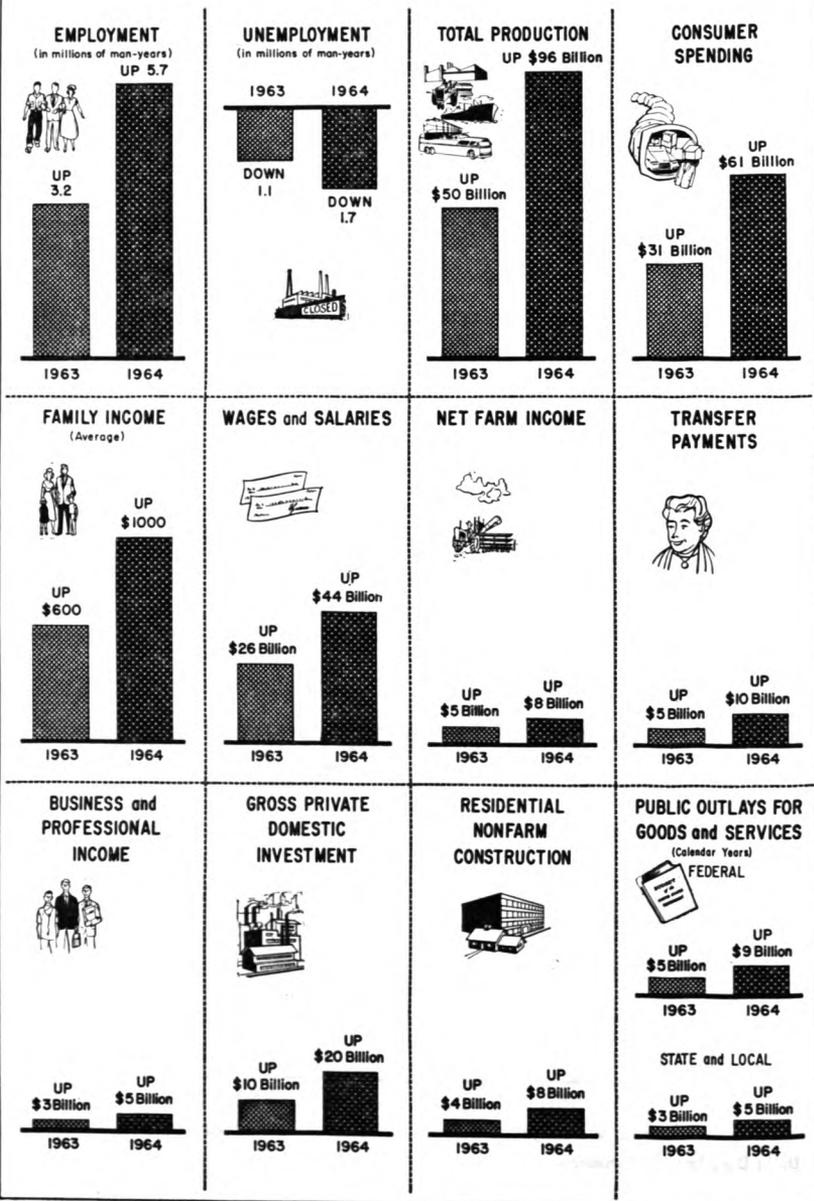
■ Depreciation and Amortization    ▨ Retained Profits and Depletion Allowances



Data: Department of Commerce.

# GOALS FOR 1963 AND 1964, CONSISTENT WITH LONG-RANGE GOALS THROUGH 1966

1963 and 1964 Goals Compared with Estimated 1962  
Dollar Figures in 1961 Dollars



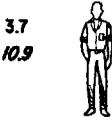
## DIFFERENCES IN RESULTS OF HIGH AND LOW ECONOMIC GROWTH RATES, 1963-1966

*Bold face - Difference in 1966; Italics - Difference for four year period as a whole*  
Dollar figures in 1961 dollars

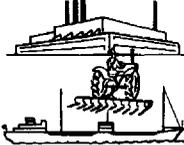
**EMPLOYMENT** <sup>1/</sup>  
(in millions of man-years)



**UNEMPLOYMENT** <sup>1/</sup>  
(in millions of man-years)

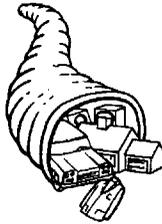


**TOTAL PRODUCTION**



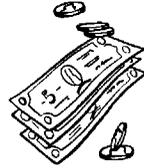
**\$104 Billion**  
*\$291 Billion*

**CONSUMER SPENDING**



**\$65 Billion**  
*\$180 Billion*

**PERSONAL INCOME**



**\$62 Billion**  
*\$229 Billion*

**FAMILY INCOME**  
(Average)



**\$1,200**  
*\$3,600*

**WAGES and SALARIES**



**\$50 Billion**  
*\$145 Billion*

**NET FARM INCOME**



**\$16 Billion**  
*\$43 Billion*

**TRANSFER PAYMENTS**



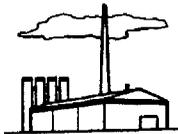
**\$11 Billion**  
*\$31 Billion*

**BUSINESS and PROFESSIONAL INCOME**



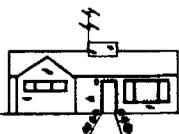
**\$5 Billion**  
*\$15 Billion*

**GROSS PRIVATE DOMESTIC INVESTMENT** <sup>2/</sup>



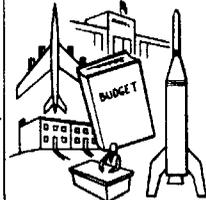
**\$27 Billion**  
*\$76 Billion*

**RESIDENTIAL NONFARM CONSTRUCTION**



**\$10.3 Billion**  
*\$27 Billion*

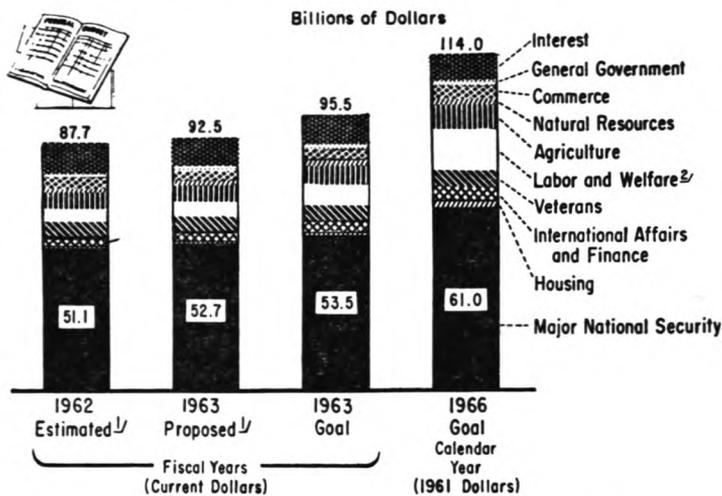
**FEDERAL, STATE, AND LOCAL GOV'T OUTLAYS FOR GOODS AND SERVICES**



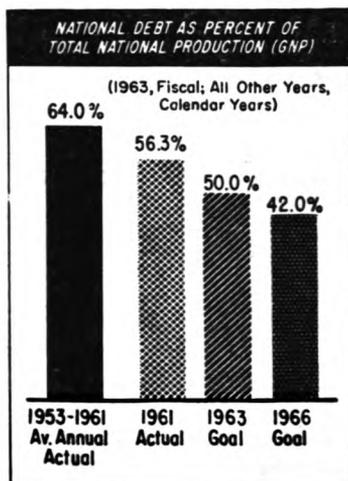
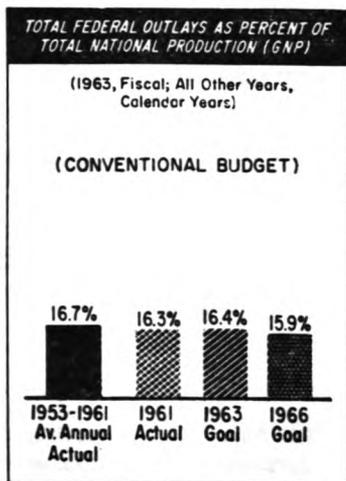
**\$12 Billion**  
*\$35 Billion*

<sup>1/</sup> High growth rate would draw more persons into the labor market than low growth rate.  
<sup>2/</sup> Including net exports of goods and services.

## TOWARD A FEDERAL BUDGET CONSISTENT WITH MAXIMUM EMPLOYMENT AND THE PRIORITIES OF NATIONAL PUBLIC NEEDS



## BURDEN OF FEDERAL OUTLAYS IN A FULLY GROWING ECONOMY WOULD BE LOWER THAN IN RECENT YEARS



<sup>1</sup>/ Based upon Budget estimates as of July 20, 1962.

<sup>2</sup>/ Including education and public health.

# A FEDERAL BUDGET GEARED TO JOBS FOR ALL AND ADEQUATE PUBLIC SERVICES

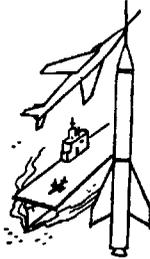
1962 and 1963, Fiscal Years; 1966, Calendar Year  
Per Capite Outley in 1961 Dollars

**TOTAL FEDERAL  
OUTLAYS**



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	16.25	471.67
1963 Goal	16.41	502.37
1966 Goal	15.96	569.43

**NATIONAL DEFENSE,  
SPACE TECHNOLOGY  
AND ALL  
INTERNATIONAL**



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	10.20	296.14
1963 Goal	10.21	312.47
1966 Goal	9.85	351.65

**EDUCATION**



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	0.20	5.79
1963 Goal	0.31	9.46
1966 Goal	0.67	23.97

**HEALTH  
SERVICES  
AND RESEARCH**



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	0.21	6.00
1963 Goal	0.31	9.46
1966 Goal	0.48	16.98

**PUBLIC  
ASSISTANCE**



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	0.45	13.10
1963 Goal	0.52	15.78
1966 Goal	0.52	16.48

**LABOR AND  
MANPOWER, AND  
OTHER WELFARE  
SERVICES**



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	0.16	4.71
1963 Goal	0.15	4.73
1966 Goal	0.14	5.00

**HOUSING AND  
COMMUNITY  
DEVELOPMENT**



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	0.06	1.80
1963 Goal	0.19	5.78
1966 Goal	0.34	11.99

**ALL DOMESTIC  
PROGRAMS AND  
SERVICES**



(Includes also  
Agriculture;  
Natural Resources;  
Veterans; Commerce;  
Interest; General  
Government, etc.)



Year	% of Total Output	Per Capite
1962 <sup>1/2</sup>	6.05	175.53
1963 Goal	6.20	189.90
1966 Goal	6.11	217.78

<sup>1/2</sup> Budget estimate as of July 20, 1962

The reason I have analyzed so carefully—I hope carefully—this whole profit picture and investment picture during these recurrent boom periods that collapsed so quickly, is because I have been asked why they collapsed. They didn't collapse because they were not making enough profits. They did not collapse because the tax policy was too severe. They collapsed because, even with a giveaway tax policy, practically, and extremely high profits, they still won't continue to go ahead when they saw more and more that they couldn't sell what they could produce, and this is true in the last year as well as in the period preceding the last recessions.

The reason we are now moving into stagnation and recession again, is precisely the same reason as in these previous periods, namely, there were plenty of cash flows, plenty of profits, a very favorable tax situation, but they still would not go ahead with adequate investment, and in fact are willing to go ahead now even less than previously, because now more than ever before they are confronted with unused plant capacity. Business Week, on the 28th of April—and this is my final point, Mr. Chairman—these business magazines amuse me. They have an editorial page in favor of more tax concessions for business. Then they have a fact page or an analysis page which recognizes the opposite.

There was a long article, based upon the McGraw-Hill survey in Business Week, which said they had plenty of cash flow, plenty of profits; that the reason they are slowing down their investment is that the investment of tomorrow is based upon the customer of today; and if only they could get the customers, they would have the markets and would make the investments.

I think this is a guide to tax policy, I think it is a guide to monetary policy, and I think it is a guide to general economic policy.

Thank you very much for your attention.

Chairman PATMAN. Thank you, sir. You may keep your seat there if you desire, and we have our next witness, Mr. Saulnier.

Will you come forward, please?

I believe, Doctor, you have a prepared statement. You may proceed in your own way.

**STATEMENT OF RAYMOND J. SAULNIER, PROFESSOR OF ECONOMICS,  
BARNARD COLLEGE, COLUMBIA UNIVERSITY, NEW YORK CITY**

Mr. SAULNIER. Mr. Chairman, I have a prepared statement, copies of which I believe have been distributed to the committee.

Chairman PATMAN. Yes; they have been distributed to the members.

Mr. SAULNIER. This statement was prepared rather hurriedly and I have already detected some points I would like to correct. I hope you will give me an opportunity to correct them before the statement is, as I expect it will be, printed.

Chairman PATMAN. You may correct them as you go along, or if you desire you can wait until you examine your transcript of testimony.

Mr. SAULNIER. Thank you, Mr. Chairman.

Chairman PATMAN. You certainly will be given permission to correct it.

Mr. SAULNIER. I will read the statement, if I may.

I want, first, to commend the committee on its decision to hold open hearings at this time on economic policy and to thank you for inviting me to participate in them.

Certainly, the hearings are timely. Although the economy is far from being in distress, things have not gone very well and certainly not as well as was expected. The 1961-62 recovery and expansion was not up to par, much less than having been an improvement over earlier recoveries. And there was those who think that after only 17 months of recovery and expansion a downturn is imminent. It also adds to the timeliness of these hearings that they come at a point when the Federal budget is being shaped up for the fiscal year 1964, and I would assume that work on the legislative program for 1963 will soon be under way in the executive branch.

In short, the time couldn't be more appropriate for an open discussion of economy policy. I think it would be agreed, also, that such a discussion is needed.

As I understand it, you have already received testimony setting forth the salient facts on the economic situation. I will try not to duplicate any of this, but before I comment on policy matters I must give you my own conclusions regarding the present position of the economy and the near-term outlook, for these are critical to my policy recommendations.

It is widely acknowledged that for some time now the indicators to which we look for clues as to the economic outlook have been far from encouraging. Warnings of a slowdown in the rate of economic advance began to be visible early this year. Month by month these warnings were confirmed; but the evidence for the month of May went beyond this and suggested a strong possibility of a downturn occurring before the end of the year. If anything, June darkened the outlook a bit.

July was another matter. Not very much data are available yet, but what there is suggests that the economy steadied itself and improved a bit. Indeed, for a month that is often hard to interpret, I would say that the evidence of improvement in July is pretty clear. Certainly, if we look at the month's developments from the point of view of their policy implications there is no doubt but that they destroyed any case there may have been for an emergency tax cut.

And perhaps I can best express my estimate of the near-term outlook by saying that I doubt that developments in the next few months will warrant emergency tax cutting.

But it would be a mistake to think that the danger of a downturn has been altogether averted. I don't think one can say at this time that it has been any more than deferred. The economy has shown resistance and strength in the last few weeks but the record for the recovery as a whole obviously suggests a lack of the kind of liveliness one would like to see.

The way I read the record, it is saying that there is no need for emergency antirecessionary tax cutting, but that there is an urgent need to strengthen the underlying forces that make for growth in our economy and to remove obstacles to growth. And I would say that the record is telling us, also, that we don't have an unlimited amount of time to shape and adopt the needed measures.

The performance of the economy in the last few years, and in particular the disappointing record of the present recovery, provide important guidance as to the kinds of measures that are needed. Four points in this record are especially noteworthy.

First, it should be clear from recent experience that we can't produce the economic growth we want merely by the increase in Federal spending. The fact is that in the fiscal year just completed net budget expenditures of the Federal Government rose by more than \$6 billion.

This followed an increase of \$5 billion in the fiscal year 1961, of which nearly 80 percent was incurred in the last 6 months of that period. And I would judge that more increases are in prospect. The budget presented to the Congress in January 1962 projected a rate of expenditures for fiscal 1963 which would be about \$6 billion higher than the fiscal 1962 rate.

Thus, we have had a \$10 billion increase in Federal expenditure rates in the last year and a half; and if things turn out as projected in January, we shall have had a \$16 billion increase in 2½ years ending June 30, 1963. There has been a sharp increase, also, in spending by State and local governments. The economy has lagged, but no one can say it has lagged because it got no boost from Federal spending.

Second, not only have we had a sharp rise in Federal spending but it has been deficit spending, which is widely regarded as being a very strong tonic for the economy. But if a deficit in the Federal budget with expenditures rising will stimulate the economy, then we should be enjoying a good deal more stimulation than we are feeling right now. There was a deficit in the conventional budget of nearly \$4 billion in the fiscal year 1961, and a deficit of \$6.3 billion was registered in the fiscal year just completed. And still the economy lags.

There are all kinds of reasons why our country, with its heavy responsibilities in the free world, should keep its financial housekeeping in strict order, but if we were to put all of these powerful arguments aside and simply look at the record as pragmatists I don't see how we can escape the conclusion that the Federal budgetary deficits just don't work the magic they are reputed to perform.

Third, it is not easy, either, to see a ground for complaint that consumer buying power has not increased rapidly enough. Between the first quarter of 1961, which was the trough quarter of the 1960-61 recession, and the second quarter of this year, disposable personal income rose more than did personal consumption expenditures. Reflecting this fact, the annual rate of personal savings went up by about \$3 billion, and the savings ratio rose from 6.7 to 7 percent.

Fourth, the record shows very clearly that the one major element in our economy that has been really lagging is the volume of expenditures by private business concerns on plant and equipment. While other major categories of national product have been increasing very well, and some, such as governmental spending, have been rising sharply, producers' expenditures on durable goods have hardly increased at all.

They rose in the recovery period, but not nearly enough; and, looking at their behavior over a longer period, they were barely larger in the second quarter of 1962 than they were in the second quarter of 1960.

Furthermore, if the amounts spent were expressed in constant rather than in current prices I expect it would be found that the physical amounts of goods involved was actually less in mid-1962 than it was 2 years ago.

When one goes over the whole record, it is pretty clear that the lag in our economy is in private investment activity, and that our major need is to create an environment that will favor a more rapid increase in this category of expenditures. What we need is a program of action that will bring this about.

In a moment I will outline a plan of policy which, in my judgment, would fit the present situation, but, before I do that, let me say that a plan of economic policy, like any broad strategical plan, must respect the constraints that are inherent in the situation in which it is intended to operate. There is no point in talking about what it would be helpful to do if only the situation were not what it is.

In the present case, it is futile, and, worse than that, to talk about policy without regard to the fact that we have a substantial and continuing deficit in our balance of payments. When I appeared before this committee last January, I said that I thought this was our No. 1 problem.

I think that is still a correct appraisal of the situation. We should shape our policy plans in the understanding that we do have a precarious international financial position; and, to the fullest extent possible, our plans should be designed to help improve that position.

Further, it is not very helpful to talk about policy plans, fiscal or otherwise, as if there were no deficit in the Federal budget. I have heard suggestions that the Federal Government is not collecting enough money to pay its expenses, even in an advanced stage of business expansion. If the advocates of this kind of tax cutting have either overlooked the existing deficit, which hardly seems possible, or they have been persuaded that tax cuts which create deficits will give such a strong stimulus to growth that they will pay for themselves with very little delay.

As I have shown, there is nothing in our recent experience to suggest that deficits, as such, will do this.

In any case, the policy program I am going to propose does respect the facts of our international financial position and our Federal finances.

Let me outline the major elements of a program.

First, it would be helpful, if this committee, and the administration, would reaffirm the budgetary policy which has been previously stated; namely, that our object in budgetary planning is to achieve a balance over the cycle, with surpluses in periods of cyclical expansion offsetting deficits during cyclical recessions. Any doubts on this should be put to rest.

Second, it is essential, in my judgment, to initiate at the earliest possible opportunity a program of tax reforms designed to stimulate a higher rate of business capital expenditures. The steps recently taken by the Treasury to liberalize depreciation allowances were a good start. The investment credit would be helpful, too, though my preference would be for a still more liberal depreciation allowance.

Beyond these steps, we ought to get the corporate income tax rate down. The 42-percent limit proposed in the Baker-Herlong bill would

be very helpful, of course, but we might set 47 percent as an interim goal. Also, we should eliminate the near-confiscatory rates imposed on the upper brackets of individual income.

Again, I would like to see these reduced over a period as contemplated in the Baker-Herlong bill, but 50 percent would be a reasonable interim goal.

Quite apart from other effects, these tax changes would be tremendously helpful to our 4 million small- and medium-sized business concerns. The task we face of providing jobs in this decade for a rapidly increasing number of young people is going especially to require a vigorous body of small- and medium-sized companies. Many will find employment in large nationwide organizations, but we should leave no stone unturned to help the small- and medium-sized companies in which large numbers of young people will find their most interesting and rewarding employment opportunities.

Third, although I want to see us do every bit of constructive, growth-promoting tax reducing that we can do, I believe we should limit what we do to what can be counterbalanced, in its immediate revenue-reducing effects, by expenditure reductions and possibly by some sales of Treasury-held financial assets.

If rate reductions of the type I have proposed promote growth to the extent that I think they will, they will eventually pay for themselves, but in the interim we should plan to pay for them in some quite tangible way.

I suggest that we go about the task of financing constructive, growth-promoting tax cuts as follows:

(1) As guidance for the fiscal 1964 budgetmaking process the President should set a ceiling on Federal spending. This ceiling should not be higher than the projected spending level of fiscal 1963 and if possible should be lower.

(2) With that ceiling as a preliminary guide, an effort should be launched at once to reduce spending on low-priority programs. The economies achieved from this budget review need not go exclusively to financing tax reductions. On the contrary, they might be divided about 50-50 between this purpose and increasing expenditures on truly high-priority programs. By high-priority programs I mean those that give clear promise of enhancing our capability for achieving a vigorous rate of economic growth.

(3) Although I would depend mainly on the reduction of low-priority spending to offset the immediate revenue cost of tax reforms it should be possible to offset some part of this budgetary impact from the proceeds of the sale of portions of the huge amount of financial assets which the Federal Government has accumulated over the years under its various direct loan programs.

It was estimated in the January 1962 budget message (special analysis E) that outstanding direct loans of major Federal credit programs at the close of the fiscal year 1962 would come to nearly \$27 billion. Obviously, one should not press a program of this kind too hard lest it raise borrowing costs in the long-term capital markets. But it should be possible to distribute significant amounts of these assets on terms that would be fully protective of the public interest and without any material effect on long-term borrowing costs.

Something between \$2.5 and \$3 billion would be a reasonable beginning goal for tax reductions of the sort I have proposed; and I believe that this immediate impact on revenues could be offset by some combination of the means I have indicated. If more can be done, so much the better.

It is my considered judgment that a statement to the effect that this is the direction of policy to be followed in tax and expenditure matters would have a very stimulative effect on our economy. But I would emphasize that it is very important to get the program underway soon. Accordingly, the tax aspects should be presented, in my judgment, in a form that will minimize the time required for consideration prior to enactment. From this point of view, the simpler the bill, the better.

(4) This brings me to the question of monetary policy, which is especially important at this time because of our international payments position and because of the lag in our economy.

No one wants a money policy that will retard the correction of our balance-of-payments position, much less a policy which would actively worsen that position. On the contrary, money policy should contribute to the needed correction. But if monetary policy is asked to carry too much of the burden of correcting, or even of protecting, an international payments position which, like ours, is traceable in good part to governmental programs it could very well be so restrictive as to offset all the stimulating effect which we could hope to produce through fiscal measures.

The risk of our getting into such a policy dilemma is reduced, of course, to the extent that we succeed in efforts such as those being pressed by the administration in connection with procurement under our military and economic aid programs. Vigorous application of these efforts to conserve dollars is an absolute requirement of policy at this time.

This requirement is underlined by the fact that free reserves seem to have been trending down recently, that the money supply currently seems to be shrinking, and money rates and bond yields have recently taken a rather sharp turn upward. Considering all elements in the situation, as the reserve authorities are in a position to do, these developments may be both necessary and beneficial.

All the same, I would hope that considering the position of the economy at this time and the extent of the more direct measures being taken to help correct our balance of payments, it will not be necessary to tighten credit conditions over their present position. Actually, some easing would be helpful to the economy, especially in the long-term section of the market.

At an earlier point in this statement I suggested the sale of some part of the financial assets currently held by the Treasury as a technique for meeting part of the cost of a growth-promoting tax-reduction program. I realize that this could have a tendency to raise long-term borrowing costs, though I should think the program could be managed so as to limit this effect to a very small amount and hopefully to avoid it altogether.

But if long-term borrowing costs have to be lifted, and in the last few weeks they have been lifted in the corporate bond market, I should think it would be better to do this as part of a program to

finance growth-promoting tax reductions than as part of a normal Federal Reserve open market operation.

(5) Finally, let me say a few words on the relation of costs and prices to economic growth. Mr. Bolling of this committee will perhaps remember a letter I wrote him a few years back responding to certain questions he put to me and in which I stressed the importance of cost increases, and particularly of labor-cost increases, as a force behind rising prices. This was not a widely held view at the time, but it has gained a good many followers since.

Indeed, not so long ago it was not even fashionable to believe in the necessity of a reasonably steady price level as a basis on which to achieve sustainable and meaningful economic growth. But views on these matters have undergone very considerable change. Nowadays, there is broad agreement that a reasonably stable price level is the only basis on which a workable economic strategy can be built.

I subscribe fully to this view, though I must confess that the conversion to it has been more rapid and more widespread than anything I had expected to witness. But this is good, and I am happy to see it; all that concerns me is that we do not overlook the fact that once price level stability has been made the basis of an economic strategy, one automatically accepts certain other requirements, too.

The most important of these is that, in the most general case, production costs must not increase by amounts that cannot be fully offset, in their effect on unit cost of production, by improvements in productivity. If this requirement is not respected, the result is a suppression of profit margins and eventually a suppression of the rate of economic growth.

There is wide agreement, I believe, that for some years we have, as a Nation, been failing to respect this requirement. Competitive conditions, and to some extent governmental pressures, have pretty much fixed a ceiling on prices; currently, many industrial prices are being reduced. But we have been less successful in limiting increases in costs. One way to put this is to say that price inflation, at least for the time being, has been checked but that cost inflation continues.

I believe that it is this inconsistency, which reflects itself in narrower and narrower profit margins, that is the major factor behind the lag in our economic growth. And I want to state quite clearly that although I believe we can improve our economic performance through appropriate monetary and fiscal policies, we must follow appropriate wage-price-profit policies or we will undo all the good these other measures can accomplish.

This is obviously what the President and his Council of Economic Advisers had in mind in setting forth certain wage and price guidelines in the January 1962 Economic Report.

There is a good deal that can be said pro and con on the idea of setting guidelines in this fashion, but without going into these arguments I must express a reservation about the wage guideline as currently defined. The principle that labor cost increases should be equated to productivity improvements does not, in my judgment, suit our present situation.

**What we need now is a chance to achieve an improvement in profit margins and some reductions in prices. If we keep our economy competitive enough, which is a requirement underlying any strategy for**

an enterprise economy, we can be sure that profit improvement will not go far beyond what is reasonable before it is translated into lower prices.

But in order to achieve profit margin increases and price reductions, production cost increases must be kept well within productivity improvements, not equated to them. The guideline, in my judgment, should be revised to this effect.

It would be helpful also to have a better understanding as to how these guidelines are to be enforced. Certainly it is clear that there is very little to be gained from enforcement procedures of the sort that were employed in the steel incident. I have four suggestions to make in this connection.

First, on the application of wage-price guidelines, I suggest that the executive branch limit its role to (i) annual descriptive and analytical reviews, presented in the Council's year-end Economic Report, of the major developments affecting wages, prices, and profits; and (ii) a critical evaluation by the President, in his year-end economic message, of wage-price-profit developments during the year.

If it should be the President's judgment that developments have not been consistent with the national interest he could state the respects in which he believes mistakes have been made and the lines along which adjustments should be made. There is ample opportunity in the medium of these two messages for the facts to be set forth and analyzed for their meaning and significance and for guidance, which I believe should be couched in general terms, to be given for the year ahead.

Short of emergency conditions, and in these connections I would interpret "emergency" quite restrictively, I believe our economy will work better if the executive branch avoids direct intervention in specific wage-price decisions. In the meantime, efforts should be pressed, as I believe they are by the President's Special Commission on Labor-Management Relations, to explore ways of improving the balance of bargaining power in labor markets.

Second, I suggest that conferences such as the one sponsored this spring by the Secretary of Labor on national economic issues be held regularly every year. Conferences of this kind are an excellent way to encourage discourse and to improve understanding among labor, management, and Government on economic policy questions.

Third, it would also be helpful to provide for the expression of views from the public on wage-price-profit developments. To this end, the Joint Economic Committee or possibly the Council of Economic Advisers might plan to have open hearings every January or February devoted specifically to this range of questions and in particular to the guidelines, if these continue to be set out by the Council and the President. As far as possible, the effort should be to give an opportunity to be heard in these hearings to all those who have potentially useful contributions to make to the discussion.

This would be a kind of annual economic town meeting. I come from New England, and I know that it is sometimes not as easy to get such meetings stopped as it is to get them started, but I think this can be managed and, in any case, the open discussion of stated public policy is always a healthy thing in a democracy. Open discussion is certain to help us find our way to an understanding of the kind of wage-price.

policy, shaped through free collective bargaining and competitive markets, under which we can achieve the kind of economic performance we all desire.

Fourth, I suggest that this committee make a special point, possibly through the scheduling of special hearings, of examining into the ways in which Government itself may be putting direct upward pressure on costs and prices. I have in mind, particularly, the Government's procurement and contracting activities and the programs under which it makes minimum wage determinations as authorized by the Walsh-Healey and Davis-Bacon statutes.

We should be quite sure that these programs are administered in ways that are consistent with the kind of wage-price policies which, under the guidelines procedure, we hope to have followed by all labor groups and business units. I would judge, drawing upon my experience in 1956-60 as Chairman of the President's Council of Economic Advisers, that there are responsible businessmen who would say that the programs tend to inflate costs. The problem needs close study.

I have limited myself in this statement to fiscal, monetary, and wage-price policies. There are, of course, other parts of a strategy of economic policy that also deserve attention. But the three I have commented on are the crucial ones. If I have overlooked points in which members of this committee have a particular interest, I shall be happy to respond to questions on them.

Thank you very much.

Chairman PATMAN. Thank you, sir. I would like to ask Mr. Keyserling a question.

This is a question that concerns me, Mr. Keyserling. If we had an across-the-board cut in personal taxes, that is, a cut which would change the income distribution in favor of the top bracket income receivers, wouldn't you have a worse fiscal structure after the period of deficit is over?

In other words, wouldn't you, in the long run, increase the troubles which the tax cut is intended to cure?

Mr. KEYSERLING. That is the way I feel about it very definitely, Mr. Chairman. I think that the equitable thing to do in taxation is the thing that is best for the whole economy—wage earners and investors, high-income groups, middle-income groups, low-income groups. The thing that is best for the whole economy is to have the economy operating fairly consistently at maximum levels of employment, production, and purchasing power.

Certainly, nobody has to worry about the adequacy of profits under such conditions and certainly nobody has to worry about how well the high-income groups do under these conditions. I don't think that the taxes on them are "confiscatory." I get around the country quite a lot, and certainly most of them, who haven't inherited great fortunes, couldn't live the way they do, and they live that way honorably, if they were really paying 91-percent taxes on the portion of their incomes which fall within that tax rate.

The fact of the matter is that our tax policy is much too hard, both directly and obliquely, on middle and lower income groups, who haven't got ways of honorable tax avoidance. Therefore, I think you are entirely correct that, when one analyzes what has actually been happening to the economy and where the deficiencies have occurred

which have hurt everybody, a larger spendable income on the part of middle and lower income families would do much for the whole economy than a larger spendable income on the part of the corporations and higher income people, not because I have any objection to their having these higher incomes, but because they translate more largely into savings than can be absorbed in investment.

The savings cannot translate fully into investment when there is inadequate ultimate demand, and, therefore, they become frozen savings, which are merely another expression for unused plant capacity and rising unemployment of plant and manpower. So I agree completely with your implication, and I feel very strongly that a mal-adjusted, improper change in the composition of the tax burden which would be represented by a so-called across-the-board tax cut, would in many respects leave us worse off than we are now.

Chairman PATMAN. Thank you, sir.

Would you like to comment on that, Mr. Saulnier?

Mr. SAULNIER. Yes, I would like to comment on that, Mr. Chairman.

I feel that there are many changes that it would be beneficial to make in our tax system.

Chairman PATMAN. We are confining this just to this across-the-board, or the low-income group.

Mr. SAULNIER. I will come to that point, Mr. Chairman. As I say, I feel there are many changes that should be made in our tax system; to my way of thinking the question is mainly one of priorities we should place on them. In my judgment, the reason why we are not achieving the kind of economic growth we would like to have is that we have an inadequate growth of investment expenditures in the private sector of our economy, and I have suggested two changes in taxes which would help overcome that.

Now, I would like to see a broad, across-the-board reduction in the individual income tax, but, Mr. Chairman, I just don't think we can afford it at this point. Our Government is providing services of increasing scope and variety for the whole American population, for every man in the street, if you will. These services must be paid for and there just isn't anybody to pay for them except the whole American people.

There is no other place to put the burden of paying for those programs. Of course, a person may persuade himself that the programs don't really need to be paid for, and some people have apparently managed to persuade themselves of this, but I don't see how you are going to run the Government safely unless you do pay for these services and to do this you must tax everyone. That is why, while I would like to see broad individual income tax reduction, I honestly cannot say, Mr. Chairman, that I see it as a practical thing to do at this time.

Chairman PATMAN. I would like to ask you a couple of questions, Mr. Saulnier. I wish you would comment on them briefly, if you please.

Mr. SAULNIER. Yes.

Chairman PATMAN. What specific monetary policy do you feel should accompany any tax reduction that takes place?

Mr. SAULNIER. Tax reductions, Mr. Chairman, of the character that I have suggested, accompanied, as I have suggested, by reductions in spending on low-priority spending programs and by some, as I have suggested, asset sales, would require no change in money policy.

Chairman PATMAN. One other question. To what extent in your view would there be an increase in investment as a result of reductions in the corporate tax rate?

Mr. SAULNIER. Would you repeat that question so that I may be sure I understand you correctly?

Chairman PATMAN. To what extent, in your view, would there be an increase in investment as a result of reductions in the corporate tax rate?

Mr. SAULNIER. I must answer that question, Mr. Chairman, by saying this: There is no one thing that will get our economy moving up again, not even a cut in the corporate income tax, though that would be helpful.

What we need is a clear definition of a policy, a policy that goes across the board, affecting expenditures, taxes, money, et cetera, and that policy should be clearly defined and projected to our people. I believe that with an understanding of such a constructive policy we would enjoy a good rate of economic growth, and within that policy I would say that the tax changes I have been talking about would be very stimulative.

Chairman PATMAN. You won't make any change—this is in connection with the next to the last question I asked you—in the present interest rate policy, which, of course, I believe you will admit is a high interest rate policy?

Mr. SAULNIER. Would you mind telling me, Mr. Chairman, what you mean by an interest rate policy? Do you mean by that the whole Federal Reserve policy?

Chairman PATMAN. Yes, sir. Of course I believe you will agree that the Federal Reserve makes the interest rate policy. You and I will agree on that point?

Mr. SAULNIER. I think I know what you mean. I just want to be sure, Mr. Chairman, that we are talking about money policy generally and not the policy with respect to the maximum interest rate that can be paid on deposits.

Chairman PATMAN. I am talking about general interest rates that have been going up and up and up over the years. Would you change that, or would you let it go like it is?

Mr. SAULNIER. I can comment, Mr. Chairman, on the current money and capital market situation and can say whether I think money policy, in that situation is too restrictive, or not restrictive enough.

It is difficult, however, to comment on money policy more generally.

Chairman PATMAN. All right, sir. What do you think about it, Mr. Keyserling? Do you think that monetary policy should be changed?

Mr. KEYSERLING. Yes; I do. I have thought so uniformly, for a long time.

Chairman PATMAN. I believe you stated what the recessions we have had in the past were. After the recessions in 1948 and 1949 we had one in 1953 and 1954; of course, more of it in 1953 than in 1954; 1955-56, more of it in 1956 than 1955; and then in 1957 and 1958, more

of it in 1958 than 1957; and then in 1960-61. Is that correct about the recessions we have had in the past?

Mr. KEYSERLING. Yes, generally speaking.

Chairman PATMAN. You think they could have been avoided by a proper monetary policy?

Mr. KEYSERLING. I agree with Dr. Saulnier, and this is one of the few points that I agree with him on, namely, that you cannot stabilize or maximize the health of the economy with any one set of policies. I think we have a broad and variegated economy, and that we need a complex of reasonably workable monetary policies, price-wage policies, fiscal policies, and others.

I think we need them all, and I think that usually they should be based upon one central approach. In other words, if it appears upon an actual examination of the economy in action that consumption is tending to outrun investment, which is a typical inflationary situation, then all of these policies should move toward exercising restraint upon consumption and do everything possible to induce investment. If the reverse is true, then these policies should move in the opposite direction. I don't see any sense at all in two policies moving in opposite directions. That would be like walking the floor with one crutch to walk part of it, and the other to walk the other part, when you need both crutches. You need all policies working in the same direction.

In more direct answer to your question, subject to above qualification, I do think that the tight money policy over the years has been a very pronounced factor in contributing to a seriously low economic growth rate and the recurrent recessions.

By and large, the rising interest rates, which are at least a consequence of a tight-money policy, if not its intent, tend to ration the national income toward those who lend us back our own money. One of the greatest economic reforms of the last 30 years, in my view, has been the movement in the opposite direction, good for everybody. I remember when I was a boy I would walk by the bank and I would see a sign on the bank, "6 percent interest on deposits."

Senator BUSH. That was a pretty average rate in those days.

Mr. KEYSERLING. Yes, and of course, the real interest rate on homebuilding was 8 or 10 or even 12 percent before you got through. If we believe in an incentive economy, if we believe in an enterprise economy, we ought to favor the fellow who enterprises and invests and the consumer who buys, as against the person who lends them back their own money, and, after all, they are lending us back our own money.

Now, we started turning the clock the other way in recent years, and I think this has been one of the most damaging factors in the whole picture. I made a study of it where I figured that something like \$23 billion had been taken out of the pockets of the average consumer, and the average homeowner, and the average family, and put into the pockets of those who are lending back our own money, during the period 1953-59. I have nothing against these people, but I think it is unsound policy. This is the first way that tight money and rising interest rates hurt the economy.

The second way they hurt the economy is that they hit the things we need before they hit the things that are booming excessively. Mr. Martin of the Federal Reserve System, a great and sincere protagonist

of having us pay more to those who lend us our own money, and I am sure he honestly believes in this policy, in early 1957 before the Senate Finance Committee, said that we needed to do this because consumption was too high and investment was too low and savings were too low.

Yet in early 1957, we had enormously idle plant capacity. The financial institutions were stuffed with savings, and we had a tremendous deficiency in ultimate demand, just as we have now. So a little while later, in consequence of this policy, we got into the worst recession since World War II from which we have never recovered; and the next year the same gentleman came before the same committee and said that the big trouble we had a year earlier was the great deficiency in consumption and that investment was outrunning consumption.

Those who make policy should be more contemporaneous with events. Their observations should not be matters of hindsight only. I think we are now in the same kind of situation basically. I agree with Dr. Saulnier that investment is too low. There is no question that it is, but why is it too low? When you move from what I might call generalization to a specific examination, industry by industry, company by company, total by total, the break-even point is not too low. The steel industry has a break-even point below 40 percent. This does not mean that costs are too high relative to profits per unit.

If they are not making enough money, it is because they have been operating at low capacity for the last 5 years or longer. I hope the committee will very carefully study these factual examinations I have made, and I am always glad when economists come forth and on the basis of a different set of figures show that there is something wrong with my analysis but there is really no way of matching analyses in terms of the data against an analysis in terms of generalities.

The fact of the matter is, as I see it, that a crucial characteristic of American industry is that it generates, at a given level of operations, a level of profits above what it can enduringly invest as against the markets which are militated against by too low a level of ultimate demand.

This has happened over and over again. It has happened four times since 1949. And it is happening again now. There is nothing wrong with first quarter profits, 1962, in any basic industry, with some rare exceptions, which would disprove the general rule. The only thing wrong is that business is operating at too low a level of capacity, and this is relevant in my view to tax policy, and to money policy, and to other basic policies, and it applies to price-wage policy fundamentally.

Chairman PATMAN. Thank you, sir.

Senator BUSH. Mr. Chairman, I have another question.

Mr. Keyserling, you and Dr. Saulnier agree about the investment factor being too low. I mean you do agree that that is one of our problems; is that right? You just said that?

Mr. KEYSERLING. Yes, sir.

Senator BUSH. Dr. Saulnier has developed a thought in here that hasn't been developed before this afternoon in these hearings this week which has to do with the question of cost. I am very much impressed with his argument here about the need for a better control

of cost and the need for not equating increased costs with productivity gains, but using productivity gains not only for wage increases, but for reduced prices, and possibly increased profits; in other words, for the division of increased gains in productivity rather than using it all up in increased costs and particularly wage costs.

Our competitive position is constantly under discussion nowadays, particularly as the Common Market is becoming more and more of an economic factor in trade, and this administration is greatly concerned about that as I think we all should be.

However, it seems to me that as I talk with business managers and people who control the question of expansion of our plants and the use of investment funds to expand plant and job making opportunities, there is sort of an underlying apprehension. It doesn't come out into the open very much because I think there is a certain fear in expressing themselves that no matter how they may try to control costs, they can't do it because of the very great preponderance of bargaining power that lies within the big labor unions.

We have seen lately this year a very substantial increase in the number of strikes over what we had last year. We have even seen some very bad strikes in defense industries and our missile plants. We had a very bad one recently in my State at the Electric Boat Works, which was not really an argument between management and labor, but an argument between unions there, which shut that plant down for a long period of time.

We have the Eastern Air Lines shutdown still because of a dispute between the unions, and some smaller union of 550 members has been able to bring that thing to a halt and throw 18,000 people directly out of work and greatly interfere with the travel incident to our trade and commerce in the eastern part of the country. We now see that we are threatened with a big railroad strike and so on.

It seems to me that this is one of the underlying causes of uneasiness and apprehension and hesitation, and I should like you, Dr. Keyserling, to give your views on that situation.

Mr. KEYSERLING. Let me try to. I think that some of the points that I would make are embodied more fully in my charted statistical analyses, which I ran over very quickly. Let me try to clarify at least what my position is in this way: First, you made the point that increases in productivity should be taken partly in wage increases and partly in price decreases.

Senator BUSH. At increased profits.

Mr. KEYSERLING. This I assent to. I think it is desirable. I haven't found many great corporations that are pioneers in this effort, but I agree with you on that.

Second, you come to the even more basic question that, in a free society, which we both believe in, nationally organized business and organized labor will contend with each other for the share that they get of the gross income, and it is only natural that labor unions should want to increase the labor share and that corporations should want to increase the profit share, which is income after costs, including wage costs.

The basic economic question, as you so well stated, is, What is a workable division from the viewpoint of the operations of the economy? I mean there is no such thing as a fair profit or a fair wage in an absolute sense.

I say that a workable division is a good division. Then I look at wages, and I look at profits, and prices are a factor in both, because the price level determines the real buying power of the wage as consumption, and the price factor determines the real buying power of the profit as investment.

First I look at the wage side, and I say wages have two functions. One of the functions of wages is to play its part in consumption. Taking that one first, I find a deficiency in consumption relative to the actual productive capacity in being of the American economy. Therefore, I reach the conclusion that, from the viewpoint of the consumer side, the wage increases have not been too high. In other words, they haven't produced a redundancy of purchasing power.

Then I go over to the profit side. I ask, Have the wages been too high from the viewpoint of leaving over enough profits after wage costs, after payment of dividends, after all other costs, to fulfill the investment function, which gets back to the cost per unit idea? Are the wage costs per unit and other costs per unit leaving the business with too small a margin of profits per unit?

The more I study the figures, and I know I am objective, although I may be wrong, as any economist may, the more I reach the conclusion, which I think is supported by all the data shown on individual industries and on the overall picture, that in each period of upturn the profits after taxes, after wage costs, after all other costs, have been too high per unit and have been too high in the overall to be used fully, and that is the only workable test of profits.

Oh, these profits have been used for a while, when we have gone up in one boom or another, but then we have had a tremendous downturn in investment, which has propitiated the successive recessions. These downturns haven't come because of an inadequacy of profits, because then they could never start. There certainly were plenty of profits during the upturns. They didn't come because of too high a wage cost.

What has happened is that the profits have been so high, after allowing for all costs, including wage costs, that they led by way of investment to tremendous excess capacity, and then downturns came. I think this is the fact of our American economic life. I don't cite it as an indictment of business. I wish that business followed a price policy and a wage policy that kept the economy in better balance. They would make more profits in the long run and they would invest more in the long run. But I can't find, and I have asked various economists—they will talk in a general way. Let me give an illustration.

Senator BUSH. You are not worried about the effect of this upon our competitive position, both at home and abroad?

Mr. KEYSERLING. Well, it is the same problem. If you say that the reason that the prices are so high in America is because the costs are too high, then you say that you have to reduce these costs, including wage costs, to get a lower price. But if you say, as I say, that the existing price is too high, not because the cost is too high, but because the profit margin per unit is too high, then you reach my conclusion. I think this conclusion is supported by the repeated collapse of each successive investment boom and each profit boom. I cannot look at the profits of any of our key industries during the past years, or first quarter of 1962, and reach the conclusion that their costs are militating against an adequate level of profit for all investment purposes.

Now, our competitive position would be improved if we had more investment. I admit that.

Senator BUSH. You do not think this factor I am discussing with you is inhibiting the expansion of investment?

Mr. KEYSERLING. I think what is inhibiting the expansion of investment is unused plant and an inability to sell what they can produce now. Investment is based on a prognosis of markets.

Senator BUSH. That does not bear out some of the testimony we have had here, like that of Mr. Ellis of the Du Pont corporation. I do not know whether you saw his testimony. He was in here a couple of days ago.

Mr. KEYSERLING. If Mr. Ellis puts before this committee, I do not mean the same facts, but the kind of analysis that I have tried to put before the committee, which looks at the factual situation instead of mere generalities, and if his facts and his analyses are as careful as mine and lead to different results, I will be perfectly willing to withdraw from my position and ask your committee to take his point of view. All that I ask is whether Mr. Ellis, in examining this question of prices, wages, and profits, and what the real inhibiting factors are, is presenting to you as relevant data, and as carefully related to the facts, as what I am trying to do. All too frequently, I find, in a lot of these big corporations, as well as in others, and I am not criticizing them, a tendency to say that wages are too high, and costs are too high, and profits are too low, and taxes are too high, all by way of generalities rather than careful factual analyses.

Senator BUSH. But this administration has expressed a strong interest itself in a hold-the-line policy, so to speak, because of our competitive position.

Mr. KEYSERLING. I am not here as an unthinking devotee of the economic policies of this administration. I am trying to be nonpolitical about it. I do not think this administration has thus far satisfactorily met the growth problem nor the unemployment problem, and neither did the previous administration. I cannot, and I do not mean to imply that anyone else is trying to treat this on a basis of the fact that, because I am a Democrat, this administration is right on everything. I think that both administrations have swung in a direction of economic policy which has not worked. If I had said this only in 1953 at the beginning of the Eisenhower administration, or only in 1961 at the beginning of the Kennedy administration, I might have had to await events to test my conclusions. All I am saying now is that what has happened squares with what I have been saying, and, therefore, if policies have not worked, there is something wrong with them.

Senator BUSH. My time is up, Mr. Chairman.

Representative REUSS (presiding). Mr. Saulnier, you have stated that the economic situation is disappointing, and you have suggested an economic program. First, you favor the recent increase in depreciation allowances. Next, you favor the proposed 7-percent investment credit, though you say you would prefer an even larger increase in the depreciation allowance. Then, you favor a cut in the corporation income tax by about 5 percentage points, and a cut in the personal income tax down to the 50-percent level. The proposed personal income tax reduction would assist families with incomes of more than \$32,000 a year, as I understand it.

Mr. SAULNIER. That is right.

Representative REUSS. The proposed tax revision would cut tax revenues, you estimate, by \$2 to \$3 billion.

Mr. SAULNIER. Two and a half billion dollars possibly.

Representative REUSS. You would offset such a reduction in tax revenues mainly by cuts in Federal expenditures. You would hold wages down in order to increase corporate profit margins.

Mr. SAULNIER. No. May I interrupt.

Representative REUSS. Yes.

Mr. SAULNIER. I would say that the increases in wages should be kept within, well within, the limits of productivity improvement.

Representative REUSS. But before you would validate a wage increase, you would make sure that corporate profit margins had expanded. That is my understanding of your testimony.

Mr. SAULNIER. Again I am not sure that I like your word "validate." I do not like to cast the Government in the role of validating or invalidating.

Representative REUSS. Strike "validate," but is it not your contention that wages either should not increase at all, or increase only after the corporate profit margins have been widened?

Mr. SAULNIER. I am afraid I would have to amend that to say concurrently rather than after.

Representative REUSS. Concurrently. All right.

Mr. SAULNIER. Which is very different.

Representative REUSS. And further on wage policy, you suggest that present minimum wage determinations under programs of the Walsh-Healy and Davis-Bacon type are too liberal, and that they should be kept down.

Mr. SAULNIER. It may well be. I think they deserve study.

Representative REUSS. Then having stated what I think to be the ingredients of your program, I must ask how it will improve the economic situation. Is it your belief that such a program would increase business investment?

Mr. SAULNIER. That is correct.

Representative REUSS. My question is, Who is going to buy the products that can be made by existing plant and equipment and manpower in our economy under your program, much less the potential output of additional, more modern facilities?

Mr. SAULNIER. The first thing I would say, Congressman Reuss, about that is that it would be very helpful, as a preliminary step, to have a clarification of what our policy is. If I may say so, I think there is a good deal of uncertainty through the country at the present time as to what our economic policy is.

Representative REUSS. I agree.

Mr. SAULNIER. And if I may say so, I think it is almost more important that we have a clarification of what the policy is than that we take this step or that step or some other step. Let me illustrate what I mean, Congressman Reuss, by the discussion of emergency tax cuts. I read the newspapers pretty regularly, a number of them, and day after day I read accounts that taxes are going to be cut; no, they are not going to be cut; we will think about it next week; we are going to wait until we have the economic figures for July 15 or for August. And the date comes and then it is not quite clear whether they are going to be cut or not.

Representative REUSS. I would agree with you there.

Mr. SAULNIER. Mind you, Congressman Reuss, I want to speak very constructively here. I honestly believe that it would be a good thing for the country if we decided here just what we are going to do. It seems to me that the facts are clear enough now to tell us what we should do.

Representative REUSS. I agree with you.

Mr. SAULNIER. I think that clearing the air, in itself, would have an electric effect through the country.

Representative REUSS. I think it is highly important that we clear the air. You, as well as Mr. Keyserling, have, in a very frank and sincere spirit, offered a concrete program for clearing the air. My specific question is, how will your program, in the cleared air which would undoubtedly accompany its enactment, generate purchasing power to take off the market goods we can produce with our present capacity together with the goods which additional capacity could produce?

Mr. SAULNIER. I would answer that question, Congressman Reuss, by saying that if a program were put forward, the business people of this country, and I say "business people of this country" advisedly, because, after all, we are talking about an enterprise economy which works well if business units work well, and does not work well if they do not work well—

Representative REUSS. My point, of course, is if business units work best when there is a good prospect of selling that which they can produce—

Mr. SAULNIER. Indeed they do.

Representative REUSS. I do not see how your program gives us that market. You would take \$2 or \$3 billion out of the spending stream when you cut expenditures by that much. I do not know how much added capital investment you expect to get. While I would agree with both you and Mr. Keyserling that the level of private investment should be raised, the addition of more capacity will not by itself generate enough consumer purchasing power to absorb the extra output.

Mr. SAULNIER. I think I understand the difficulty you have with the statement I made, and I would like to try to clarify it. I started to say that if a program were put forward which the business people and the American people generally accepted as a constructive program, one that they could understand, one to which they could subscribe, I think this would have the effect of improving the confidence which people feel in their future and of removing the uncertainty that they feel in the present situation. That result alone would have an expansive effect on our economy. And within the context of that program you would be doing things in the tax area that would be stimulative.

Then, Congressman Reuss, I would like to comment, if I may, on your observation that Federal expenditure reductions would take funds out of the stream of expenditures. I am not sure that that needs to be the case, and I suggest that there is one area of the Federal budget to which one might look for possibilities for expenditure reduction, where I think a lowering of expenditures would not necessarily take money out of the income stream, but would in effect shift activity from, shall we say, the public to the private sector. That

is the area of the budget which we call Federal credit programs, and which is a very substantial part of the budget.

Representative REUSS. Thank you.

Mr. SAULNIER. I do not want to make that suggestion, Congressman Reuss, quite sincerely. There are many expenditures where Federal Government is spending the money—it is in the Federal budget—but if the Federal Government were not spending, it very likely would be spent in the private sector of the economy.

Representative REUSS. Thank you very much.

Congressman Curtis?

Representative CURTIS. In listening to these discussions I am impressed, particularly in relation to tax cutting, which it is assumed without offer of proof would stimulate the economy, with the further unproved assumption that demand may be equated with consumer purchasing power. It seems to me that therein lies some of the misconceptions. To prove my assertion I would relate it to the agriculture sector of our economy. As near as I can see, we could increase consumer purchasing power double, triple, or any amount, and it would have very little bearing on utilizing our agricultural surpluses. It seems to me that we have reached a stage in our economy where at least in some sectors we are dealing with an economy of plenty as opposed to one of scarcity. That is why I relate it to the agricultural sector, because that seems quite clear, and what have we done about that? Because the real consumer demand has not been there, we have artificially put it in there through Federal expenditures, agricultural subsidies, and that is where the purchasing goes on of our agricultural produce. In that instance we can continue to improve our efficiencies of wheat farming, cotton farming, or whatever, and lower our unit cost in that fashion, but still the difference is made up with tax dollars where the Federal Government just buys the surplus and stockpiles it. I wonder if you would comment on that, Dr. Saulnier, as it relates to this question that we are now talking about, of whether it is the consumer demand area or rather consumer purchasing power that is the inadequacy.

Mr. SAULNIER. Congressman Curtis, I do not diagnose the problem in that way.

Representative CURTIS. As consumer demand?

Mr. SAULNIER. I do not say that the American economy is generally an affluent economy.

Representative CURTIS. Do you agree with my analysis in the agricultural sector?

Mr. SAULNIER. In the agricultural sector, I would say we have a distinct problem of overproduction.

Representative CURTIS. That is right, which is affluence, and even if our distribution system were better, and even though we may have some of these low consumer purchasing power groups that Dr. Keyserling talks about, even if we project hypothetically the amount that they could buy in the field of agricultural produce, I think using that model we find that it would not make much of a dent in the agricultural surplus production. I think it is important that we break down these economic aggregates into components, because I suspect that in other areas what we are really seeing to a large degree is consumer choice having a great play, and not only consumer choice as between what

the consumer spends the dollar for, but whether the consumer is going to save the dollar, instead of spend it whether he is going to invest it or whether he is going to hoard it, if he saves it. I think there is a difference between investing and hoarding, whether he is going to invest it, spend it, or hoard it, becomes very important.

Mr. SAULNIER. If I may comment just for a minute on that—  
Representative CURTIS. Yes.

Mr. SAULNIER. There is common route by which we get to wrong conclusions on these matters. I think it is not unfair to say that theories on these things divide into two major categories. One of these is that there is an inadequacy of demand, and that somehow or other it is this inadequacy of demand that keeps our economy from working at its optimum level. Those who hold that theory typically argue that the way to correct the situation is to increase consumer demand or overall demand. Sometimes the proposal is for higher wages. Sometimes, and frequently nowadays, it is not that, but to cut taxes. There has been quite a shift, I would say, in the last 10 or 15 years in the formulation of this theory, but it comes in the end to pretty much the same thing.

Representative CURTIS. It is based on that volume.

Mr. SAULNIER. It is based on the general premise that there is an inadequacy of demand and that if you somehow increase purchasing power, whether by wage increases or tax cuts, you will get yourself moving again.

Representative CURTIS. I wanted to ask one question.

Mr. SAULNIER. May I conclude and just add one point.

Representative CURTIS. Yes. I am sorry.

Mr. SAULNIER. I don't deny the possibility of there being an inadequacy of demand in a specific economic situation, but in many economic situations, and I think in the present economic situation, our problem is to be found in the relationships within our economy and in our capacity to make the kind of economic adjustments that must be made if our economy is to work well.

More specifically, I have mentioned the relationship between costs and prices. This is a key to a large part of our problem. I would also like to say to this committee, and I have not mentioned it in my testimony, that I think we need to do a great deal more in the area of education, in vocational training, in the area of guidance, to fit our people better to the employment opportunities which do in fact exist. I think we can make considerable improvements in our economic performance by these methods. I do not believe that you can substitute a program of expanding demand for such programs. Failing a solution of these problems of internal relationships and capability to perform adjustments, failing a solution of those problems, I think the demand-type formula will produce largely an inflationary result.

Representative CURTIS. I want to comment on that in this other way, too, because there are areas where there is a real demand. I was very interested in our Federal budget for the National Institutes of Health, and I was interested in two growth figures. One was the growth rate of technicians and people that are needed, research people, by the NIH, and the other was the growth rate of money available to be spent by NIH. The money available to be spent has a very high

rate of increase. The increase of technicians available, the manpower situation, people available who were trained, was a much lower rate of increase. It was just nonsense to be talking in terms of putting more money in there. We did not have the skills available to fill the jobs going begging here. It takes time to train people in these skills. So even in the areas where there is demand, and I submit there are real areas, treating demand as an aggregate in my judgment is a gross error.

I want to ask one question if I may on this growth thing. The President stated—I do not know whether you saw this, in his press conference—that the economy had expanded by 10 percent since he took office, and he seemed to imply that this was a better record than under the Eisenhower administration. I do not want to get it into the political aspects, but I mention this because we are comparing periods and we are trying to relate what is our economic situation. Inasmuch as you followed it closely under the previous administration I wonder if you would comment on that.

MR. SAULNIER. I will comment on it. I did notice that statement by the President. As I recall, his statement was that gross national product had increased by 10 percent since he took office. Now, it is true that gross national product in current prices has gone up by about 10 percent since the first quarter of 1961, which was the trough quarter of the 1960-61 recession. However, if you look at GNP in constant prices, in order to get a measure of the increase in the actual output of physical goods and services, you will find that the increase is only a little better than 7 percent. I was a little surprised that the President used the current price figures rather than the constant price figures, but I was even more surprised that he found it remarkable that there had been an increase of even 10 percent during a period of business cycle recovery. There is nothing remarkable about that. In fact, I would say the thing that is most noteworthy about GNP in the 1961-62 recovery is that the increase in it was less than what it has been in earlier recoveries. Indeed, it is the tendency of this recovery to lag that accounts for our having hearings here today, I would assume.

Representative CURTIS. My time has run out.

MR. SAULNIER. You can judge this recovery by almost any measure, and find that the increases are less percentagewise than they have been in previous recoveries.

Representative CURTIS. Thank you.

My time is up.

Representative REUSS. Senator Proxmire?

Senator PROXMIRE. I want to ask both Dr. Saulnier and Dr. Keyserling questions. I want to say, Dr. Keyserling, that I thought your statement that our monetary policy now represents an open declaration of war upon the programs the Nation needs was a very accurate understatement of the situation. I could not agree with you more. Dr. Saulnier, you seem to agree to some extent on at least the restraining nature of monetary policy and I was most heartened to see that you say on the bottom of page 10 and the top of page 11:

I would hope that in considering the position of the economy at this time and the extent of the more direct measures being taken to help correct our balance of payments, it will not be necessary to tighten credit conditions over their present

position. Actually, some easing would be helpful to the economy, especially in the long-term section of the market.

I welcome that.

Dr. Saulnier, you discuss your proposal to lower corporation income tax rates, and I am chairman of the Subcommittee on Small Business in the Senate Banking Committee and am interested in your assertion that, quite apart from other effects, these tax changes would be tremendously helpful to our 4 million small- and medium-sized business concerns.

I presume that you are proposing a 5 point cut in the basic tax, not in the surtax, the 30 percent.

Mr. SAULNIER. I would reduce the tax from 52 percent to 47 percent.

Senator PROXMIRE. Right; but this is made up of two parts, the 30-percent basic tax and the 22-percent surtax.

Mr. SAULNIER. Yes.

Senator PROXMIRE. I presume you are proposing a cut in the 30-percent basic tax by 5 points.

Mr. SAULNIER. Yes.

Senator PROXMIRE. Even this would give very little help as I see it to small business. In the first place, some 75 percent or more of our businesses are not incorporated, and these unincorporated firms are virtually all small. No. 2, of those that are incorporated, about 40 percent, 339,000, have no taxable income. These are overwhelmingly small firms. Of those corporations that do have a taxable income, most have a taxable income of less than \$5,000, and therefore their maximum benefit from your tax cut would be \$250 per firm, so that on this basis I cannot see that 90 percent or 95 percent of small business would get very much benefit from the corporation income tax, although I think it may have merit on other scores.

Mr. SAULNIER. I could not cite a figure for you now, Senator Proxmire, but there are many hundreds of thousands of small businesses in this country, small- and medium-sized businesses, organized as corporations, paying a corporation income tax.

Senator PROXMIRE. The figure I have for 1958—I presume there are more now—was 611,000, of whom 507,000 had an income of under \$25,000, and their income represented only 7 percent of the total corporate income. There are 85 percent of the corporations with 7 percent of the income that is taxable.

Mr. SAULNIER. Yes. I was speaking here with special concern for the fact that small- and medium-size companies by and large finance themselves. They grow out of the money they make themselves, whether they are organized, Senator Proxmire, as a corporation and are retaining corporate income, or whether they are organized as a partnership or a proprietorship—

Senator PROXMIRE. On this I agree with you 100 percent.

Mr. SAULNIER. And are taking their income as individual income.

Senator PROXMIRE. The Butters and Lintner study at the Harvard Business School, for example, showed that if firms 40 or 50 years ago had the kind of corporate income tax rates we have now, none of the big firms could possibly have grown to the size they have. You would have no chance to grow through investment, through what has been the traditional way. I would agree with you on individual firm growth, but I cannot see that the individual small businessmen,

or that 95 percent of them, are going to get any real relief from a reduction in the corporation income tax. I think from the standpoint of growth perhaps you would justify it, not from the standpoint of helping most of our small businesses.

Mr. SAULNIER. I am afraid I cannot agree with you, but for the moment I would like to pursue the point of agreement that I have with you, which is that the growth of small- and medium-size businesses is financed mainly out of the income which they make themselves and retain, and the amount of income which they can retain out of what they make, whether they are corporations or whether they are partnerships and taxed as individuals, depends in large part on the tax rate. A lowering of that rate, including the high rates on individual income, would assist small- and medium-sized concerns in retaining income which for the most part would be reinvested in the business.

Now, a large company, a very large company, also depends on retained income, but at least they always have the option of capital market financing, which the small company normally does not have.

Senator PROXMIRE. You could not be more correct on that, but the figures do show that 70 percent of the net income of corporations are those very few firms with incomes over a million dollars a year. They are going to get the main benefit of this particular tax cut, but you are absolutely right, there is no other way that a small business firm can grow by and large except by reinvestment of earnings.

Mr. SAULNIER. Precisely.

Senator PROXMIRE. I would like to pursue the question a little bit that Congressman Reuss asked because I am puzzled by it, and I think there is an interesting contradiction and conflict between you and Dr. Keyserling on this, and that is that you say that business investment seems to be the principal weakness of our economy and we must stimulate private business investment to really move ahead. At the same time your prescription for a tax cut would be a tax cut that would primarily increase business cash flow, and you say that you would reduce Government spending so that there would at least be no aggregate increase in the deficit.

Mr. SAULNIER. Low priority Government spending.

Senator PROXMIRE. Low priority Government spending, and you would follow a policy of keeping wages in some restraint. At least you would make sure that they do not exert any upward pressures on prices. I think it is a very pregnant question, in view of the full documentation that Dr. Keyserling has given us this afternoon, in which he has given us data that I think is very hard to refute without contrary data. How is this going to enable the economy to move? How can you do it? The fact is, as a number of witnesses have testified here, there has been ample cash flow, plenty of money available, and many of the biggest firms have so much cash available that it is almost embarrassing. General Motors is an example of this. Why should more of the same be the answer under these circumstances?

Mr. SAULNIER. For the reason that I think a tax policy that would have a greater effect in promoting investment expenditures, and which would permit the funds to be retained out of which that expenditure could be financed, would result in a higher level of investment spend-

ing and would, as I think we all will agree, have, in agreeable circumstances, a multiplied effect through the economy. I would say, Senator Proxmire, that I am concerned also about measures being taken to promote a higher rate of investment expenditure because I have the distinct feeling that we have been tending to fall behind in recent years in these matters relative to countries elsewhere in the world.

Senator PROXMIRE. My time is up, but I had a printing company in Wisconsin, and we expanded our plant. We did it for one reason. We thought we had a good market. We thought we could see an opportunity for us to increase our production by selling more. No matter how much had been available for us in depreciation reserves, or even in profits or how good our profit margin was, if we did not feel we had the market, I think it would have been a very stupid decision for us to make.

Mr. SAULNIER. I think I understand your thinking on this. Just let me say that in our country, organized as it is on an enterprise system basis, on a profit system basis, we have managed somehow, not really by design, but more or less inadvertently, to develop a tax system which, if we sat down to work one out that would discourage risk taking, could not be more artfully designed. But, all the same, we have it. What I am saying is: Let us strive for a tax system which is better designed to encourage investment, risk taking, and business activity generally.

In this connection, while I do not make the point in my statement, I think we would be well advised to give very careful consideration to the substitution of some other form of taxation for the profits taxation we currently have. And for that other type of taxation I would suggest a producers value-added tax. Our present tax system, which puts the accent mainly on profits, not only has the effect of discouraging risk taking, but it tends to have a braking effect on the economy when we move toward higher levels of activity. It is excessively unstable in its revenue-gathering effects, and I would like to see us develop a tax system with greater stability in it in this respect.

Representative REUSS. Thank you, Dr. Saulnier.

Representative CURTIS. I had one thing I would like to ask Dr. Keyserling.

Representative REUSS. Mr. Curtis?

Representative CURTIS. Mainly because it was in Dr. Saulnier's statement, and I did not see it in yours. I had this excerpt from the New York Times, an article you wrote which appeared there on August 5, and one of the things you said in there was this:

An unequivocal Presidential assurance against repetition of the recent degree of intervention in price decisions, wage making, and industrial disputes, this would remove a main barrier to confident business investment in new plant and equipment. More investment would create more jobs.

Do you still adhere to that? You did not mention it in your statement. That is the reason I was bringing it up.

Mr. KEYSERLING. I adhere to it. I have the same position today that I had on August 5. I am for more investment, and I am at all times for appropriate risk taking. But when we have 15 or 17 percent of our plant capacity idle, and have had an average of so much idleness for a number of years, then there has been too much risk

taking, and I am not flippant about it. The risks have been very ill advised, when they result in building plants that are not being used. All I want is to encourage risk taking by getting the plants used, and to get the plants used you have to have more sales, and then there will be risk taking on a sound basis. Otherwise, if the other very simple formula is correct, why not reduce the corporate tax rate from 52 percent to 22 percent? You would get so much risk taking, and you would have so many plants built, that pretty soon idle plant and manpower would get entirely out of hand. I am for risk taking in proper proportions.

Representative CURTIS. May I comment on that?

Senator Proxmire is chairman of the subcommittee of this Committee on Economic Statistics, and we held some recent hearings, and have a very good report on industrial capacity. One of the things that has always intrigued me, is the so-called unused capacity. I think discussion about it needs to be always in context with the limitations of those statistics. What I want to relate it to is this: A great deal of the so-called unused capacity that is constantly referred to is obsolete capacity, and the more rapidly innovation comes, the more obsolete plant and equipment we have. How do you relate that?

Mr. KEYSERLING. Congressman, are the 9 percent of the human beings available for work, who have not got a chance to work, obsolete?

Representative CURTIS. Yes; their skills are.

Mr. KEYSERLING. Their skills are obsolete?

Representative CURTIS. Yes, and they need retraining.

Mr. KEYSERLING. Just a minute. First of all, let me divide this into two parts. The 9 percent unused labor force that you say is obsolete—

Representative CURTIS. I said their skills were, Doctor.

Mr. KEYSERLING. All right; that their skills are obsolete. But these unemployed correlate fairly well with my estimates of idle plant capacity, and, therefore, the plant capacity is not truly obsolete, because to have the labor force fully employed you would be using a major part of that plant.

Representative CURTIS. Could we stop there? I do not follow the logic there.

Mr. KEYSERLING. I am saying that if you had full employment of manpower—

Representative CURTIS. What would you have them do?

Mr. KEYSERLING. I will come to that. I want to answer that question about what you would have them do, but let us take it one at a time.

Representative CURTIS. I could not follow the logic as you were relating the 9 percent.

Mr. KEYSERLING. I will try to answer your three questions, because you have asked me three questions. First, I say that, if you had full employment of manpower, and still had 15 to 17 percent of your plants not running, then you could say that the part of the plants that were not running were obsolete, but when you have 9 percent unemployed manpower, you cannot say this, because you cannot say that you do not want people to be working.

Representative CURTIS. But obsolescence relates to demand. There is not the demand for buggy whips any more.

Mr. KEYSERLING. I am coming to the demand question second.

Representative CURTIS. You have this thing all wrapped up so we can't follow it.

Mr. KEYSERLING. You can follow it if you let me answer.

Representative CURTIS. All right. I will try.

Mr. KEYSERLING. If you let me answer it you will follow it very well, because you have a tremendous capacity for following it.

Representative CURTIS. You are very kind.

Mr. KEYSERLING. It is true. Let me answer it, and you will follow it.

Representative CURTIS. All right.

Mr. KEYSERLING. I am saying that the argument is made, with respect to the 15 or 17 percent idle plant capacity, that this is not really idleness because we should have a reserve supply of plant. Obsolescence is a relative term. You call that part of idle plant obsolescent in the context of the part of the plant that you now think represents optimum efficiency to have idle.

I say that, if the United States wants to have 15 percent or more of its plant idle, as reserve supply at full employment, then you can make some argument for it, because there wouldn't be people to operate the unused part anyway. But if you have 15 or more percent of your plant idle and 9 percent of your manpower unemployed, then something is wrong, because you can't apply the argument to the 9 percent manpower that you apply to the plants. You can't say people are obsolete. Now, I will come to the matter of training. That is your second question.

Mr. CURTIS. Could I stop on this one first?

Mr. KEYSERLING. Surely.

Representative CURTIS. You say you like to refer to specifics. Let's take this statement, and I think I am about right. Monsanto Chemical Co. says that about 90 percent of their dollar sales today are products they had nothing to do with 10 years ago.

Mr. KEYSERLING. That is the second question. That I was just ready to answer.

Representative CURTIS. You talked about 17 percent of the obsolescence being reserve. It isn't reserve. There is no demand for this.

Mr. KEYSERLING. I am coming to the demand factor. Let us take them one at a time. My first point is that, if you had a large amount of unused plant and full utilization of manpower, you would say that the unused plant was a desirable reserve; for example, if we got into a war and had to call more people into the labor force on a super-labor-force basis, and so forth and so on. But when we have 15 percent or more idle plant and 9 percent idle manpower, which pretty well correlates with it for a variety of reasons, then you can't say that the situation is sound, because you can't treat human beings like plants and you can't say it is perfectly all right if they are idle. You can't say that human beings should be a reserve supply.

Now, to the second question. The second question you asked is, How can you get this idle manpower and this idle plant used if there isn't demand? Let me answer that part of the question.

Representative CURTIS. For the specific products.

Mr. KEYSERLING. For the specific product.

Representative CURTIS. Which that plant manufactures.

Mr. KEYSERLING. Yes. You gave the agricultural example. It seems to me that there has been a confusion in the discussion among actual demand, purchasing power, and real needs. I define actual demand to mean what people are actually spending out of resources that they have to spend. I don't think that anybody can contest that actual demand, whether it comes from income, whether it comes from credit, whatever it comes from, is far below our current productive capacity of manpower and plant.

This is incontestable in my view. It is far below it, and because it is far below it, actual demand has to be lifted.

Now, I come to the next question. Your next question is, would actual demand be lifted if the people had more purchasing power, or would they just save it, or, to put it in another way, have they got enough purchasing power now but are they just not making the actual demand because they have everything they need or want.

Here is where I think your agricultural example is absolutely fallacious, because it is always true in our economy that as to some specific products there is a saturation point, and this may now be true in agriculture. This simply means that you have to shift your resources to some other kind of production, but it is still true that, in the overall economy, you can't say that the potential demand isn't there, in the sense of needs being satisfied, when there are such tremendous unmet wants.

If you think that \$4,000 a year or less for one-fifth of our families, and \$6,000 a year or below for two-fifths, is the optimum of what the American economy can use and consume, assuming the purchasing power is there, then I would disagree with you.

Representative CURTIS. Let's get back now. You have registered one point; in the agriculture sector if it is saturated, then you have obsolescence or unused capacity.

Mr. KEYSERLING. The only way you can translate those productive resources into other sectors of the economy, because you can't plow people under, you can't plow families under—you could plow crops under—is to create enough demand in other parts of the economy to absorb those underutilized resources.

Representative CURTIS. The point I am going to suggest to you is that they are there. That is why I referred to the NIH. I will give you an area where there is tremendous demand, for private nursing homes or any nursing homes.

Mr. KEYSERLING. Then if the demand is there, and this is the root question, why do we have 9 percent idle manpower?

Representative CURTIS. Because it takes time to train and retrain. It takes time to retool, to build plants. It takes time to do these things. It takes time for research and development, and that is why all these dealings in aggregates that you are doing, in my judgment, ignore these components wherein lie the differences and difficulties.

Mr. KEYSERLING. But the problem of retraining and retooling is a constant problem over the years in the American economy, so you are saying in another way that a level of 9 percent unemployment is the

fractional or proper level of unemployment that we should have, in view of the time that it takes to retrain and retool.

Representative CURTIS. No, I am not. What I am saying is that we have been ignoring this problem and by not treating it we have created a situation where it is entirely too high and it should not be that high. We are losing ourselves in aggregates; we are not paying attention to these components.

Mr. KEYSERLING. Roughly speaking; namely, let's say that unemployment was 5 percent in 1953 and 9 percent in 1962, do you think that this almost doubling of the unemployment rate throughout the United States is due basically to a deterioration in retraining programs?

Representative CURTIS. Yes; or turn it around and put it this way. The more rapid your innovation in your society, and that is my real test of economic growth, the more you are going to create obsolescence, both in skills and in plant. Going into these figures of innovation I was very interested in these figures, that 25 percent of the goods and services on the market today were unknown 5 years ago.

Mr. KEYSERLING. Let's assume for the moment that most, or a large part, of the 9 percent of your unemployed are unemployed because they are inadequately trained. What is the galvanizing force to train them, and what are you going to train them for, if the jobs aren't there?

Representative CURTIS. The jobs are there.

Mr. KEYSERLING. They are there?

Representative CURTIS. Yes. You have to identify them, 900,000 jobs going begging in the one field alone, the health field, hospital technicians, practical nurses, doctors.

Mr. KEYSERLING. You are not defining jobs there in the sense of the jobs being available. You are defining an unmet need.

Representative CURTIS. I am talking about jobs where people are trying to hire people and there aren't people with the training available, like in the National Institutes of Health.

Mr. KEYSERLING. Do you think, on a nationwide basis, that the jobs available for which people are untrained equate in any practical way with the total volume of unemployment?

Representative CURTIS. Yes; not trained now, but could be trained.

Mr. KEYSERLING. I disagree with you.

Representative CURTIS. I think we need to study this problem together, but I think this: that just as our Nation throughout its history has had a shortage of labor, it is true that there is a shortage today. What we need to do is get the dictionary of skills in the Department of Labor brought up to date. We need to study what are the unfulfilled demands for labor, and then we can talk about it, work up some statistics. We haven't even touched this area, we have so concentrated our minds on failure, the unemployed, that we have neglected success, the jobs going begging.

Mr. KEYSERLING. Then what you are really saying, if I understand it, and it is rather an important innovation in economic thinking is, that, after all, the business cycle in its virulent forms, in other words, quick shifts from high employment to low employment, from full capacity use to low capacity use, from prosperity to recession to de-

pression to recovery, is explained mostly by variations in the adequacy of training as we go along and isn't due to basic economic forces outside of the particular problem of training.

Representative CURTIS. No; you misunderstand me. I say that this is becoming the dominant factor in our dynamic economy. It has always been a factor.

Representative REUSS. Your time has expired.

Senator PROXMIRE?

Senator PROXMIRE. I would just like to say, before I ask Dr. Saulnier one more question and a couple of questions for Dr. Keyserling, that as I remember the Tobin study which was made by the Council of Economic Advisers a couple of years ago, and the Knowles-Kalacheck study that was made for this committee, both stated that structural unemployment, that is, the fact that people who are unskilled are heavily unemployed and we don't have adequately trained people for many jobs, could not really account for a substantial proportion of the unemployment, and I have seen no contrary studies, although I have heard some contrary assertions from Chairman Martin and others who contend that our main problem is structural unemployment.

It is hard to find any documentation to confirm that assertion.

Representative CURTIS. If the Senator would yield just on that, if you had allowed me to bring in witnesses at the time we held the hearings I think we would have documented our theory, but unfortunately the list of witnesses was compiled without my having an opportunity to contribute. I would have been glad to have brought in witnesses to try to establish this point.

Mr. KEYSERLING. May I just make one very brief comment?

Senator PROXMIRE. Yes.

Mr. KEYSERLING. If the problem is due largely to the falling behind of skills, the falling of skills behind technology, if that were the main problem, then assuredly speeding up technological progress by swinging more of the economy to investment in plant, which would speed up the rate of technological progress, would accentuate this problem, if it is the right explanation.

In any event, you couldn't fit together the proposition that unemployment was mainly structural and the proposition that you should try to spark investment at the expense of consumption.

Representative CURTIS. It would simply be an extension of the problem. Because we can cope with the problem if we will identify it.

Senator PROXMIRE. We can get on that shortly. I would like to say to Dr. Saulnier I went to Harvard Business School and enjoyed it very much. I recognize that it is, I think, a very responsible school and I think quite conservative school, although it is associated with Harvard. The attitude on the basis of political polls and so forth indicate it is about 95 percent Republican or at least it was when I was there and I think still is.

The National Association of Manufacturers, which is not an outstanding liberal association, although I think it is a fine group of people, financed a study at Harvard Business School of the impact of taxes on risk taking, a whole series of studies, and I wonder how you

would explain the fact that these studies showed no adverse effect on risk taking as a result of our tax system.

Mr. SAULNIER. I am not acquainted with the study. I must say the result astonishes me.

Senator PROXMIRE. As you see it, it works both ways.

Mr. SAULNIER. Perhaps you would be good enough to give me a reference on that and I would be glad to comment on it.

Senator PROXMIRE. Fine. The studies were criticized by the National Association of Manufacturers, as I understand, after they were made.

Mr. SAULNIER. I may find myself in a critical mood, too, after I check it. It stands to reason that a high profits tax will tend to suppress risk taking.

Senator PROXMIRE. You recognize how it works both ways. If you have a high profit tax, and (1) a carryback and carryforward loss provision on your taxes; (2) you have capital gains provisions where there is every incentive for risk-taking in that sense as compared with other types of investment; (3) you have the kind of law we passed recently for the small business investment companies, where your losses are treated as ordinary losses and your gains as capital gains; (4) there are all kinds of other provisions in our tax laws to encourage risk-taking, including oil depletion provisions and mineral depletion provisions which would encourage people to risk their funds in mineral investment. So that there are all kinds of ways in which there are at least counterbalancing forces against the obvious discouragement that would come from people having their income reduced through a profits tax. Most profound of all perhaps is the marginal utility factor which I think may be very significant. That is, if people had no income tax on, say, \$100,000 worth of earnings, the incentive for working hard to earn another \$10,000 might be quite different and far less than if they had an income tax and their net income would be \$45,000 or \$50,000 after taxes whatever it works out to, because by almost any standard they would be satisfied with \$100,000 and many would not be satisfied with the lesser after-tax figure.

Your friend, Dan Throop Smith, I understand, was the editor of this—a fine man. He was my finance professor at Harvard.

Mr. SAULNIER. Was he the author?

Senator PROXMIRE. He was the author. I know you have respect for him.

Mr. SAULNIER. I have great respect for him and this increases my interest in having this citation.

Senator PROXMIRE. You may have a different interpretation. Dr. Keyserling, you are not asking for a quickie compensatory fiscal tax cut in the sense of balancing fiscal policy to get us out of recession. You are asking for a fundamental, substantial, permanent tax cut. Isn't that correct?

Mr. KEYSERLING. Yes. The essence of my whole position is that we should not be engaging in an antirecessionary program now. We should be engaging in a fundamental correction of the imbalances which have made themselves more and more manifest in the whole economy for 9½ years.

Incidentally, I think that this is the safest, and surest, and soundest way to prevent a recession, as a sound, long-range policy. The

whole essence of my concern is that we are predicating whether or not we should have a tax cut now on the imperfections of prophesy as to whether a recession threatens in 3 weeks, 5 weeks, or next year, which nobody can really answer, whereas we should be predicating action now—and we confuse the situation by calling it emergency—upon the fact that we have had a problem for  $9\frac{1}{2}$  years, and it is emergency only in the sense that we are 2 or 3 or 5 years too late already.

I regard an appropriate tax cut now as a permanent, durable, sound improvement in the American economic process.

Senator PROXMIRE. Is this your economic advice? If the politicians decide that the best way they can achieve that, given the attitudes in Congress, is to wait until next year, you may deplore the wait, but you might recognize the political realities that there would be more chance of getting it then?

Let me ask you then, in your statement on page 4, you engage in something that even baffles me from the standpoint of arithmetic. Frankly, it seems to be bootstrap hoisting.

Take your program of a \$10 billion cut. Well, let's say a \$7 billion tax cut and a \$3 billion increase in expenses. You might call it an initial \$10 billion increase in the deficit. You say that this would result in about the same deficit ultimately as the deficit we are going to have without it.

In saying that I am baffled because you use a multiplier of  $2\frac{1}{2}$  to 3, and taking your extreme multiplier of 3, this would mean that if you have a \$10 billion drop in revenue and increase in expenditures, net, then your multiplier would give you a \$30 billion increase in gross national product. If you apply the one-sixth rule, of revenue increasing about one-sixth, with an increase in the gross national product, you would get back about \$5 billion and the result would be that the deficit would be increased by \$5 billion and you would have a \$9 to \$12 billion deficit, not a \$4 to \$7 billion deficit, and a deficit that would match the biggest we have ever had in peacetime.

Mr. KEYSERLING. There are several ways in which I think you don't correctly understand what I am saying. In the first place, the one-sixth figure is not correct for the purposes that I have in mind. In other words, you derive the one-sixth figure presumably by looking at the average tax take related to the size of the economy, but this has nothing to do with the progressive rate at which an increase in gross national product during an upturn rather than a downturn increases the tax take under a progressive tax structure.

Senator PROXMIRE. You are giving the benefits to the lower income end of the economic scale. The prime benefits would not flow, at least directly, to corporation income?

Mr. KEYSERLING. Indeed they would, because the fact that I am giving the benefits to the lower end of the income scale doesn't affect the fact that this is my formula for an overall upward movement of the whole economy by correcting the imbalances.

In other words, I am not saying, because I give the tax reductions to the lower end of the income scale, that this wouldn't improve the investment picture and the profit picture. My position is precisely that it would, because this is what is wrong with the investment and the profit picture.

My computation works out as follows:

The President's proposal for an approximately balanced Federal budget in fiscal 1963 seems to be based upon an estimated GNP of about \$585 billion in fiscal 1963. But my estimate now, in line with that of many other economists, is that the program proposed by the President would result in a fiscal 1963 GNP of not better than \$565 billion, and perhaps as low as \$555 billion or even lower. These figures, respectively, would be about \$20 to \$30 billion lower than the \$585 billion figure estimated to produce a balanced budget. The \$20 billion lower figure would result in an estimated deficit of about \$4 billion, and the \$30 billion lower figure would result in an estimated deficit of about \$7 billion. These estimated deficits are based upon the fact that, under a progressive tax system, and allowing for the relatively greater impact upon profits of unfavorable economic developments, the reduction in Federal tax receipts would be much more than one-sixth of the amount by which GNP is lower than \$585 billion, and also the deficit would increase proportionally as the GNP deficiency grew. Coming over to my proposal, I estimate that it would result in a fiscal 1963 GNP of close to \$600 billion, allowing for the multiplier effect and the timing factor, contrasted with the \$565 or \$555 billion figure. This \$600 billion figure would be about \$15 billion higher than the \$585 billion figure which would yield a balanced budget under the spending and tax proposals of the President. This \$15 billion increment would, because of its composition and because of the progressive tax system, recoup \$3 billion or more of the \$10 billion planned deficit which I propose, thus resulting in my estimated deficit of \$6½ to \$7 billion. This \$3 billion or more recoupment is based upon the fact that profit and other income trends, combined with the progressive tax system, would yield incremental tax revenues coming to more than one-fifth of the \$15 billion increment in GNP (\$600 billion minus \$585 billion).

Senator PROXMIRE. My time is up. I would like to see this arithmetically. I think you would make many converts if you could show this because this really bothers me. It bothers many, many Senators, because if you can show that you can reduce taxes and not increase the deficit, it would be miraculous. In fact it would be an accomplishment like that of the fabled Baron Munchausen who found himself sinking in quicksand and only saved his life by pulling himself out by his bootstraps.

Mr. KEYSERLING. Further let us just take as a test case, or take two test cases—take the \$12 billion deficit that we ran in fiscal 1959, and take the \$6.3 billion deficit that we ran in fiscal 1962 just ended. Take those two deficits. One of the charts that I have shown here illustrates this matter for the period 1953-62 as a whole.

Then take the size of the GNP during these years with those deficits, and apply as to the beginning of each of those 2 years, on a judgmental basis, what the size tax cut and increased spending might have lifted the actual economic performance during those 2 years to given levels.

Now, economists would have some differences of opinion, but I think you would find that we wouldn't have run a bigger deficit in either of those 2 years if we had adopted the alternative policy. In any event, I would like to suggest finally that, even if I am wrong, even if the deficit under my policy were \$2 billion higher than under the alternative, I

don't think a \$2 billion higher deficit is much to spend for a \$30 to \$45 billion higher level of national product which gives you the prospect, in terms of real wealth, of achieving a budget balance at full employment in later years.

Senator PROXMIRE. I just say it might be \$6 or \$7 billion higher. Furthermore as the debt is reduced through increasing Federal revenues the multiplier is reversed and far below balance.

Representative REUSS. The Senator's time has expired. We are very grateful to both of you gentlemen for being with us for almost 3½ hours this afternoon. If there are no further questions, we will stand adjourned until 10 o'clock tomorrow morning in this chamber. We stand adjourned.

(Whereupon, at 5:25 p.m. the hearing in the above-entitled matter was recessed until 10 a.m. of the following day.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

FRIDAY, AUGUST 10, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, Griffiths, and Thomas B. Curtis; Senators Douglas and Proxmire.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will be in order, please.

We continue hearings on the state of the economy and on the policies for full employment, production, and purchasing power.

This morning we have a panel of economists on fiscal policy recommendations. George C. Hagedorn, director of the Research Department, National Association of Manufacturers; John K. Langum, consulting economist and president of Business Economics, Inc., Chicago; Joseph A. Livingston, financial editor, Philadelphia Bulletin; Stanley H. Ruttenberg, director, Department of Research, AFL-CIO.

Gentlemen, we thank you for coming. We are very glad to have you. Our procedure is to have each witness make an opening statement. Then the members of the committee put questions to the panel under a 10-minute rule for questioning by each committee member.

Mr. Hagedorn, you may proceed in your own way, sir. I believe you have a prepared statement.

## STATEMENT OF GEORGE G. HAGEDORN, DIRECTOR, RESEARCH DEPARTMENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. HAGEDORN. I would like to read my prepared statement, Mr. Chairman.

Chairman PATMAN. You may do so, sir.

Mr. HAGEDORN. Differences of opinion as to the proper fiscal program to be followed at any given time are usually the product of differences in basic conceptions of the function of fiscal policy generally. For that reason it is well to start with a statement of the principles on which the approach advocated in this paper is based.

They are relatively simple and not at all original. First, spending should be kept to the minimum needed for performing the necessary functions of the Federal Government. In that way the Government does not use up economic resources which would otherwise be avail-

able for supporting the growth of the private economy. Second, the tax system should be designed to raise revenues necessary to meet these expenditures, but with a minimum of interference with private economic activity and expansion.

This sounds like a very old-fashioned way of viewing the function of fiscal policy in our economy, and maybe it is. But I also think it is the most realistic and appropriate guide for facing the complex set of economic difficulties in which the Nation presently finds itself. The bulk of this paper will be devoted to explaining the reasons for that conclusion.

Since the principles just stated may seem rather general and abstract, it had better be explained at the start that there is a practical way of implementing them. It is through the earmarking, in advance and by legislation, of the revenue increase which comes from economic growth to income tax rate reform rather than to increased Federal spending. Such a program, spread over a series of years, offers the best hope for a gradual reduction of the burden which excessive tax rates now place on economic activity and economic expansion. It is attainable within the framework of a balanced budget.

The approach advocated here may be contrasted with the view that the Federal budget should be regarded as a positive instrument of national economic policy. According to this latter view, the budget should be designed to supplement private demand to whatever degree is necessary at the given moment. Some of the adherents of this view state that they prefer tax reduction to expenditure increase as a means of increasing total demand.

However, the basic logic of this approach would lead to the conclusion that one way of increasing demand is as good as the other. The net effect of the budget on the economy is to be assessed by the size of the deficit or surplus. According to the jargon of this philosophy, the greater the deficit, or the smaller the surplus, the more expansionary the budget is in its economic effects.

The case between the two alternative views of the proper objective of fiscal policy could be argued on general principles. However, for the present occasion the discussion will be limited to a comparison of the two approaches in the light of the specific economic situation in which we now find ourselves.

You have been holding extensive hearings both at this time and earlier this year, on the state of the economy. So I am not going to try to give you a comprehensive review of that subject. I just want to make a few points that I think are relevant to the current issue of fiscal policy.

No. 1, the problem before us is one of chronic suboptimum economic performance, rather than of a short-term cyclical downturn which may or may not be in the offing.

For almost 5 years, ever since the latter part of 1957, unemployment has remained at or above 5 percent of the labor force.

There is one exception, I think February 1960, it got down to 4.8 percent. That is the only month in the period where it got below 5 percent.

The real cause for concern has not been the two recessions which occurred during that period, neither of which was severe, but the

tendency of the subsequent recovery to lose momentum before reasonably satisfactory levels of economic activity had been reached.

We are not in a situation calling for radical emergency action. But we should be concerned with discovering and removing the barriers which prevent us from attaining fuller realization of our economic potential.

Two, although total economic activity showed a substantial growth over this period, two important elements did not participate fully in that growth—corporate profits and business investment expenditures. By contrast, consumer incomes and consumer expenditures have kept pace with the general growth.

The facts are summarized in the following table:

*Percent increase, 1957 to 1st half of 1962*

	<i>Percent</i>
Gross national product.....	+24.0
Corporate profits after tax.....	+15.0
Business expenditures for plant and equipment.....	- .2
Disposable personal income.....	+23.0
Consumer expenditures.....	+24.0
Compensation of employees.....	+25.0
Government expenditures.....	+38.0

I might say corporate profits have gone up much less. Business expenditures for plant and equipment have not gone up since 1957. Actually that figure shown for corporate profits after tax perhaps doesn't really adequately describe the degree to which profits have been stagnant in the postwar period generally. In the last decade, ever since 1950, corporate profits have fluctuated between \$20 and \$25 billion, and really have gotten no place in that period. They have gone up and down in cycles, but there has been no growth in corporate profits. While the gross national product, the dollar value of economic activity in the country has doubled.

These data certainly do not suggest that present economic difficulties are due to inability or unwillingness to spend on the part of the public generally. The problem centers rather on the inadequacy of profits and of business investment.

Three, costs of production have increased because wages have gone up faster than productivity. In recent years it has been impossible to recover such increased costs in higher prices. This is an important cause of the squeeze on profits already noted.

The relationship between the cost of an hour's work, and the output achieved by it, is summarized as follows:

Period	Percent change per year	
	Average hourly compensation	Output per man-hour
1947-52.....	6.2	2.7
1953-57.....	4.6	2.3
1957-61.....	4.0	2.5

**NOTE.**—The data apply to all employees of nonagricultural industries.

There has been a gap between those two figures. The cost of an hour's work has gone up faster than the physical yield from each hour's

work. The gap has somewhat narrowed in recent years in the period since 1957, but there is still a sizable gap between those two figures. The discrepancy between average hourly pay and output per man-hour is a measure of the increase in cost per unit of production. This discrepancy has been somewhat less since 1957 than in earlier years.

The trouble has been that, since 1957, market conditions have been such that it is no longer possible to get back the increased cost in higher prices. Since 1957 the wholesale price index for industrial products has increased by only 0.3 percent per year on the average. There has actually been a slight decline in such prices since 1959.

The net result of rising costs and practically steady prices has been a squeeze on profits. The incentive for business expansion, or even for the maintenance of current operations, has been curtailed. Marginal operations which would otherwise be profitable, and provide jobs, are not worth undertaking.

Four, as a result of past deficits in our international balance of payments, foreign short-term claims against this country now exceed our gold stock. This necessitates that measures used for promoting economic expansion at home shall not depend on low interest rates and shall not encourage increases in costs of production.

The gold stock has declined to a level only slightly above \$16 billion. Foreign short-term balances—which are potential claims against gold—have risen to \$19 billion.

A situation of this type is not necessarily dangerous or inherently disastrous. Foreigners are not likely to convert their balances into gold as long as they can earn reasonably competitive interest on them, and as long as they are confident that such balances are ultimately convertible into American goods at internationally competitive prices. But if they come to believe that we will pursue economic policies which will make it impossible to preserve such conditions, they might begin to withdraw gold at a rate which could eventually force us to abandon the convertibility of the dollar at its present rate.

Fiscal policy to increase demand—the wrong approach. With this background it seems clear that a fiscal policy designed to raise the level of demand by increasing the Federal deficit is entirely inappropriate—for a number of reasons.

First, the economic problem which confronts us is chronic, rather than intermittent or temporary. An occasional deficit to meet a temporary situation might be tolerable. But an indefinite series of deficits to offset persistent underlying maladjustments is not to be contemplated.

Second, adoption of such an allegedly expansionary fiscal policy would encourage and intensify the very forces which have brought about the present economic difficulty. Uneconomic wage increases have a restricting effect on economic activity and on employment. If we pursue a national policy of using Federal deficits to “bail out” those who are responsible for such uneconomic cost increases, we are in effect encouraging them to go ahead and promising to guarantee them against the consequences of their own actions.

Finally, adoption of this course would diminish foreign confidence that we have any real noninflationary solution to our economic problems. They are watching to see whether we intend to underwrite cost increases by Government deficits, or adopt the alternative policy

of promoting growth through the control of costs and the improvement of efficiency. The former course could only lead to inflation and ultimately the devaluation of the American dollar. The consequences for our own economy and for the free world generally would be very serious.

The conditions for prosperity and economic growth: A program for promoting high levels of employment and economic growth with generally stable prices, of course, involves many elements. As long as we are to remain predominantly a private enterprise market economy, such a program must center on the incentives for, and the resources available to, private economic activity.

As already noted, the two poor performers in our recent economic history have been profits and business investment. A program for growth and prosperity must certainly provide for a reversal of these trends.

The growth of labor costs at the expense of profits is a problem that must be dealt with. The constant upward pressure on labor costs is due partly to the power of labor organizations to raise wage rates and fringe benefits regardless of market conditions, and partly to a failure on the part of the public to understand that such cost increases curtail employment opportunities and economic expansion.

Since I have been asked to speak here primarily on fiscal policy, I will concentrate on that aspect of the problem. There is an important contribution that Federal fiscal policy can make to prosperity and growth. It is through enactment of a systematic program of rate reduction applied both to the corporate income tax and to the personal income tax. Such a program would increase the flow of capital for modernization and expansion and improve the profitability of business operations.

Such a program should be carried out within the general framework of a balanced budget. Otherwise, it would be merely another form of the deficits-to-increase-demand approach which should be rejected for the reasons given earlier.

The tax rate reform should be permanent and it should be substantial in amount. It should apply to both corporate and personal income taxes since both affect incentives and both affect the supply of capital for private investment. The objective should be, not an expansion in demand, but an improvement in profitability and an increase in the flow of savings for investment. Hence, while such a program should involve reduction of individual rates all along the line, it should also provide for a substantial compression of the steep progressivity of the rate structure.

This is, of course, too big a package to be achieved all at once. But it is not impossible of achievement if we have enough determination to adhere to a program of gradual rate reduction spread out over a series of years, meanwhile preventing any further increase in Federal spending.

The program just described is designed to meet the longer term problem of chronic economic sluggishness, rather than the immediate short-term danger of a cyclical downturn. But the lift that early adoption of such a program would give to the confidence of business and the public would have a prompt and salutary effect on the economic trends of the immediate future. Progress toward a solution of

the long-term problem contributes substantially to improving the short-term outlook. Unfortunately, the converse is not equally true.

I recommend this approach to your consideration. It is a practical resolution of the dilemma posed by the barriers to growth involved in the present tax system, and the inflationary effects of tax-reduction involving substantial and persistent government deficits.

(Tables accompanying Mr. Hagedorn's statement follow:)

TABLE A.—*Gross national product and related totals*

[In billions of dollars]

Year	Gross national product	Disposable income	Consumption expenditures	Compensation of employees	Corporation profits after tax	Business expenditures for plant and equipment	Government expenditures <sup>1</sup>
1947.....	\$234.3	\$170.1	\$165.4	\$128.8	\$18.2	\$20.6	\$43.8
1948.....	269.4	189.3	178.3	141.0	20.5	22.1	51.0
1949.....	258.1	189.6	181.2	140.8	16.0	19.3	59.5
1950.....	284.6	207.7	195.0	154.2	22.8	20.6	61.1
1951.....	329.0	227.4	209.8	180.3	19.7	25.6	79.4
1952.....	347.0	238.7	219.8	195.0	17.2	26.5	94.7
1953.....	365.4	252.5	232.6	208.8	18.1	28.3	102.0
1954.....	363.1	256.9	238.0	207.6	16.8	26.8	96.7
1955.....	397.5	274.4	256.9	223.9	23.0	28.7	98.6
1956.....	419.2	292.9	269.9	242.5	23.5	35.0	104.3
1957.....	442.8	308.8	285.2	255.5	22.3	37.0	115.3
1958.....	444.5	317.9	293.2	257.1	18.8	30.5	126.6
1959.....	482.8	337.1	313.5	278.4	23.7	32.5	131.6
1960.....	503.4	349.4	328.5	293.7	22.7	35.7	136.8
1961.....	518.7	363.6	338.1	302.2	23.3	34.4	149.3
1962.....	\$ 548.5	\$ 378.6	\$ 352.6	\$ 318.4	\$ 25.6	\$ 36.3	\$ 158.7

<sup>1</sup> Purchases of goods and services, transfers, interest, and subsidies.

<sup>2</sup> 1st half estimate.

<sup>3</sup> 1st quarter estimate.

Source: U.S. Department of Commerce; Council of Economic Advisers.

TABLE A-1.—*Various economic magnitudes as a percent of gross national product*

Year	Disposable income	Consumption expenditures	Compensation of employees	Corporation profits after tax	Business expenditures for plant and equipment	Government expenditures <sup>1</sup>
1947.....	72.6	70.6	55.0	7.8	8.8	18.7
1948.....	73.0	68.7	54.3	7.9	8.5	19.7
1949.....	73.5	70.2	54.6	6.2	7.5	23.1
1950.....	73.0	68.5	54.2	8.0	7.2	21.5
1951.....	69.1	63.8	54.8	6.0	7.8	24.1
1952.....	68.8	63.4	56.2	5.0	7.6	27.2
1953.....	69.1	63.7	57.1	5.0	7.7	27.9
1954.....	70.8	66.5	57.2	4.6	7.4	26.6
1955.....	69.0	64.6	56.3	5.8	7.2	24.8
1956.....	69.9	64.3	57.8	5.6	8.3	24.9
1957.....	69.7	64.4	57.7	5.0	8.4	26.0
1958.....	71.5	66.0	57.8	4.2	6.9	28.5
1959.....	69.8	64.9	57.7	4.9	6.7	27.3
1960.....	69.4	65.3	58.3	4.5	7.1	27.2
1961.....	70.1	65.2	58.3	4.5	6.6	28.8
1962.....	\$ 69.0	\$ 64.3	\$ 58.0	\$ 4.7	\$ 6.6	\$ 28.9

<sup>1</sup> Purchases of goods and services, transfers, interest, and subsidies.

<sup>2</sup> 1st half estimate.

<sup>3</sup> 1st quarter estimate.

Source: U.S. Department of Commerce; Council of Economic Advisers.

Chairman PATMAN. Thank you, sir. Our next witness is Mr. John K. Langum. Mr. Langum, you have a prepared statement, I believe. You may proceed in your own way.

**STATEMENT OF JOHN H. LANGUM, PRESIDENT, BUSINESS  
ECONOMICS, INC., CHICAGO, ILL.**

Mr. LANGUM. I would like to go over my prepared statement, and with that I have prepared a document of 10 pages of tables which I should like to use along with my prepared statement.

Chairman PATMAN. Without objection they will be inserted in the record.

(Document referred to above follows:)

**CORPORATE PROFITS AND CASH FLOW**

John K. Langum, president, Business Economics, Inc., Chicago, Ill.

*Corporate profits in relation to depreciation accruals and capital outlays,  
1946-61*

(In billions of dollars)

Year	Corporate profits after taxes	Depreciation and amortization allowances	Cash earnings	Plant and equipment outlays	Net cash earnings	Corporate dividends
1946.....	\$13.4	\$4.2	\$17.6	\$12.5	\$5.1	\$5.8
1947.....	18.2	5.2	23.4	17.0	6.4	6.5
1948.....	20.5	6.2	26.7	18.8	7.9	7.2
1949.....	16.0	7.1	23.1	16.3	6.8	7.5
1950.....	22.8	7.8	30.6	18.9	13.7	9.2
1951.....	19.7	9.0	28.7	21.8	7.1	9.0
1952.....	17.2	10.4	27.6	22.4	5.2	9.0
1953.....	18.1	11.8	29.9	23.9	6.0	9.2
1954.....	16.8	13.5	30.3	22.4	7.9	8.8
1955.....	23.0	15.7	38.7	24.2	14.5	11.2
1956.....	23.8	17.8	41.6	29.9	10.9	12.1
1957.....	22.3	19.1	41.4	32.7	8.7	12.6
1958.....	18.8	20.8	39.1	26.4	12.7	12.4
1959.....	24.5	21.6	46.1	27.7	18.4	13.7
1960.....	23.0	23.1	46.1	30.8	15.3	14.4
1961.....	23.8	24.8	48.1	29.6	18.5	15.0

*Profit margins and rate of return on equity, all manufacturing corporations,  
1947-61*

Year	Profit after taxes per dollar of sales	Annual rate of profit after taxes on stockholders' equity
	Cents	Percent
1947.....	6.7	15.6
1948.....	7.0	16.0
1949.....	5.8	11.6
1950.....	7.1	15.4
1951.....	4.8	11.8
Average for period.....	6.3	14.1
1952.....	4.3	10.2
1953.....	4.3	10.4
1954.....	4.5	9.8
1955.....	5.4	12.3
1956.....	5.3	12.0
Average period for.....	4.8	10.9
1957.....	4.8	10.7
1958.....	4.2	8.4
1959.....	4.6	10.2
1960.....	4.4	9.1
1961.....	4.3	8.7
Average for period.....	4.8	9.4

*Inventory valuation adjustment in relation to corporate profits before taxes, selected years*

Year	Inventory valuation adjustment	Corporate profits before taxes	Inventory valuation adjustment as ratio of corporate profits before taxes
	<i>Billions</i>	<i>Billions</i>	<i>Percent</i>
1947.....	-\$5.9	\$29.5	-20.0
1948.....	-2.2	33.0	-6.7
1950.....	-5.0	40.6	-12.3
1956.....	-2.7	44.7	-6.0
1957.....	-1.5	43.2	-3.5
1961.....	0	45.6	0

*Rate of return on net worth, leading manufacturing corporations (First National City Bank data)*

[In percent]			
Year	Year		
1925.....	10.7	1952.....	12.3
1926.....	10.8	1953.....	12.5
1927.....	9.0	1954.....	12.4
1928.....	11.6	1955.....	15.0
1929.....	12.8	1956.....	13.7
Average for period.....	11.0	Average for period.....	13.2
1947.....	17.0	1957.....	12.8
1948.....	18.9	1958.....	9.8
1949.....	13.8	1959.....	11.6
1950.....	17.1	1960.....	10.5
1951.....	14.4	1961.....	10.1
Average for period.....	16.2	Average for period.....	11.0

*Corporate profits and cash earnings in relation to corporate sales, 1946-61*

[In percent]

Year	Corporate profits after taxes/corporate sales	Depreciation and amortization allowances/corporate sales	Cash earnings/corporate sales	Net cash earnings/corporate sales
1946.....	4.96	1.55	6.50	1.88
1947.....	5.24	1.50	6.73	1.84
1948.....	5.28	1.60	6.87	2.03
1949.....	4.32	1.92	6.24	1.84
1950.....	5.27	1.81	7.08	3.17
1951.....	4.03	2.01	6.40	1.58
Average per period.....	4.83	1.77	6.66	2.09
1952.....	3.45	2.08	5.53	1.04
1953.....	3.46	2.25	5.71	1.15
1954.....	3.28	2.61	5.87	1.53
1955.....	3.84	2.62	6.46	2.42
1956.....	3.71	2.74	6.45	1.72
Average per period.....	3.54	2.46	6.00	1.57
1957.....	3.32	2.84	6.16	1.30
1958.....	2.85	3.08	5.94	1.93
1959.....	3.31	2.92	6.23	2.49
1960.....	3.02	3.03	6.05	2.01
1961.....	2.98	3.17	6.14	2.36
Average per period.....	3.10	3.01	6.11	2.02

*Capital outlays and corporate dividends in relation to cash earnings, 1946-61*

[In percent]

Year	Plant and equipment outlays/cash earnings	Corporate dividends/corporate profits after taxes	Corporate dividends/cash earnings
1946.....	71.02	43.28	32.95
1947.....	72.65	35.71	27.78
1948.....	70.41	35.12	26.97
1949.....	70.56	46.88	32.47
1950.....	55.23	40.35	30.07
1951.....	75.26	45.69	31.36
1952.....	81.16	52.35	32.61
1953.....	79.68	50.33	30.77
1954.....	73.83	52.33	32.34
1955.....	62.53	48.70	28.94
1956.....	73.28	51.49	29.66
1957.....	78.99	56.50	30.43
1958.....	67.52	65.96	31.71
1959.....	60.09	55.02	29.72
1960.....	66.81	62.61	31.24
1961.....	61.54	64.28	31.18

*Cash flow in relation to sales, all manufacturing corporations, 1961*

## BY INDUSTRY

	Percent of sales		
	Net profit after taxes	Depreciation and depletion <sup>1</sup>	Total
All manufacturing corporations.....	4.3	3.3	7.6
Durable goods.....	3.8	3.2	7.1
Transportation equipment.....	4.0	2.7	6.6
Motor vehicles and equipment.....	5.3	3.3	8.6
Aircraft and parts.....	1.8	1.7	3.5
Electrical machinery, equipment, and supplies.....	3.4	2.3	5.8
Other machinery.....	4.1	3.5	7.6
Metalworking machinery and equipment.....	3.2	3.1	6.4
Other fabricated metal products.....	2.4	2.6	5.0
Primary metal industries.....	4.8	4.8	9.6
Primary iron and steel.....	4.5	5.0	9.4
Primary nonferrous metals.....	5.3	4.4	9.7
Stone, clay, and glass products.....	5.6	5.2	10.8
Furniture and fixtures.....	1.5	1.6	2.8
Lumber and wood products, except furniture.....	1.8	4.7	6.5
Instruments and related products.....	5.4	2.9	8.3
Miscellaneous manufacturing and ordnance.....	3.6	2.0	5.6
Nondurable goods.....	4.6	3.4	8.0
Food and kindred products.....	2.3	1.8	4.0
Alcoholic beverages.....	3.2	2.0	5.2
Tobacco manufactures.....	5.7	.8	6.5
Textile mill products.....	2.0	2.4	4.6
Apparel and other finished products.....	1.2	.6	1.8
Paper and allied products.....	4.6	4.2	8.8
Printing and publishing, except newspapers.....	2.8	2.1	4.9
Chemicals and allied products.....	7.3	4.6	11.9
Basic chemicals.....	8.1	7.0	15.2
Drugs.....	9.8	2.2	12.0
Petroleum refining and related industries.....	10.1	7.5	17.6
Petroleum refining.....	10.3	7.6	18.0
Rubber and miscellaneous plastics products.....	3.8	3.1	6.8
Leather and leather products.....	1.1	1.1	2.2

## BY SIZE

All asset sizes.....	4.3	3.3	7.6
Under \$1,000,000.....	1.2	2.1	3.3
\$1,000,000 to \$5,000,000.....	1.8	1.9	3.8
\$5,000,000 to \$10,000,000.....	2.8	2.2	5.0
\$10,000,000 to \$25,000,000.....	3.1	2.4	5.5
\$25,000,000 to \$50,000,000.....	3.8	2.6	6.6
\$50,000,000 to \$100,000,000.....	4.0	2.9	6.8
\$100,000,000 to \$250,000,000.....	4.1	3.2	7.2
\$250,000,000 to \$1,000,000,000.....	4.8	3.8	8.1
\$1,000,000,000 and over.....	8.4	5.7	14.0

<sup>1</sup> Including accelerated amortization of emergency facilities.

*Annual rate of profit after taxes on stockholders' equity at end of period, all manufacturing corporations, 1961*

BY INDUSTRY		Percent
All manufacturing corporations.....		8.7
Durable goods.....		8.1
Transportation equipment.....		10.6
Motor vehicles and equipment.....		11.4
Aircraft and parts.....		9.8
Electrical machinery, equipment, and supplies.....		8.9
Other machinery.....		7.8
Metalworking machinery and equipment.....		6.0
Other fabricated metal products.....		5.9
Primary metal industries.....		6.4
Primary iron and steel.....		6.2
Primary nonferrous metals.....		7.1
Stone, clay, and glass products.....		8.8
Furniture and fixtures.....		4.9
Lumber and wood products, except furniture.....		10.5
Miscellaneous manufacturing and ordnance.....		9.8
Nondurable goods.....		9.6
Food and kindred products.....		8.9
Alcoholic beverages.....		7.3
Tobacco manufactures.....		13.6
Textile mill products.....		5.0
Apparel and other finished products.....		7.0
Paper and allied products.....		7.8
Printing and publishing, except newspapers.....		8.5
Chemicals and allied products.....		11.8
Basic chemicals.....		10.6
Drugs.....		16.7
Petroleum refining and related industries.....		10.3
Petroleum refining.....		10.3
Rubber and miscellaneous plastics products.....		9.3
Leather and leather products.....		4.4
BY SIZE		Percent
All asset sizes.....		8.7
Under \$1,000,000.....		5.6
\$1,000,000 to \$5,000,000.....		6.0
\$5,000,000 to \$10,000,000.....		6.8
\$10,000,000 to \$25,000,000.....		7.0
\$25,000,000 to \$50,000,000.....		7.6
\$50,000,000 to \$1,000,000,000.....		8.3
\$100,000,000 to \$250,000,000.....		8.4
\$250,000,000 to \$1,000,000,000.....		9.3
\$1,000,000,000 and over.....		10.8

Mr. LANGUM. The record since World War II for total profits after taxes of all corporations is shown in the first column in the table on page 1 entitled "Corporate Profits in Relation to Depreciation Accruals and Capital Outlays." This record reflects the varied developments which have occurred in the American economy. A marked pattern of cyclical fluctuations is evident, even in terms of the more moderate swings in the business cycle which have been experienced in the last decade and a half.

On the downside, in recessions from 1948 to 1949, from 1953 to 1954, and from 1957 to 1958, the sharp declines are manifest. As is the case in most measurements of the level of economic activity, the effects on corporate profits of the recession of late 1960 and early 1961 are buried in the annual figures.

In that recent recession, however, corporate profits after taxes dropped from a seasonally adjusted annual rate of \$24.9 billion in the

first quarter of 1960 to \$2.3 billion in the first quarter of 1961. Similarly, in terms of recovery and expansion, there should be noted the sharp rises from 1946 to 1948, from 1949 to 1950, from 1954 to 1955, and from 1958 to 1959. The current recovery has carried total corporate profits after taxes from the \$20.3 billion annual rate seasonally adjusted in the first quarter of 1961, to \$26.3 billion in the fourth quarter of 1961, \$25.6 billion in the first quarter of 1962, and about \$26 billion in the second and third quarters of this year.

The problem of adequate profitability for business enterprise under present-day circumstances, however, is pointed up by the unsatisfactory performance in the second and third year of good times following recession. Thus, profits declined from 1951 to 1953, from 1955 to 1957, and from 1959 to 1960. Given this pattern, the decline in corporate profits from the fourth quarter of 1961 to the first quarter of 1962 was a most disheartening development.

Beyond the cyclical swings, however, something more fundamental has been occurring in the level of corporate profits. Over the last decade or so, the total dollar amount of reported earnings in peak years has moved sideways—\$22.8 billion in 1950, \$23 billion in 1955, \$23.5 billion in 1956, \$22.3 billion in 1957, \$23 billion in 1960, \$23.3 billion in 1961, with a temporary breakout to \$24.5 billion in 1959, on the basis of revised figures, and the \$26 billion figure in recent quarters. Meanwhile, gross national product rose from \$285 billion in 1950 to almost \$519 billion in 1961, corporate sales went up from \$432 billion in 1950 to \$783 billion in 1961, and invested capital rose in equally substantial measure. This combination of developments has resulted necessarily in continued decline in the ratio of corporate profits to gross national product, marked deterioration in profit margins, sharp drop in rate of return on stockholders' equity, and no return at all in reported earnings to the increment to invested capital during these years.

Herein lies the profit squeeze—in terms of reported figures without interpretation—which has been so widely discussed. Measures of the profit squeeze are shown on page 2 in terms of profit margins and rate of return on equity from 1947 through 1961 for all manufacturing corporations. Profit after taxes per dollar of sales dropped from 6.3 cents an average in 1947-51 to 4.8 cents in 1952-56, and to 4.5 cents in 1957-61. Annual rate of profit after taxes on stockholders' equity dropped from 14.1 percent on average in the first 5 years of the post-war period to 10.9 percent in 1952-56, and to 9.4 percent in the last 5 years.

Another measure of the profit squeeze is shown on page 332 in terms of the relationship of corporate profits after taxes to the corporate sales. This ratio dropped from 4.83 percent in 1947-51 to 3.54 percent in 1952-56, and to 3.10 percent in 1956-61.

These developments have been stated in terms of overall data as reported and without analysis of their underlying causes. They are the basis of deep concern in business circles. They mean to many a grinding down of profits to such low levels as to threaten the successful operation of our private enterprise economy and to impede attainment of adequate performance of the economy.

Close examination of the underlying data and analysis of the casual factors involved, however, point to a different conclusion. In my

judgment we do have a profit squeeze. We do need to give consideration to an adequate level of profits. We do need to encourage business investment through increasing cash flow. But, the historical record in terms of the overall data as reported greatly exaggerate the real decline in corporate profitability which has occurred. More than that, undue concern about the profits situation has in itself caused weakening of business confidence and hurt the cause of adequate recovery. Furthermore, erroneous interpretations of the situation regarding corporate profitability direct attention away from the more basic matters making for the good health of the economy and with that the well being of corporate profitability as well.

As I see it, there have been three fundamental factors causing the decline from the high levels of profit margins and rate of return as reported which prevailed in the early postwar years. These are: First, the unusual circumstances of the early postwar years which led to record levels of profits never reached before or after. Second, the tremendous stepup in depreciation charges during the last decade which has lowered reported earnings but has increased cash flow. Third, the inadequate growth in the economy generally from 1957 on and particularly the sideways movement of real output in the private durable sector.

Unusual circumstances of high demand and short supply made the early postwar years the most profitable period corporate enterprise has ever experienced. Beyond this, costs, including the cost of plant consumed, were seriously understated and reported profits were greatly overstated. In particular, the tremendous burst of demand in the early postwar years brought about a rapid increase in prices which gave rise to major inventory profits included in reported corporate profits. The effect on profits of inventory valuation from changing prices has been specifically recognized and measured by the Department of Commerce. Some aspects of this are shown in the table on page 332 entitled "Inventory Valuation Adjustment in Relation to Corporate Profits Before Taxes."

The degree to which inventory valuation raised reported profits is indicated for selected early postwar years—1947, 1948, 1950—in contrast to certain recent years. When prices are rising, as they were sharply in the early postwar years, higher profits emerge from inventory valuations at lower levels of costs. The Department of Commerce includes corporate profits before taxes in national income only after adjustment for inventory valuation. Thus the high profit margin ratios and rate of return figures in the early postwar period were substantially boosted by inventory profits occurring as a result of rapid inflation and other understatements of costs and overstatements of reported profits. Such years hardly offer a reasonable base of comparison.

As a matter of fact, much of the decline in corporate profitability as indicated by reported data is simply a return to more usual circumstances from extremely abnormal situations prevailing after World War II. This is indicated to some degree by the authoritative data shown on page 4 concerning rate of return on net worth of leading manufacturing corporations prepared and published over the years by the First National City Bank of New York.

Rate of return on equity declined from an average 16.2 percent in 1947-51, to 13.2 percent in 1952-56, and to 11 percent in 1957-61. But that 11 percent during the last 5 years of profit squeeze is exactly the same as the average of 11 percent in the 5 years from 1925 through 1929, the previous high point of corporate profitability.

Basic emphasis must be given to rising depreciation charges. Data on this matter are shown on page 331. The dollar amount of depreciation and amortization charges, as measured in the Department of Commerce series on sources and uses of corporate funds, is shown in the second column. Depreciation charges have risen from \$7.8 billion in 1950 to \$19.1 billion in 1957, and \$24.8 billion in 1961.

The sideways movement in total corporation profits during much of the last decade or so has resulted partly from this tremendous rise in depreciation allowances. This situation in terms of individual companies as well as the economy, has caused many financial analysts to devote a great deal of emphasis to the concept of "cash earnings," that is, the sum of reported earnings plus depreciation charges. It will be noted in the table on page 1 that cash earnings of all U.S. corporations have risen from \$30.6 billion in 1950 to \$48.1 billion in 1961.

The rise in depreciation charges and in so-called cash earnings has been due to two major factors. First, business enterprises have made substantial and continuing expenditures on plant and equipment.

I might interpolate that while some of those expenditures have been for increasing capacity, they have also been for modernization and cost cutting, and have been the effective medium by which many business enterprises have been able to achieve a substantial offset to higher employment costs, and thus hold down and restrain the increase in cost per unit of output, which otherwise would have occurred on a much bigger scale.

As the amount of depreciable property has risen, the depreciation charges related to that property have risen.

Second, accelerated amortization of defense facilities in connection with the Korean war and liberalized depreciation enacted in the Revenue Act of 1954 have increased depreciation charges. Ahead of us, of course, is the effect of a potential \$4.7 billion increase in depreciation, of which \$3.6 billion is for corporate businesses, under the new guidelines set forth by the Treasury Department in its recently announced basic reform in the standards and procedures used for the determination of depreciation for tax purposes.

The tremendous rise in depreciation charges during the postwar period is an essential element in appraisal of recent profit developments. Certainly the nature of depreciation accruals as noncash charges against sales is valid, as is the resultant concept of cash flow available for dividends on investment in business assets. A cash earnings concept may be necessary for comparability, given changes in the rate of depreciation and amortization allowances.

While depreciation accruals represent noncash costs, they are nevertheless true costs. Total costs, as Leonard Spacek has recently emphasized, are made up of (a) costs spent in prior years but used up today, (b) costs spent today, and (c) costs accrued today to be settled in future years, and reality prevents any one of these cost elements from disappearing. There are no real profits to a business enterprise

until all costs are recovered, including full recovery of investment in assets in terms of book value, to say nothing of current value after inflation. Earnings computed after all costs are covered are still the only true earnings.

Nevertheless, the rise of depreciation accruals and cash earnings in absolute and relative amount has clearly changed the financial position of corporate enterprise. The rules of the game for recording costs have certainly been altered by changed depreciation standards and procedures of the Internal Revenue Service. The quality of reported earnings has been substantially strengthened and improved, as has been the stability and protection of dividend payments, by the rising levels of depreciation accruals and cash flows. Furthermore, the financing of new plant and equipment outlays is materially eased by rising cash earnings.

These developments may be observed from consideration of the data on page 331 concerning cash earnings and plant and equipment outlays. From some standpoints, a concept of "net cash earnings" might be meaningful as an alternative approach. "Net cash earnings" are defined as cash earnings less plant and equipment outlays. The table indicates that the level of "net cash earnings" in 1961 and in 1959 was far higher than in previous years. Year-to-year changes in net cash earnings are caused, of course, by short-run fluctuations in plant and equipment outlays as well as in reported earnings.

The data on page 332 relate corporate profits and cash earnings to corporate sales. The reported figures on corporate profits after taxes in relation to total corporate sales have declined substantially during the postwar period as a whole, as previously noted. But attention must also be given to the matter of rising depreciation and amortization charges. The ratio of these charges to total corporate sales rose from 1.77 percent in 1947-51 to 2.46 percent in 1952-56, and to 3.01 percent in 1957-61. The rise in this ratio is equivalent to all of the decline in the ratio of total corporate profits after taxes to total corporate sales during the last 10 years. Cash earnings averaged somewhat higher in relation to corporate sales in the last 5 years, 6.11 percent, than in the previous 5 years, 6 percent. The same is true of net cash earnings in relation to corporate sales.

Information as to cash flow in relation to sales in 1961 for manufacturing corporations by industry and by size is presented on page 333. Similarly, data on rate of return for manufacturing corporations by industry and size are presented on page 334.

Another set of basic relationships concerning cash earnings is shown on page 6. A reasonably close correspondence historically has existed between business capital outlays and cash earnings. This is shown in the column at the left on page 6.

Likewise, as shown in the two columns at the right, corporate dividends have been maintained in reasonably close relationship to cash earnings, although the payout ratio in terms of reported corporate profits after taxes has risen during the postwar period.

A third key factor accounting for the behavior of corporate profitability during recent years has been the inadequate growth in the economy generally from 1957 on. Particularly important in this respect has been the sideways movement of real output in the private durable sector. As an example, the steel industry needs more busi-

ness, much more than it needs higher prices. Here is where the matter of achieving a level of corporate profitability which is necessary and desirable merges with the general public interest in achievement of the fullest potential of the economy. What is good for the economy will be good for corporate profits. Adequate expansion and growth in the American economy is the most important ingredient of high and rising corporate profits.

My judgment is that much of the historical decline during the post-war period in corporate profitability as reported is not as significant as is commonly thought in business circles.

But, the hard and bitter struggle that every business is engaged in—no matter how big or how small—must receive adequate attention as a key factor in the current economic scene. Every business firm must make vigorous efforts to keep pace with competition, to develop new products, to introduce the newest technological improvements, and to try to keep at least even in the hard and relentless race against higher costs. These actions by businessmen in response to the profit motive, in turn, are a most important ingredient of adequate expansion and growth in the American economy.

Chairman PATMAN. Thank you, sir. Our next witness is Mr. Joseph A. Livingston. Mr. Livingston, we are very delighted to have you and glad to hear from you. You have a prepared statement, I believe.

**STATEMENT OF JOSEPH A. LIVINGSTON, FINANCIAL EDITOR OF  
THE PHILADELPHIA BULLETIN AND NATIONALLY SYNDICATED  
COLUMNIST**

Mr. LIVINGSTON. Yes, sir. I am honored and complimented to have been invited to appear before this committee. As a newspaperman, I am accustomed to have Senators and Congressmen talk to me and not listen to me. I hate to think of myself as a worm, but it is pleasant to have the worm turn.

If economics were an exact science, this committee wouldn't be holding hearings. And if I or anyone else knew the correct answers to this Nation's economic problems, again there would be no need for hearings. We'd simply accept the judgment and policies of this economic giant.

An economist is a bundle of biases, who isn't always able to see history and trends in the making because of his biases and theories. I offer that generality, because I may be completely wrong in what I am about to say.

It seems to me that too many economists believe in deficit spending as a panacea for everything. If business slacks off a bit, let the Government cut its income, either by spending more or taxing less.

If we have chronic unemployment, let the Government jab some deficit adrenalin into the system.

If we don't grow as rapidly as the Soviet Union or Western Germany or Italy or France, well, obviously, it's the Government's fault. It is not doing enough.

We are trying to treat prosperity in the same way we dealt with depression.

I fear we have been misled by comparisons. We note how rapidly European nations and Japan have expanded production and employment, and we say: "We're laggards. We're not doing as well." We forget that the war destroyed the farms, factories, and commercial organizations of these countries. We also forget that these countries had lagged far behind the United States even before the war—in industrial techniques.

After the war, as the Good Samaritan, we made available funds to build plants, technicians to explain our technology to them, and economic aid of all sorts. It was only natural these countries would grow more rapidly than the United States. So much more had to be done.

These countries have one other big advantage in the growth race. They can imitate and emulate. We have to innovate. Thus, after the war, the French, Italian, West German, Belgian and to a lesser extent British manufacturers had a whole line of proven consumer products which they could offer housewives—washing machines, dryers, mixers of all sorts, freezers—household conveniences which had sold well here and presumably would excite European housewives too. The manufacturers and distributors didn't have to engage in extensive market research; they didn't have to invent. All they had to do was copy. And they're still doing it—manufacturing and distributing products which were first widely marketed in this country. Most industrial countries of the world are just finishing the first lap in post-war development, whereas we are in our second or third. Hence, the slower pace.

I fear that we, the emulated, are in danger of becoming the emulators. We have looked at the rapid development of European nations in recent years, and said, almost childishly, "Gee, how fast they are growing. What are they doing that we ought to do?" Instead of recognizing that in most of these countries they are doing what we already have done. We note that some of their plants are more modern than ours; that their steel mills, having been built from the ground up, are in excellent competitive shape, and that their governments have offered special incentives to encourage plant development.

Should we not ask ourselves: Are their policies and tax structures useful here, or were they devised to meet specific and indigenous postwar conditions?

Let me cite an example. This administration has favored an investment tax credit. This amounts to a 7 or 8 percent subsidy to manufacturers of equipment. Undoubtedly lower prices will induce some firms to buy equipment.

But it seems to me, this can be accomplished more easily and less deviously by tax reform.

The investment tax credit has been used in Europe, I have been told by Treasury officials, effectively. But Europe has a scarcity of labor. Laborsaving devices are especially needed at the present time.

We don't have a shortage of workers.

Furthermore, Europe has been short of capital and the investment credit was the European way of encouraging investment. We are not short of capital in the United States. Rather, we are long on both labor and capital.

Why should the Government encourage investment to modernize plant and equipment, or to save labor? Might it not be better for the

unemployed and for the economy in general if the Government encouraged expansionary activity.

The Nation would be far better off if businessmen weighed alternatives: Is it more profitable and useful to modernize plant and save labor, or is it more efficient to maintain and improve or retrain the present labor force to particular productive purposes?

But the Government offers a tax carrot to businessmen to do what most of them would do anyway. It introduces one more gimmick into an overgimmicked tax structure. And it does not by so doing, in my opinion, create an atmosphere of expansion, innovation, and experimentation. And that is what, in my opinion, the economy needs.

Perhaps our problem is that the postwar appetites are jaded. We want more products coming off the industrial dreaming boards. We want more risk-taking and less worry about tax avoidance. This can be achieved only by restructuring our tax system.

It is significant that even though the gross national product has risen nearly 40 percent in the last half dozen years, expenditures by industry on plant and equipment have bumped up against a \$35 to \$36 billion ceiling. It is also significant that the gross national product has doubled in the last dozen years and that corporate profits after taxes have bumped up against a \$23 billion ceiling; maybe this year they might break through, if estimates for the first half are correct.

It could be more than a coincidence that plant and equipment ceilinging out at about the same time as corporate profits and that both in relation to the gross national product are well below their peaks, as the following table shows:

*Percent of gross national product*

Year	Corporate profits	Plant and equipment	Year	Corporate profits	Plant and equipment
1929	8.0	( <sup>1</sup> )	1953	5.0	7.7
1939	5.5	6.0	1954	4.6	7.4
1945	3.9	4.1	1955	5.8	7.2
1946	6.4	7.1	1956	5.6	8.4
1947	7.8	8.8	1957	5.0	8.4
1948	7.9	8.5	1958	4.2	6.9
1949	6.2	7.5	1959	5.1	6.7
1950	8.0	7.2	1960	4.6	7.1
1951	6.0	7.8	1961	4.5	6.6
1952	5.0	7.6	1962 (estimated)	4.7	6.7

<sup>1</sup> Not available.

A very popular theory among economists today is that taxes have become an economic drag. Every time we approach full capacity, taxes drain off too much purchasing power. Therefore, recoveries are aborted, and the growth rate is kept low relative to the growth rate in other countries. However, considering the frequent deficits and their size, it hardly seems as if the Government is taking too much out. It seems to be putting in. Mr. Saulnier said this yesterday.

However, I do think and agree that the way the tax system is structured, not the size of the take, impedes growth. I think we need lower corporate and personal taxes. I would reduce individual taxes across the board—in the lowest bracket from 20 percent to 18 percent or even 16 percent, and lop off the top rate at 60 percent and possibly

50 percent. I would try to get the corporate rate down to 45 percent or even 40 percent. As an offset to the loss in revenue, many exemptions and loopholes will have to be eliminated. This last is the big job.

Taxes have become so high that they enlist the best minds in corporations, in law firms, in accounting firms, in tax avoidance. It becomes more profitable to save on taxes than to make money—to produce goods and services—on which you have to pay taxes. The more successful a person is the lower is the incentive to become more successful. Our tax system is a disincentive system, and, a temptation to immorality.

It is quite possible that we are on the threshold of a recession. Evidence can be assembled to make a case either way. My own feeling—and the word “feeling” can be translated into hope—is that any decline, if there is one, will be shallow, something we can weather.

We have talked persistently in the postwar period of cutting costs, becoming competitive, yet every time we have faced a readjustment, we have been inclined to inflate, and thus prevent the modest readjustment in costs, in prices, that industrial cycles, adjustments, are supposed to bring about.

We talk about a government of checks and balances. Periods of industrial lull are, in a sense, a check to keep the economy in balance. I would rather save a tax cut for the overhaul of the tax structure next year. Privileged taxpayers will cite “strong” reasons why their various vested loopholes should not be closed. Congressmen favoring tax reform will have to offer substantial cuts in personal and corporate taxes to generate enough general enthusiasm to overcome the intense and specific objections of the privileged and the lobbyists.

I think if we restore profits to the profit system, we will stimulate the incentive to innovate, experiment, and expand, both for the corporation and the individual. The Government won't need to offer special inducements to put up new plants, because businessmen will want to expand. There will be more money—profit—in it.

During the period of the great depression, it was right and proper for the Government to undertake stimulation of purchasing power. We still want rising standards of living at all levels, and especially at the lower levels. In this context let us be thankful that, though we have unemployment in the United States, few families go hungry. In the Soviet Union, which so often is served up as an economic example of rapid growth, supposedly, there is no unemployment, but plenty of hunger.

Economics does not abhor slack. Only certain economists!

Slack is part of the process of growth and change. We have slack on the railroads because of trucks, passenger cars, turnpikes, and airlines; slack in steel because of aluminum, concrete, and plastics; slack among writers because of the decline in the number of newspapers and magazines; and slack among politicians because for every senatorial and congressional seat there are usually three or four candidates.

The wave of the past won't perpetually suit the present. At this juncture in our economic development, it seems to me we will achieve future economic growth and higher employment by regenerating faith and confidence in profits as profits and not in trying to breast-feed the economy every time it whimpers.

Thank you for listening to me.

Chairman PATMAN. Thank you, sir. Our next witness is Stanley H. Ruttenberg, director of the Department of Research, AFL-CIO. You have a prepared statement, I believe.

**STATEMENT OF STANLEY H. RUTTENBERG, DIRECTOR, DEPARTMENT OF RESEARCH, AFL-CIO**

Mr. RUTTENBERG. Yes, I do, Mr. Chairman. I would like to engage in debate with each of the three gentlemen that preceded me, but I shall refrain from doing that at the moment, and go to the text of my prepared statement. I would like to discuss in further detail the reason we view the flexible use of fiscal policy to counter a downward cyclical trend to be of the utmost importance. This kind of limited fiscal objective is entirely apart from the longrun structural reform of the tax system which I hope will be undertaken next year. While overall reform is vitally needed, it is also important to recognize, as President Kennedy and the Commission on Money and Credit already have done, the vital role that flexible use of the power to levy taxes can play to help meet the problem of recurring short-run economic downturns.

Since World War II we have already suffered severely from four business recessions, and in my judgment the economy is already on the threshold of the fifth.

The losses due to these business downturns, if measured in goods and services we could have produced but did not and the tax receipts the Federal Government could have collected but did not, total scores of billions of dollars. Moreover, they have imposed incalculable misfortune upon the families of the unemployed.

It is true that none of the postwar recessions reached the depth and duration that would characterize them as "depressions." This is largely due to the wholesome effect of a series of stabilizers, most of which have been built into the economy since 1929, often despite strenuous opposition. Taken together, they have helped to sustain economic demand and the stability of our economic institutions and have checked the downward business spiral that in the past has too often overwhelmed us.

Unlike the deflationary chain reactions that set in after the 1929 stock-market crash and on other occasions, family income and demand have been helpfully sustained during the postwar downturns by social security payments, farm-income supports, minimum wages, and the stabilizing impact of long-term management-labor wage agreements. Banks have not crashed during the postwar recessions and hundreds of thousands of homes have not been foreclosed, as a consequence of foresighted legislation enacted in the 1930's. Economic stability has been further aided by those corporations that have not reduced investment levels during business downturns but have held to long-term plans. Furthermore, during each recession, unemployment compensation has been helpful—although inadequately so—in countering the wage and salary losses of the jobless and the underemployed. Moreover, important countercyclical levers to make credit more easily available at a lower cost have continued to be available to the Federal Reserve System as a significant antirecessionary tool.

All of these factors have helped apply brakes to the postwar recessions and, as business inventories were worked down, have helped speed recovery. Nevertheless, the cost to the Nation of any recession is tremendous. What is more, the downward phase of the economic cycle is now reoccurring with increasing and alarming rapidity.

For example, the economy enjoyed 45 full months of recovery from the low point of the 1949 recession until the next downturn began. After the slump of 1954, on the other hand, the recovery phase of the cycle lasted only 35 months and, after the recession of 1958, it ended after 25 months. And now, only 17 months since the low point of our most recent recession, the recovery is already faltering. Unless we act, another downturn may be on the way.

The sole issue to which I wish to address myself is the timeliness of a prompt temporary countercyclical tax cut to prevent this downturn from occurring.

It is not my intention to debate the effort of the chamber of commerce and NAM to stampede the Congress into permanent corporation and top-bracket income tax reduction. I am confident that this poorly timed effort to impose a permanent and inequitable long-term cut—completely unrelated to the short-term cyclical needs of the economy and clearly intended to make tax reform impossible next year—will be rejected.

Furthermore, I will not discuss now, but set aside for another hearing, the relevant long-term question of the appropriate level of aggregate Federal tax receipts and budget outlays in relation to the effort to sustain long-term economic growth.

My point of emphasis is very clear. A basic distinction must be made between a tax cut designed to stimulate economic activity, and one designed to produce permanent and structural tax reform.

The U.S. Chamber of Commerce in making its proposal to cut corporation and upper individual income taxes did so, I am convinced, as a means of stopping tax reform of the kind that Mr. Livingston referred to in his remarks.

Countercyclical tax cuts designed to stimulate economic activity should not be used as a means of accomplishing tax reform. A tax cut at this point in time should produce the maximum impact in stimulating the economy.

The economic situation is today sufficiently serious, as I shall indicate later in my statement, to justify an immediate, emergency short-run tax cut. If such a tax cut were enacted now, and terminated on December 31, 1962, it would in no way interfere with either permanent tax reform or efforts to bring the budget into balance at a higher level of economic activity. The Congress would be free next year to approach these two problems unencumbered by the action which it should take this year.

I would strongly recommend that the Congress enact a tax cut of approximately \$5 billion, to become effective as soon as possible and terminate December 31, 1962. The impact of such a tax cut upon the economy would be much greater than just the \$5 billion because it would be concentrated in a 3- to 4-month period. The impact on the budget would be a loss of \$5 billion, while the impact on the economy on an annual basis would be the equivalent of almost \$20 billion.

Such a tax cut could have immediate impact upon the spending stream by reducing the withholding taxes on personal individual income taxes by \$10 per week for 10 weeks for each taxpayer. Those taxpayers whose total withholding tax is less than \$10 per week could apply immediately for a tax refund that would permit them to have a total tax cut of \$100. Individuals not subject to withholding could apply for a tax refund of \$100.

This kind of tax cut would put income into the hands of the American consumers, whose tendency has always been to spend the greatest proportion of their income on maintaining adequate and decent living standards for themselves and their families.

This is in direct contrast to a \$100 tax-cut spread over a 52-week period. Such a cut would add less than \$2 per week to each taxpayer's take-home pay. The impact would be considerably less upon the economy than one which gives the same \$100 tax cut to individuals in a 10-week period.

A good case can be made for differentiating between this type of immediate, emergency, short-run tax cut and tax changes which are designed at permanent and structural tax reform.

The Commission on Money and Credit in its report last year made a very clear distinction between temporary and permanent tax changes. I was privileged to be a member of this Commission during its 3 years of intensive study, in the good company of 17 leading bankers and business executives and 7 other distinguished citizens.

The investigations of the Commission, which was financed by the Ford Foundation, in the main, encompassed the whole field of monetary and credit policies and their influence upon employment, prices, and economic growth. One of its most significant recommendations is its endorsements of a flexible fiscal policy as a means of helping to stave off excessive cyclical swings.

In the report of the Commission a year ago, much attention was given to ways that our existing built-in economic stabilizers can be improved. But, in addition, the report declared:

Even if the automatic stabilizers can be improved discretionary fiscal measures will remain an important instrument of stabilization policy.

The Commission then carefully weighed how a flexible tax policy should be applied as a countercyclical tool. Its most important conclusions follow:

One, with regard to a clear distinction between temporary and permanent tax changes, the Commission states:

Discretionary fiscal policy requires speed of decision and effect and can only be successful if temporary and reversible fiscal changes for stabilization purposes are dissociated from permanent and structural changes. Techniques should be developed by which taxation and expenditure policy can be applied more flexibly, and the first step in this direction lies in a sharp demarcation between short-run cyclical changes and long-run structural changes.

Two, with regard to how the temporary tax should apply, the Commission states:

Clearly, as a stabilization instrument, the first-bracket rate adjustment is superior to proportional adjustments in the entire rate structure in stimulating consumption, since for each dollar of income tax reduction the lower income groups would receive a proportionately larger share of the reductions.

A change of this sort is also flexible and reversible. Withholding changes can be made promptly, regardless of their size. Congress and the administration have

had experience with intrayear changes in withholding rates, for example in 1948, 1950, and 1951. The technique is readily and easily applicable. Declarations of estimated tax can also be promptly modified in line with the new tax liabilities.

The Commission, therefore, concludes that when discretionary tax adjustments are used to promote short-run economic stabilization, they should consist of variations in the first-bracket rate of the personal income tax.

Such variations should be regarded strictly as temporary departures from a permanent tax structure.

The Commission proposal should not be and cannot be viewed as a business-oriented or as a non-business-oriented tax. It is the kind of fiscal proposal which is deemed to be in the interests of the entire Nation. I would call to your attention once again that the Commission was made up of 25 people, 17 of whom were business executives, corporation officials, or insurance company presidents.

Last January, in his Economic Report to the Congress, the President cited three major measures which he views to be essential to help sustain prosperity. Noting that—

recurrent recessions have thrown the postwar American economy off stride at a time when major industrial countries have moved steadily ahead.

President Kennedy urged strengthening of the unemployment compensation system, standby authority to increase public works construction, and, finally—

Presidential standby authority for prompt temporary income tax reductions.

The costs of a temporary tax cut, the President pointed out, should be measured against the costs they are designed to forestall:

The tens of billions of potential output that run to waste in recession; the pain and frustration of the millions whom recessions throw out of work; the budget deficits of \$12.5 billion in fiscal 1959 or \$7 billion this year.

And the President concluded:

The proposed partial tax suspension would launch a prompt counterattack on the cumulative forces of recession. It would be reflected immediately in lower withholding deductions and higher take-home pay for millions of Americans. Markets for consumer goods and services would promptly feel the stimulative influence of the tax suspension.

It would offer strong support to the economy for a timely interval, while preserving the revenue-raising powers of our tax system in prosperity and the wise traditional procedures of the Congress for making permanent revisions and reforms in the system. \* \* \*

Essentially, the President's proposal, in the main, conforms to that of the Commission on Money and Credit, but differs in one very important respect. The President proposes that the temporary 5-percentage-point cut be in all individual income tax rates as contrasted to the Commission on Money and Credit's recommendation that the 5-percentage-point reduction be in the "first bracket of the personal income tax." Such a change, as proposed by the President would considerably reduce the economic benefit resulting from the cut.

Events since the President submitted his Economic Report to the Congress prove the timeliness of his legislative proposals of 6 months ago.

The promising recovery of last winter has faltered; at best we are now moving sideways. Total demand generated by consumers and the other segments of the economy just has not been sufficient to utilize an everrising capacity to produce. The latest figures suggest, as a

matter of fact, that total demand may now be headed down. Meanwhile, a large part of our production plant is idle and this considerably dampens hope for an immediate investment boom. Moreover, despite small fluctuations up and down, unemployment has remained intolerably high and by winter is likely to again reach 6 percent or more.

It may be a fact that the Nation is still statistically poised at an all-time GNP high; nonetheless, we clearly have failed to achieve a full recovery in terms of today's needs and potentialities. What is more, the "mixed bag" of available economic indications already points to the likelihood of an impending descent—if not in a month or two, then a little later.

Clearly the economy needs an antirecessionary temporary tax cut now of the kind the Commission on Money and Credit has proposed. Surely it is far wiser to take steps to prevent the Nation's fifth post-war recession from occurring, than to do nothing now and seek to regenerate the economy next year when the cost will be far higher.

Finally, I must express concern over rumors, and I guess it is more than rumor, that the Federal Reserve Board will seek to offset a tax cut, if one comes, by a tighter money policy. Action of this kind would simply destroy the beneficial effects of the tax reductions.

While it is important to take monetary measures to help ease the balance-of-payments problem, they must be selective and constructive in nature. A general effort to tighten the availability of funds and thus raise interest rates across the board now to meet the payments problem just cannot be tolerated at a time when the American economy needs credit ease and lower borrowing costs in order to overcome stagnation.

Policies to meet the international monetary problem can and must be shaped that do not undermine the achievement of what must be our number one objective—the restoration of recovery.

Chairman PATMAN. Thank you, sir. Mr. Rutenberg, to what extent do you believe that the tight money and high interest policy of the Federal Reserve has contributed to our present plight?

Mr. RUTTENBERG. Mr. Chairman, I believe very strongly that the Federal Reserve System, which has been maintaining a level of free reserves in the banking structure, of somewhere around \$500 million during the early parts of 1962, and then moved down to somewhere in the neighborhood of \$400 million, and more recently, although it has fluctuated up and down, it has been between \$320 million and up to \$450 million, but it looks like the tendency is to come down on the level of free reserves. Simultaneously with this happening, we have seen over the course of the last 6, if not 8, weeks a rise in the long-term interest rates by 20 basic points, at least.

I think this move on the part of the Federal Reserve Board at this point in time, when the economy still has 5½ percent, 5.5 percent of its labor force, totally unemployed; when it has something like 600,000 additional workers who are not in the labor force, who should be there; that has something like 2½ million workers who are working part time for economic reasons, who would be working full time if full-time jobs were available; an economy which has about 15 percent of its total plant and equipment lying idle is wrong. I think a policy which holds down the level of free reserves, which tends to force up the

long-term interest rates is absolutely and unequivocally, in my judgment, the wrong policy for the Federal Reserve to be following at the moment.

Chairman PATMAN. Mr. Martin did say that he would give this tax cut what you might call a Russian veto. He is going to stop it. He said that in testimony before our Committee on Banking and Currency on July 17, 1962. I will place in the record the exact statement that he made in reply to a question that I asked him, and in reply to a question Mr. Reuss asked him.

(Testimony referred to follows:)

EXCERPTS FROM TESTIMONY OF MR. WILLIAM MCCHESENEY MARTIN, JR., CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

(Hearings of the Committee on Banking and Currency, House of Representatives, July 17, 1962)

Mr. PATMAN. What is your view of the other part of the recommendation to get the economy going that we ought to stimulate the economy with a large Federal deficit?

Mr. MARTIN. That gets into the field of fiscal policy that I don't believe is my province or prerogative to deal with.

I will return to the simple statement I made earlier. In the event a decision is made which widens or further deepens the deficit we are already running, I want to put the Federal Reserve specifically on record this morning, if I haven't done it already, that I think that we must not finance a deficit by bank-created funds, that how the deficit is financed is of vital importance and that it should be financed out of bona fide savings and not by writing up assets on one side or the other of the bank ledger (pp. 90, 91).

Mr. REUSS. \* \* \* Now, you made a statement a moment ago which I think is quite historic. You said—and I want to be sure that I heard you right—that if the administration and the Congress go ahead and cut taxes by \$7½ billion as advocated by the U.S. Chamber of Commerce or by \$10 billion as advocated by Walter Reuther or whatever—you said that nobody should rely on the Fed for financing any of that deficit and that all of the deficit would have to be financed from so-called real savings.

Did I hear you right?

Mr. MARTIN. I think you heard me substantially correctly, but I didn't say "all" of it. I don't think you can completely measure this operation, but I am sure that the role of the central bank is to see that the debt is financed when deficits develop in a way which will bring into play the savings of people and not just create money out of thin air, which is what is done when the banking system does it by writing up assets on one side and liabilities in the other" (pp. 106, 107).

\* \* \* I think that easy money has done about all it can do at the present time for the employment and growth of the economy \* \* \*

Representative CURTIS. Did he use the words "Russian veto"?

Chairman PATMAN. No; I did that. I used the term "Russian veto."

Mr. RUTTENBERG. Whether it is Russian or not, it is a veto.

Chairman PATMAN. It is a Russian veto. That is what I called it. Mr. Martin didn't call it that. Mr. Ruttenberg, you served on that Commission on Money and Credit. Weren't you really shocked to find out how little power the Congress of the United States has left the Executive to use in carrying out his duties insofar as it applies to monetary affairs?

Mr. RUTTENBERG. As far as the Executive is concerned, he is left with relatively little authority at all in the monetary field because the Congress has delegated this authority to the Federal Reserve.

Chairman PATMAN. That is right. Dr. Weston testified the other day, sitting right there where you are, and he told us, a committee of Congress, that he was not going to talk about monetary affairs because

we didn't have anything to do with it. He was going to talk about fiscal affairs. I congratulated him on reprimanding the Congress for not carrying out their constitutional duties. I think he is exactly right.

During the depression when Congress was preoccupied with trying to improve conditions and willing to do anything in the way of cooperating, they passed a law in 1935 to change our banking laws. They changed it substantially, as you know, primarily for the depression period, but it has lasted until now.

During that time they created the most powerful group on earth, the Open Market Committee. It functions through 7 public members of the Federal Reserve Board and 12 presidents of Federal Reserve banks, who represent the private banking interests of the Nation. They determine our policy. They determine the volume of money, and what the interest rate will be. It seems to me that is a lot of power.

In 1935 this Open Market Committee was set up with 7 members, with 14-year terms. The law says not to exceed 14 years, I believe. It will be another year before—2 more years before Mr. Robertson's term will expire, in 1964; 4 years before Mr. Balderson's term expires, 1966; 6 years before Mr. Shephardson's term expires, 1968; 8 years before Mr. Martin's term expires in 1970 as a member of the Board; 12 years before Mr. King's term expires; and 14 before Mr. Mitchell's term expires. It occurs to me that Congress, in trying to get the country out of the depression and eager to pass any measure that might help, took away from the Executive the principal weapons we can use for the purpose of aiding this country in time of distress.

Do you agree to that, or not

Mr. RUTTENBERG. You mean by the long terms of the Federal Reserve Board members?

Chairman PATMAN. By putting such great power into the hands of a few people. In other words, the Federal Reserve has seceded from the Government. They were looking for an occasion to try it, and during the last year or two of Mr. Truman's administration, when Mr. Truman's popularity line was down a little low, they took advantage of it and seceded from the Government.

Senator DOUGLAS. Don't start that.

Mr. LIVINGSTON. So did the vice chairman.

Chairman PATMAN. Now they are operating as a fourth branch of government. They are not elected by the people, in any way, shape, or form.

They are off by themselves for a 14-year term, and they claim that each member is responsible to his own conscience and God, and nobody else—not to the Congress, not to the people—his own conscience and God.

That is to whom they are responsible. Don't you think we better take another look at what we did back in 1935?

Mr. RUTTENBERG. Mr. Chairman, I was a member, as you said, of the Commission on Money and Credit, which functioned for 3 years and made a report. I had some 8,000 words of dissent in that Commission report, but the one part of the report with which I fully agreed and dissented not at all, was the issue of the reorganization of the Federal Reserve System. The reorganization included, among other

things, the abolition of the Open Market Committee, as such, and the turning over the function of the Open Market Committee to members of the Federal Reserve.

Chairman PATMAN. I have advocated that a long time, and I agree with you.

Mr. RUTTENBERG. Secondly, that the Chairman should be appointed, and his term should expire coterminous with the expiration of the Presidency.

Chairman PATMAN. To make him more responsive to the President.

Mr. RUTTENBERG. In a sense, a President can come in as President Kennedy did, in 1961, and he could not change the Chairman of the Federal, March 1963, when his term expires.

Chairman PATMAN. If he does make a change, he has to select somebody on the Board at the time. He could not go outside.

Mr. RUTTENBERG. He would not necessarily have to, Mr. Chairman. If, for example, you had also the termination of a member of the Board's term coinciding with the odd year in which the President takes over.

Chairman PATMAN. It would be a coincidence.

Mr. RUTTENBERG. It so happened that there was a term expiring and there was a vacancy. Governor Vardeman resigned at the end of his term, and Mr. Mitchell, of Chicago, was appointed. At that point in time, had the President authority to change the Chairman, he could, if he wanted to have done it. One of the recommendations of the Commission on Money and Credit is that you reduce the number of members of the Federal from 7 to 5. You run their terms 10 years. You have them expire in the odd years so that the odd year when the President takes office, he will not only have a vacancy, but he would also have the right to designate his own Chairman without changing as a member of the Board, the man who might have been previously Chairman.

Chairman PATMAN. My time has expired. I am glad you went that far. I hope the Congress can do something about it because it is not treating the President of the United States right to make him depend upon the Open Market Committee, to do what he should have the power to do himself. Certainly the Committee should be more responsive to the President. I yield to Mr. Curtis of Missouri.

Representative CURTIS. Thank you, Mr. Chairman. I presume from that that you are glad that they didn't make these life-term appointments, as we do our Federal judges.

Chairman PATMAN. I certainly am. We didn't do that. I think the Constitution did it.

Representative CURTIS. Yes. I am pleased about one thing particularly in Mr. Ruttenger's paper, of drawing the issue, and I think you do it fairly, you point out a basic distinction must be made between a tax cut designed to stimulate economic activity, and one designed to produce permanent and structural tax reform.

I believe our hearings in the Ways and Means Committee, which were in secret session, as well as these hearings here, have demonstrated a muddled approach to this. Many of the people who were here urging a tax cut were thinking in terms of tax reform. I know the theory, I feel, the theory that is being advanced in our public discussions along the lines of that which was recommended by this Com-

mission on Money and Credit, the recommendation in the President's message to the Congress to give him standby authority. The urgings now are, instead of the President having this standby authority, the Congress should move in here.

This is the matter with which I take issue. I am expressing my own view. Those who have advanced this theory, in my judgment, have not come forward to examine into what its effect would be. They have been begging the question. This has never been tried before, has it, Mr. Ruttenberg?

Mr. RUTTENBERG. What has not been tried?

Representative CURTIS. The use of fiscal policy, tax cutting, to stimulate economic activity, this temporary tax cut. We have examined into our history with other witnesses and I can't find a period when this was ever done. We have tax reform which amounted to tax cutting, but this kind of approach has never been followed.

Mr. RUTTENBERG. I think, Congressman Curtis, it is fair to say that the approach which has not been followed is one which involves a temporary reversible tax cut.

Representative CURTIS. That is right.

Mr. RUTTENBERG. We have had tax cuts that have been justified one way or another for economic reasons, and for stabilization reasons.

Representative CURTIS. I disagree. I think in all our tax cuts, thank goodness, we have been concerned whether the tax laws are good, and talking about revenue. There are people, and I am one of them, who believe that our taxes should be for the purpose of revenue, and we should try to make them as neutral as possible in their economic impact.

Mr. RUTTENBERG. Congressman Curtis, I don't want to have to disagree with you, but I would like you to refer back in your own mind, as a member of the Ways and Means Committee, to the testimony of the Secretary of the Treasury, Mr. George Humphrey, in 1953 and 1954, and unless I am mistaken, the great emphasis which he placed upon the basic tax changes of the Revenue Act of 1954, was to stimulate economic activity.

Representative CURTIS. No.

Mr. RUTTENBERG. You check back on the record.

Representative CURTIS. That may be something we can both check, because I am going on memory, too. I can certainly say this, as one who sat through those long sessions, that we were thinking in terms of tax laws and what specifically was equity and what specifically we needed in order to get revenue, and what the economic impact of a particular tax was, whether it was a good tax from the standpoint of collecting revenue efficiently, and what its impact might be. I don't think we ever were going on the theory—and I have never in all my years on the Ways and Means Committee—ever heard anyone discuss this economic innovation that has been an idea floating around for years—that if you do cut taxes that you would stimulate the economy, per se.

I frankly think it is a theory that is untested. Let us go in and test it, though. I wish that our witnesses would do so, those who follow this theory. Here is the question I have asked. Here we are in a period of deficit financing. Take your example of a \$5 billion quickie tax cut. We have just gone through some rather lengthy

hearings on debt limitation in the Ways and Means Committee, where we increased the amount of bonds that we could issue to a \$308 billion ceiling. This \$5 billion tax cut you propose would immediately mean that we would have to increase the amount of bonds that we could market to \$318 billion, but that is not the basic point.

The real point to consider is this: What is the economic impact of having to market \$5 billion worth of bonds on top of the amount that we already have to market in the private economy? If you are going to try to market the \$5 billion in E bonds, for example, you take away the very money, if you are successful in marketing them, that you have given to the consumer. Dealing in economic aggregates, why is there a stimulus from taking \$5 billion from the tax revenues and turning it over to the people or the private sector, and then withdrawing \$5 billion from the private sector in the bonds you sell them? Where is the economic stimulus in that kind of a process?

Mr. RUTTENBERG. You see, Congressman Curtis, I don't quite approach the problem of Treasury debt financing from the same point of view you do.

Representative CURTIS. I do it as a legislator who has to try to figure out how we are going to sell the bonds.

Mr. RUTTENBERG. Let us just look at the situation. It is true, as you point out, that if a \$5 billion deficit ensues, and this has to be financed by the issuance of Government bonds, if it is done: (1) by selling more E-bonds, this in effect takes up the tax cut and the people who had the tax cut, in a sense, may be the ones who buy the E-bonds. Therefore, I don't think E-bonds would be bought because it is my judgment that people who get this kind of tax cut in the low- and middle-income brackets, would spend the overwhelming proportions. The Treasury financing would fail. You would have to find another way. Let us assume they issue long-term bonds, and these long-term bonds are then bought by the banks. This, in a sense, then reduces the level of free reserves in the American economy, reduces the level of available funds for lending purposes, and in a sense, does the kind of thing on the tightening of money policy that I was criticizing at the end of my own statement.

Let us assume that they do do this, though, and that they do have to float the \$5 billion deficit in terms of long-term bonds, or even intermediary term bonds. I don't care. It has the purpose of going to the banking structure as against going to individuals in buying the bonds. If it goes to the banking structure and the free reserves are reduced by the selling of the new Treasury bonds, and if the economy needs to have a higher level of loanable funds in the banking system, then the thing to do is for the Open Market Committee of the Federal Reserve, at that point, to step in and see to it that the money supply of the country as reflected by the lendable funds, is at adequate levels. I am not saying we go back to the problem that preceded the accord of 1951.

I am not saying that the Federal Reserve should buy the Treasury bonds that are put on the market at the point and time they are put on the market. It is highly conceivable that the Treasury can float \$5 billion of bonds, and at that point in time and a future point when the Federal Reserve feels the level of money supply should be increased, should buy other bonds through the Open Market Committee.

Representative CURTIS. My time has about run out. Now, we are beginning to discuss the real problem. Up to date those who have been proposing this quickie, have been perfectly content to say we will pass this whole problem over to those who have the problem of debt management and let them figure out what they are going to do with the \$5 billion of additional bonds that have to be sold without any examination into the economic impact that marketing this additional debt might have on the economy.

I want to emphasize all of this is in light of a very serious balance-of-payments situation which has produced a strained situation where we are trying to keep short-term interest rates high and long-term interest rates low.

As one witness said yesterday, he said it was an impossibility. It almost seems like it is.

Mr. RUTTENBERG. I don't think it is.

Representative CURTIS. It is a very difficult thing, at any rate. This quickie proposal poses great problems in the area of debt management and monetary policy. All discussion of these problems, Mr. Ruttenberg, by the witnesses who have been talking about this quickie, has been absent in their prepared papers. None have been prepared to discuss this key issue.

They have begged the question. The only time the issue is discussed, is when I raise the question. They have not given it previous thought. In my judgment, the Commission on Money and Credit didn't relate its suggestion to an actual situation such as we have today, of deficit financing, coupled with a serious balance-of-payments problem.

I doubt if they would recommend a "quickie" in that kind of economic climate.

Mr. RUTTENBERG. My response to you this morning, Congressman Curtis, is not an improperly advised one of how the Treasury debt financing should be taking place with the deficit financing of the Government.

Representative CURTIS. Why is it not in your prepared paper?

Mr. RUTTENBERG. I was prepared on this because we had a go round on this in the secret session of the Ways and Means Committee.

Representative CURTIS. That is right. Why is it not in the prepared statement so that the people who question it can read it? I think you are passing on a debt management problem to those of us in the legislature who have to be concerned about it, or in the executive, the Treasury Department, and you do not discuss the problems of debt management and the economic impact it might have.

You simply pass it over and say the "quickie" will stimulate the economy, without dealing with the problems that are created by doing it.

Chairman PATMAN. Thank you, Mr. Curtis. Senator Douglas?

Senator DOUGLAS. I would like to pass.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. I would like to comment, Mr. Langum, on your paper, and particularly on the very revealing chart you have in your supplemental materials, entitled "Corporate Profits and Cash Flow." The chart relates to cash flow, that is, net profit after taxes and depreciation and depletion allowances, in relation to sales of all

manufacturing corporations in 1961, by size. There I am struck by the fact that as you progress from corporations with under \$1 million—is that in assets or sales?

Mr. LANGUM. Total assets.

Representative REUSS. And move in the direction of corporations with \$1 billion in total assets, the percentage of net profits after taxes moves quite progressively from a fairly miserable 1.2 percent to a fairly lush 8.4 percent. When you add in the depreciation allowances, it moves in exactly the same progression from 3.3 to 14 percent.

In the case of the \$1 billion corporation, the rate of net profit after taxes is about eight times the rate for the \$1 million corporation. Total cash flow for the largest class of corporations is at a rate five times the rate for the smallest size class. In computing your depreciation allowances, I take it you used the allowances in effect in 1961?

Mr. LANGUM. Yes, sir.

Representative REUSS. The discrepancy between the rich and the poorer corporations would be even larger if you took into account the increased depreciation allowances made by the Treasury last month and the 7-percent investment credit, once enacted, would it not?

Mr. LANGUM. I think it would increase to a moderate degree the differences shown on page 8. I believe the Secretary of the Treasury noted, in commenting on the new depreciation guidelines, about the differing degree of usage of increased depreciation accruals and possibly a tax credit by the larger corporations with excellent accountants and technical staff to do so.

I think that it would probably be a moderate proportion. But it certainly, in my judgment, would be along the lines of the differences shown in these tables.

Representative REUSS. The general point I got from your paper is that, if you take into account cash flow, including depreciation and depletion allowances, corporations generally have never had it so good.

On this table, I take it that the bigger the corporation, the larger the cash flow in percentage terms.

Mr. LANGUM. I think that is true in terms of cash flow, because unquestionably there has been a major step-up in cash flow with the rise in depreciation accruals. I think, however, that we should look upon that as a matter of greatly strengthened and improved quality of reported earnings.

In terms of reported earnings, the rate of return on equity, which I think is the ultimate measure, in the last 5 years has been about the same for leading manufacturing corporations as in the years of the late twenties.

Representative REUSS. I have a question for Mr. Hagedorn. You referred to the foreign short-term financial claims against this country and said that, therefore, measures used for promoting economic expansion at home should not depend on low interest rates.

I would ask you this question: Now that the Western World has laboriously attained the goal of currency convertibility among the major free world nations, isn't it really quite drastic to conclude that whenever any country, Ruritania, decides for good or bad reasons that it is going to raise its interest rates, we have to raise ours correspondingly, lest foreign or domestic capital leave this country?

Mr. HAGEDORN. No, of course not, Congressman. Holding balances in this country has attractions that may be entirely aside from the competitive interest rate.

Representative REUSS. Those attractions would include the avoidance of currencies that may have speculative dangers, even though the countries of those currencies pay a high interest rate.

Mr. HAGEDORN. Certainly. The quality of the loans must be considered.

Representative REUSS. Another reason for holding balances is one quite apart from interest rates. It involves lubricating the wheels of international trade.

Mr. HAGEDORN. The ability to get goods for those balances. Certainly that is an important consideration in their willingness to keep balances here.

Representative REUSS. I am glad to hear you recognize both of those things, because it seems to me they militate against a too great obsession with differential interest rates.

I would hate to see this country adopt the policy that whenever some country somewhere, by reason of its central banking policy at the moment, raises its interest rates, we raise ours competitively. If the free world starts doing that, the sky is the limit.

Mr. HAGEDORN. Yes. I realized, as I wrote this, that the comparison of the \$16 billion we have in gold and \$19 billion of short-term balances might sound like a scare statement to somebody. I didn't mean it as such. We are in the same position as a commercial bank. There is no reason to expect them to have cash in the vaults to pay off all their depositors at once. But they certainly have to maintain their assets in a condition that recognizes the fact that they have a certain amount of demand claims against them.

We, as a nation, are in that same position. The interest rates we maintain is one of the many factors we have to take into account.

Representative REUSS. I am wondering if this country should become so alarmed because other countries have temporarily higher interest rates than ours. For example, if Ruritania's central bank wants to raise its interest rate structure to 8 percent, why should we become alarmed if holders of claims against this country then take off after that 8 percent?

Mr. HAGEDORN. I doubt that the Ruritanian economy could pay 8 percent on any very large volume of balances, Congressman. I have not seen recent figures on the national income of Ruritania. I would guess they simply cannot. After all, the income on investments or the interest on balances has to come out of the product of the economy.

Representative REUSS. Yes, except non-Ruritanian countries such as Germany and France. I hoped you would not goad me into mentioning them. They have had rather high interest rates in recent years. I am wondering whether it is a cause for alarm in a free world of convertible currencies, if holders of claims choose to put down their money where they get the highest interest rates. I don't see why this should bother us.

Mr. HAGEDORN. I would be very much alarmed if our gold started flowing out of the country at a rate which would make it impossible for us to maintain the convertibility of our own currency.

Representative REUSS. Gold doesn't flow until the central banks of these countries demand it. Are they likely to demand it because temporary short-term money has come their way because of the higher interest rates? I shouldn't think this is necessarily the case.

Mr. HAGEDORN. The foreign central banks are in the same position as a depositor is in the domestic bank, when they look at each other and wonder which one is going to start a run on the bank. This would have been true before the changes in our own banking system in the past 30 years.

If, 50 years ago you had a town where the people were all doubtful about the solvency of the local bank, each one of them would recognize, it is a bad thing for me as well as all the others if I start a run on the bank. We don't want to see that happen to our bank. But on the other hand, if it is going to happen, I better get there first.

The foreign central banks might reason in much that way.

Representative REUSS. Just as Federal deposit insurance to a degree has stopped the depositors of domestic banks from ganging up and starting a run on the bank, so some of us hope the recent \$6 billion standby agreement of the International Monetary Fund will, in a modest way, constitute a step toward an international depositors insurance fund, and thus remove us from the mercy of foreign central bankers.

Mr. HAGEDORN. I don't agree that it would remove us.

Representative REUSS. Lessen the exposure.

Mr. HAGEDORN. It will protect us to a degree. Yes, Congressman, I would agree that you can't compute in any mechanical way the interest rates we must maintain in the light of all foreign interest rates.

Foreign interest rates are a complex of rates in different places and for different qualities of loans. I would certainly not be willing to agree that we could ignore that foreign complex of interest rates. That is what makes the Federal Reserve Board decision so difficult. It can't be done in any mechanical way. As Mr. Livingston said, if economics were an exact science we wouldn't have much to argue about here.

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

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much, Mr. Chairman. I don't particularly have a question, and I don't want to testify, but I would like to address some remarks to Mr. Livingston and Mr. Ruttenberg.

I read a column of yours last week, I believe, Mr. Livingston, in which you questioned the matter of where a tax cut would be spent if you gave everybody \$100. Just before I read it I had sent out a newsletter to my own constituents, about 30,000 of them, asking them where they would spend it. The answers that I have received are quite interesting.

One of the Detroit papers picked up the question and asked what each one would do if he got the \$100 at one time. One woman had replied in what I thought was the most interesting of all the answers, "I would buy a cashmere coat, and I know where there is a sale on right now." She was then asked, do you have any preferences in the way you get the tax cut? She said, no, she didn't. Just as long as she got the \$100 and the cashmere coat. One of the more knowledge-

able answers that I have personally received, because I spread the \$100 tax cut over 12 months in equal installments, came from a man who said this would be a tremendous tax cut for 50 million people. That personally he would fritter it away but that he would feel he was spending his grandchildren's candy money. At any rate, I had the feeling, as I sat in Ways and Means and listened to the economists, that they were multiplying \$100 by 50 million people by a multiplier of 2½ and dividing the grand total by 300 for refrigerators or 3,000 for cars, to determine what the effect of a tax cut would be.

I hope when I have conducted my amateurish and nonscientific poll, at least I will have a better idea of where this money is going to go.

I expect the chairman will let me spread it on the record of this committee hearing.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. Yes, I would like to say first to Mr. Livingston that I agree with a great deal you said.

No. 1, too many economists feel deficit spending is a panacea for everything. I think that is true. I do not think it can help a great deal.

Regarding your statement that the investment tax credit amounts to a 7- or 8-percent subsidy to manufacturers of equipment, there is no question about it. This is the first time this Government would permit anybody to depreciate more than 100 percent, which is in effect what we would be doing.

Over on page 4 of your statement, you say that:

I think the way the system is structured impedes growth. I think we need lower corporate and personal taxes and to reduce individual taxes across the board—

and so forth. You have a reduction in the personal income tax first bracket from 20 percent down to 16 percent; a cut in the corporate rate down to 40 percent ultimately, 45 percent as an interim goal.

Everybody would like to see it. But in view of the very great likelihood of increased expenditures, which increased \$6 billion last year and \$6 billion the year before, the fact that so many of these expenditures have become sacred cows whether they should or not in defense and space, are you not going to run a perfectly enormous deficit if we even come close to approaching this tax reduction you propose unless we have some alternative revenue source?

Mr. LIVINGSTON. I think you are quite right, Senator. I don't presume to be a tax expert and I don't presume to say how these revenues can be made up. But it seems to me that we have a condition of pernicious anemia in this country. The pernicious anemia is the result of our tax structure.

I would rather see a deficit, and a large deficit incurred—I am not afraid of deficits per se—if we can get this country moving again, as the President has so well said.

But I don't think we are going to get it moving again if we don't stop business organizations and businessmen in general from working to find out ways how to avoid taxes.

Whenever you get a rate of above 50 percent, you make it more profitable to find ways to save taxes than to actually do the job. I don't have to tell you the numerous devices that are schemed up to do it.

You buy a piece of property from somebody because your income is very large. You set up a mortgage by which you can pay the thing off progressively. It is all covered. And then you take depreciation on the property against your other income.

There are all kinds of schemes like that. You could cut down the business expense allowance that Senator Douglas has talked about. I think there would be no trouble at all of putting a limitation on businessmen's expenses if you at least gave the businessman an incentive to save on expenses.

A law partner or an accountant is in the 60- or 70-percent bracket; he does not want to save on his expenses. He wants them to go up because this is the way to increase his standard of living. But if you said you can have half of what you don't spend, at least you have a chance to say, "Look, \$25 a day is enough." We came down here and we were told the limit we had was \$15 a day. That might be a little too little for a businessman.

The tax structure is tilted to prevent people from going out and doing things. I think you can get some of this money back by changes of various sorts.

Senator PROXMIER. I would agree that we have to plug lots of loopholes. We would lose less than \$400 million by reducing the top bracket from 91 to 65 percent. There is a lot of sentiment in Congress for it. I think there is a real possibility we might achieve it.

But even still as I look at your arithmetic, there is a \$6 billion corporate tax cut and a \$12 billion individual tax cut if you go from 20 to 16 percent and everybody else the same way. Most of that loss is in the lowest bracket.

As I say, it sounds very unlikely we can really cut expenditures. I have introduced amendments to do so, too. I think there may be an inconsistency here if you indicate that we cannot solve this problem by deficits and we have to be concerned about them. If we can have an \$18 billion tax cut, even given a good multiplier and better tax collection, I do not see how we can avoid an immense deficit.

Mr. LIVINGSTON. There is a difference in concepts there, Senator. What I said is we cannot solve this problem by deficits. That is right; I still think so. Because every time you have a deficit you do tend to inflate the economic structure. You push up costs. When you push up costs with an inflexible price ceiling and a low rate of profit, you deter the incentive to innovate and experiment on the part of businessmen.

I am not trying to defend the businessman's rate of profit per se. As a matter of fact, just before the meeting started, Mr. Ruttenberg said, "Are you trying to agree with the NAM?" and I said, "Just as a stopped clock is right twice a day, so the cycle has swung around so that the NAM is finally right."

Mr. HAGEDORN. I think our record is a little better than that.

Mr. RUTTENBERG. I don't think it is even that good, George.

Mr. LIVINGSTON. I am not sure whether going down from 20 to 16 is right or going down from 20 to 18 is right. Obviously there has to be some measure of wisdom and common sense in doing this and working out the figures.

These were put down as goals, as something to strive for, and if the theory of the present mystique among economists is correct that

our problem is growth and if I am right that this is what is lacking and you get the economy really chortling at \$600 or \$650 billion GNP, then your taxes will roll in at these low rates.

We have quantified the economy in terms of the gross national product in terms of what might be accomplished if everybody were working. Then we said, "My gosh, everybody is not working; this is our lag; this is our failure."

Now, the quantification does not tell us anything about the economy at all. It is merely a description—a certain set of statistics based upon certain sets of assumptions made by our economists at Harvard, Michigan, or elsewhere.

What we all want to find out is why the dickens do we have this anemic performance. I think our anemic performance is in part because we are the leading nation in the world. I said that in my paper. We cannot expect to grow more rapidly until we get some new industry, something entirely new that revitalizes our economy and makes us want to spend.

Senator PROXMIER. Let me ask this: Why is this such an anemic performance? I think we can do better and there are all kinds of things to stimulate our economy in education and research. But actually 3.5 percent is substantial growth. We are by far the world's most developed nation. As you point out in your paper, you cannot compare us with Germany and Italy and France and it is ridiculous to do so.

They are going to grow faster in the next 10 years. They are bound to. They will also have worse inflation and so on.

But if you take the fact that we have grown at 3.5 percent and not try to compare it with this very high level, and then recognize that we are now moving into a very exciting period when we are emphasizing research so heavily—the amount of Government and private money going into research has been terrific, especially in the space effort—the consequences of this are likely to be a more dynamic economy than we have had in the past.

It seems to me the feeling of pessimism that persuades us in a time of relative prosperity that we need a substantial tax cut, varying from \$6 to \$18 billion, depending on the witness, it seems to me is committing our reserves when the situation does not justify it.

Mr. LIVINGSTON. I don't think our performance has been anemic. As a matter of fact, we have had an 8 percent increase in our total output of goods and services in the last year.

Our performance is only anemic in relation to what economists say we ought to do, in relation to the quantification of the full use of our resources.

I happen to believe, and I know this is hardhearted to say, that there are times when you have to have slack and when some people have to be unemployed. When you reduce carloadings on the railroads, the result is unemployment. When you use plastics instead of steel, it means that the steel companies do not sell as much steel.

This process is going on at a very rapid rate in this country. It may be this is the best possible performance we can get, except in my dealings and talking with business men I do know that the tax structure itself, because of the progressivity of the rates, and because of the gimmicks—gimmicks such as stock options for business executives

and capital gains rates. As long as it is more profitable to find out ways to save on taxes, I think you are taking away some of the best moneymaking minds from the actual production of goods and services.

This is all I am trying to say.

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

Representative CURTIS. I do want to say this, Mr. Livingston: I read your paper with great interest and what you have just said I could not agree with more. It is a theme I have been trying to preach for years, unsuccessfully, I might say, apparently.

Mr. LIVINGSTON. We are common spirits in that.

Representative CURTIS. We certainly are.

I have described our tax structure as like these pinball machines. There is more time spent getting into the 25 slot or zero slot than in ringing the bell in solving economic problems. That is why I want tax reform.

Mr. LANGUM, I was really interested in some of your charts and figures and this approach. I am going to do a lot of thinking about what you have here.

One of the points on chart 4, rate of return on net worth, this is something I have been after for some time.

Let me ask you this: This is First National City Bank data. How did they go about getting their net worth, because it is a difficult thing to get? Do you know how they computed this?

Mr. LANGUM. Yes; I believe so. They are using, of course, the balance sheet figures in the annual reports to shareholders of the companies.

In net worth or what they call sometimes net book assets, they have common stock equity.

Representative CURTIS. At what value?

Mr. LANGUM. At book value.

In addition, preferred stock. So it is total equity including both the common equity and the preferred stock equity and then they take the ratio of net income as reported to that total net worth.

Representative CURTIS. Would this net worth, do you think, be realistic? Suppose one of these corporations were sold and the net worth on the book was \$10 million, would it be apt to get a price of \$15?

Mr. LANGUM. I think for many successful corporations in recent years that in such a transaction the market price would be above the book figures. One way of looking at that is that the market prices of common stock typically for successful firms are far, far above book value per share.

Another way of looking at this and understanding it is that given the inflation that we have had, the book figures are recorded in dollars of different value. In other words, the basic unit of measurement has changed. So that if we sort of repriced net worth and expressed it in current dollars, that statement of net worth would be higher than the book figures and the rate of return would be lower.

Representative CURTIS. The reason I am so glad to get this much is that I have always looked at the figures of corporate profits, and I have been disturbed about the fact that they seemed to have leveled off.

I was even more disturbed because I felt that the profits as a percentage, the rate of return to the amount of money that had been plowed into that enterprise would be even lower.

Your chart here seems to indicate that it is not quite as bad as I had thought.

Mr. LANGUM. That is right. And not as bad as is frequently thought to be the case in many business circles. I do believe, as I said in my testimony, there is a profit squeeze. Businessmen are in a real hard race between cost and sales and in turn, between income and capital invested. But the historical figures, this decline from 1947 to 1961, just simply do not indicate the real profit situation.

Representative CURTIS. The other thing that relates to this is this business of turnover of capital assets and replacement. I had felt that post-World War II inflation, because of the impact of inflation on the corporate tax, had amounted to a capital levy.

I am not sure that it caused as much damage as I thought that it would. But if you follow what I mean, take the telephone company, they have a telephone pole that they put in the ground for a hundred dollars or whatever it is, then they replace it 10 years later and it costs \$200 for the same identical thing. They don't care about the dollar. They want the telephone pole in order to stay in business.

Let us take it another way, they would only be allowed to set aside \$100 on their depreciable asset and then they have to spend \$200. This means they would have to dig up another hundred somewhere else.

I have never seen a study in depth made of the impact of inflation on capital investment as it was affected through our tax structure.

I have felt that it has been a real one. I have seen it come out in this way. Where businessmen have come before the Ways and Means Committee and asked for the LIFO formula instead of FIFO on inventory.

I have never seen any studies made on the inflationary effect on depreciable capital assets comparable to inventory.

Mr. LANGUM. That is a very important point. Some studies have been made on that. I have made those myself in the case of numerous utilities and the American Accounting Association has formally prepared studies on this.

The problem has two aspects. First of all, without any doubt in my judgment after inflation, particularly in the earlier postwar years, that depreciation charges per books understated the cost of plant consumed, and hence overstated the reported profit figures.

That was widely noted at the time in business discussions of profits, and the point was quite right. Parenthetically now we should not use those overstated profits as a measure of where we ought to be.

The other part is this, however. Many corporations have had substantial retained earnings, and beyond that this major rise in depreciation accruals and hence cash flow. So that many corporations have been in this situation; I believe, that the reported earnings and the reported rate of return figures also were really overstated, particularly earlier in the postwar period. But they were not really hurt because the money was coming in, although stated in other forms, to cover the full cost of plant consumed and replaced, except for the point that the reported income was first taxed as income even though the costs were understated.

So it is a complex problem. There is no doubt that many firms, many utilities are in this situation, with heavy plant investment and low retained earnings.

There has been a real capital levy in effect.

Representative CURTIS. I appreciate that. There is one other point I wanted to make. I just want to throw it out. It seems to me there is an economic phenomenon occurring today and it has been gradually moving in, resulting from what I regard as very rapid technological advancement in our society which it seems to me is real growth.

There is where I differ with Mr. Livingston; this is not an economic situation. I refer to statistics which show that 25 percent of the goods and services on the market today available to the consumer were unknown 5 years ago, and things like that.

In this business of depreciation we set up our tax laws to relate to new machinery and equipment worn out. But the economic phenomena today is obsolescence rather than wearing out. This has been the underlying reason for these new schedules. We always used the term "useful life" in the tax law, but only a big company like the telephone company had the accountants and engineers who could come in to establish useful life that related to obsolescence.

The bulk of our industries never could get by the Bureau of Internal Revenue in getting their capital assets depreciated before they wore out.

The question I am coming to is this. I suspect that our capital assets turn over a lot more rapidly today than ever before.

Back in the 1920's or 1930's I suspect that when they built plants they could count on their being useful and available and not obsolete as compared to today—I was talking to Monsanto Chemical and I think my figures are right; they said that 90 percent of their sales today are of products that were not even in existence in 1950.

Knowing the kind of capital equipment necessary to produce chemicals the 1950 capital assets are largely junk. It is obsolete. Would you comment on that and also the general idea.

Are there studies being made into capital plant turnover today?

Mr. LANGUM. Yes; again that is an important point. We might look at it this way.

First of all, in terms of the key concepts. As I see it, the ultimate measurement of corporate profitability that encompasses all the factors is rate of return on total capital, total income available for capital in ratio to total debt and total preferred and total common equity.

That rate of return on total capital is determined in the first step by two other things. First, the overall profit margin. The ratio of that income available for capital to total corporate sales.

Second, by the turnover of that capital, by the ratio of sales to capital. In other words, a company could have and companies have had this, a lower profit margin but a higher turnover of capital in relation to sales with the two offsetting or more than offsetting so that the actual rate of return on invested capital is not impaired.

This matter of obsolescence, and more generally modernization and cost cutting in expenditures on plant and equipment by business is extremely important.

That is one of the reasons why I put in this little concept of net cash earnings and for other reasons as well, to point up the sheer financing of plant and equipment expenditures.

Many businesses are in this situation. They have to make new plant and equipment spending, not particularly for expansion of capacity but to keep alive, to keep in business. They have to keep spending on new plant and new techniques and new equipment to try to offset rising employment costs and hold unit costs down and yet these expenditures that are in a sense almost current costs are capitalized and not charged off on the income account.

We are up against some new situations here where old concepts are not quite the right ones. Certainly we need to know what we are saying when we talk about these concepts. So that the more rapid obsolescence of plant and equipment, the stepped-up pace of technological progress and also, I think, in a technical sense a greater rate of capital turnover are important factors.

Representative CURTIS. Thank you.

Senator PROXMIRE. I would like to ask Mr. Ruttenberg: You discuss the position of the Commission on Money and Credit and your own position.

Do I understand correctly that there were two or three basic proposals. One, to improve automatic stabilizers. Two, to provide for a greater discretionary fiscal opportunity for the administration.

Was there a third, a permanent tax reform?

Mr. RUTTENBERG. In the Commission report.

Senator PROXMIRE. Or would that be included in the automatic stabilizer?

Mr. RUTTENBERG. The Commission on Money and Credit carefully avoided going into the issue of the specifics of tax reform. But it does say, there is a very small part of its report which talks in general terms about the need for reform, the need for basic change.

They said that this was an area that went beyond the original assignment of the Commission and therefore, they would not go into it in detail.

Senator PROXMIRE. Is it your position that we need improvement in the automatic stabilizers such as unemployment compensation and social security as No. 1.

No. 2, I am sure that you advocate the provisions for stepped-up discretion for the President to provide public works and tax cuts at his discretion.

Mr. RUTTENBERG. Yes.

Senator PROXMIRE. And three, a basic permanent reduction in taxes; is that right?

Mr. RUTTENBERG. A basic permanent reform of the tax structure. I would not necessarily put it in terms of a net reduction in revenue.

Senator PROXMIRE. You are also calling for a quick, immediate reduction of \$5 or \$6 billion.

Mr. RUTTENBERG. Five billion dollars concentrated in one quarter which has an annual impact of substantially greater than that. For the short run.

Senator PROXMIRE. If you get into that, supposing Congress passed that to take effect September 1 for 3 months! Then business is good but it could be better. There are still 4½ or 5 percent of the work force unemployed. Congress is just going to have to stick with that, are they not?

Mr. RUTTENBERG. Stick with what?

Senator PROXMIRE. With the \$5 billion quarterly of \$20 billion annual tax reduction.

Mr. RUTTENBERG. Of course, as the proposal is, as I have made it and suggested, when Congress would reconvene on January 3, 4, or 5 of 1963, the tax rates that exist as of today would be back in existence then and the Congress would then take a fresh look at the problem. At that point in time I would hope that an emergency stabilizing type of tax cut would no longer be needed.

But at that point the Congress could take then a fresh longterm look at the problems which you have been interested in for many years, namely, the closing of tax loopholes, and the whole host of areas where through tax evasion and tax avoidance so that the income tax base against which these very high rates that everybody now professes to be against never apply.

People don't pay these rates. Anybody that pays these rates above 60 or 65 percent just has bad legal advice.

Senator PROXMIRE. Would this be a \$10 a week cut for every taxpayer in effect? Wasn't this the basic AFL-CIO proposal?

Mr. RUTTENBERG. This was the proposal.

Senator PROXMIRE. For 10 weeks?

Mr. RUTTENBERG. That is right. For a total of \$100.

Senator PROXMIRE. Have you made a Katona-type study or Gallup poll study to determine how much of this particular kind of tax cut, which is quite different, would be spent?

If somebody expects \$10 a week for 10 weeks they would be pretty foolish to buy a home or a car or to make any substantial purchase. There might be a tendency for many people to feel they better save it.

Mr. RUTTENBERG. It depends on what you are relating this type of a \$10 a week for 10 weeks tax cut to. If it is related to the kind of tax cut that Congresswoman Griffiths was talking about, namely, \$100 tax cut spent over 52 weeks, I dare say the impact upon the economy of a \$10 a week tax cut as I recommended as against an impact of \$2 a week tax cut would be considerably different.

I dare say that one of the important considerations in terms of a tax cut for stabilizing reasons, one of the important factors is that it ought to hit very hard and very quick at stimulating economic activity.

You don't do this by spreading \$1.50 or \$1.75 over 52 weeks.

Senator PROXMIRE. What happened with the veterans bonus that was paid after World War I?

Mr. RUTTENBERG. What happened to it? I was one of the participants in this in a State bonus in the State of Pennsylvania, my home, and I daresay I, like a lot of other GI's, spent it very quickly.

This was something that came to us in a one lump check.

Senator PROXMIRE. Was a study made so that we know what the overall effect was?

Mr. LIVINGSTON. There was a bump in spending.

Senator PROXMIRE. Was 75 percent spent within half a year?

Mr. RUTTENBERG. I don't think anybody can estimate this. It is very difficult. We can look at it this way. People with incomes generally in the neighborhood of \$5,000 to \$6,000 a year or less, gross income, tend, according to the survey of consumer finances, to spend more than they earn.

This is the sheer facts of life. As you get up to the people with incomes of \$50,000 or more, obviously they are saving substantially more.

Senator PROXMIRE. When you go into that a little, you find one of the reasons they do require steady income to buy is that every durable good they buy they buy on time.

Mr. RUTTENBERG. Certainly.

Senator PROXMIRE. Two-thirds or three-quarters of automobiles are bought on time. Every house is bought on time. When you are analyzing a hundred dollar tax cut, maybe they spend it but again, it is the kind of spending that would not have the same stimulation as some other kind of a tax cut.

Mr. RUTTENBERG. I am not so sure about that, Senator. If you had a \$10 a week tax cut for 10 weeks, it is conceivable to me that they would use it to pay off some indebtedness.

Senator PROXMIRE. Sure, that's exactly the point but then what happens?

Mr. RUTTENBERG. At which point they are then back into the same position that they have normally been in where they tend to spend more than they earn and they will now be able to commit themselves to expenditure for items that are substantially greater in amounts than the \$10 a week tax cut.

But because they have been able to pay off some of their indebtedness they are able to put themselves further into debt in terms of what the American system, it seems to me, has always done.

This is the sheer facts of life whether we like it or not. I think this is the way people live. They live from hand to mouth. They live to buy the things they want.

Senator PROXMIRE. Don't you think you would build up a tremendous popular insistence on continuing this benefit?

Mr. RUTTENBERG. In continuing the benefit?

Senator PROXMIRE. In continuing the lower tax rate. People who had their incomes increased this much, their take-home pay increased, temporarily.

Mr. RUTTENBERG. Obviously, if you cut their taxes to zero they would love to stay there continually.

Senator PROXMIRE. I am thinking of it in terms of politics. We have responsibility, practically all Members of Congress feel they have to eventually balance the budget and have some sense of responsibility toward meeting the expenditures and the rapidly rising expenditures we have.

If we are going to put ourselves in a position to have a \$5 billion tax cut in 3 months and confront the political reality of constituents who want it and need it then you better have it now. Today the tax cut is not popular on the basis of the surveys. But once you give it, try to take it away. That's likely to be something else.

Dr. Katona's survey conceded that taxpayers didn't want an income tax cut but a property tax cut. The Gallup poll indicated the same thing.

Mr. RUTTENBERG. It is not the province of the Congress of the United States to do anything about property taxes but it is in the income tax.

Senator PROXMIRE. Every single income group which received over \$3,000 a year in the Katona Poll opposed a tax cut. Those who had incomes of less than \$3,000 wanted a tax cut. I sent out and got documentation to show that two-thirds of those incomes under \$3,000 a year paid no income taxes.

What they do pay are property taxes or sales taxes or both and they want a property tax cut, or a sales tax cut. These are the kind of taxes they are talking about. The question was, would it be a good idea to have a tax cut or reduce taxes without specifying?

Mr. RUTTENBERG. Aren't we really begging the question, though. Maybe you disagree with the fundamental underlying concepts.

The underlying concept is that here is the American economy that started out early in 1962 with the expectation of having an annual rate of GNP of \$570 billion, having an annual GNP in the second quarter of 1962 of \$565 and \$570 billion.

Senator PROXMIRE. We failed to live up to our super expectations. But we had the biggest increase in the peacetime history of the Nation.

Mr. RUTTENBERG. But instead of getting to \$565 or \$570 billion we are at \$552. Instead of being on the way toward a 5-percent-or-less rate of unemployment by the end of 1962 we are on our way to a 6 percent or greater level of unemployment.

I say the issue is what does the Congress of the United States, what does the Executive do, faced with a situation in which at least 5.3 percent of the labor force in unemployed, where more than likely the rate of unemployment now is much closer, if you take the part-time job and turn it into the equivalent full-time employment, and take the failure of the labor force to grow, a rate of 4 percent, with plant lying idle, most industries are not booming. Faced with that problem we will either have a worse decline in economic activity or we might be able to inject discretionary fiscal policy, emergency tax cutting as a means of stimulating this activity.

I think this has to be separate and distinct from the longrun problem of the meeting the Government needs for expenditures which you and I and everybody else is for, I hope.

Better educational facilities: I think our economy can't adequately grow unless we do something about the shortage above high school level in education. We need to do many things in these areas.

This is no reason why we should use that as an excuse to let the economy drift further down into the doldrums in 1962.

Senator PROXMIRE. It is very interesting and entirely appropriate and proper that you are concerned with unemployment and I am deeply concerned with it. This has distorted our whole picture.

We have 5½ percent unemployed for 7 months. It is a very depressing statistic. But because of this, I would say this is the overwhelming reason we are talking about a tax cut today and have in recent weeks. I think what we have to recognize is that this is not the only approach. I think there are other approaches, including the supply side of the labor force.

I have said this before but I would say it again. A very large proportion of those unemployed are young people who can't get jobs because they don't have skills. One of the reasons is because they drop out of school, they leave school too early, and admittedly this is outside of the jurisdiction of the Federal Government.

I think we should persuade the States to lift the age of leaving schools, to provide education programs, to do what they can to prepare these young people for the jobs that are not filled now.

That is one aspect. This involves well over a million people who are unemployed and under 20. The second aspect as Chairman Heller told us, is that one of the reasons the work force had not grown, and it was the only specific reason he gave, was because of the earlier retirement period on social security.

They can now retire at 62 instead of 65. He didn't quantify this but I think there may be a substantial number involved. I can tell you from having gone to hundreds of plant gates in my State that this is something our working people want very much, an opportunity to retire at 60 but to do so they would have to accept a lower benefit.

You can't increase social security tax very much, I agree. It is very high now. There is no reason why they can't have the opportunity to retire earlier if they wish to do so.

These two things, I think, are one kind of approach to this situation. While recognizing that we have a terrific challenge from the Soviet Union we have to do all we can to build up our economy, we have not grown enough, that we have a long way to go, still I think we could constructively look at limiting our labor force.

I am not one of those who is ready to die when the labor unions say they are interested in a 35-hour week. I am against a 35-hour week. I think there is not much excuse for people working less than 40 hours. But there is nothing sacred about 40 hours.

We had a 60-hour week and a 48-hour week. If labor unions want to talk about it and negotiate down to 38 hours or 37 hours and gradually work toward a 35-hour week, if people choose leisure instead of higher income, I think this is a perfectly legitimate consideration.

The thing is that we have gotten frozen on the notion that we have to have virtually full employment of a labor force of people between the ages of 14 and 62 or 68, and we have not recognized that in the kind of mature and developed economy that we have with a terrifically strong surge of research and automation that it is perfectly possible for us to achieve wonderful growth and to continue to lead the world without being frozen in this labor force concept we have now.

Mr. RUTTENBERG. I can comment on this if time permits. I agree with you fully that we have a very serious problem of training our youth as they come up. We have a very serious problem of what to do about earlier retirement.

Obviously, I think people want to retire earlier. People are living longer than they used to. This creates the problem who assumes the responsibility for the leisure time of the individuals who retire at 60 or 62.

But aside from these problems, I would like to call your attention to the fact that if one looks at the labor force problems of the last 7 or 8 years, it is true that the number of individuals 14 to 19, their participation rate in the labor force has declined.

It is also true that the participation rate, the number of individuals 62 years of age and over has also declined in the labor force.

This is a partial explanation for the failure of the labor force to grow, but only a partial explanation. It has been my good fortune to be a member of the President's Committee to appraise employment

and unemployment statistics of which Dr. Gordon of the University of California is Chairman, in looking at this problem, the participation of the labor force between 20 and 62 has gone down.

Senator PROXMIRE. Including women?

Mr. RUTTENBERG. Including married women.

Senator PROXMIRE. Maybe from a value standpoint it is better that they stay in the home with their children in some cases.

Mr. RUTTENBERG. But the participation rates of males 20 to 62 has as well gone down over this period. If you take 1955 and come up to date. All I am saying is that the answer to the problem of the failure of the labor force to grow does not rest exclusively in the issue of the youth staying in school longer or the older folks retiring earlier.

Senator PROXMIRE. That is right. We have 3 percent of our married males out of work.

Mr. RUTTENBERG. 4.4 percent adult males.

Senator PROXMIRE. The figure I had was different. But it is too high whatever it is. I think it is something we should be concerned about. But it is far less than the overall unemployment number. I have just a couple of more questions to ask of the other gentleman.

I was delighted to see your statement, Mr. Ruttenberg, on page 7 that action to tighten money would simply destroy the beneficial effects of tax reductions.

I agree with you 100 percent. I think this is very useful. I think one definite thrust of at least part of us on this panel and these hearings has been to try to counteract the otherwise overwhelming tendency on the part of many economists, commentators, and leaders that what we need are lower taxes and higher interest rates.

You are putting on the brakes and stepping on the gas at the same time. Dr. Langum, your chart on page 6 shows that plant and equipment outlays in relationship to cash earnings have been dropping and dropping fairly steadily.

They are now the lowest in any year that you have listed here and perhaps the lowest in many, many years. This represents, in my judgment, a perfectly devastating case against the investment credit.

That proposal would open up a new loophole. Business doesn't seem to want it. Your figures show they don't need it. Your figures don't reflect the new depreciation revision which will increase the cash flow and decrease the ratio of plant and equipment outlays to cash earnings.

So it would seem to me on the basis of the statistics you have, the case for the investment credit is pretty hard to sustain.

Mr. LANGUM. I think we have to consider several things on this. It is true that the ratio of plant and equipment outlays to cash earnings has declined for some years and in the current recovery, plant and equipment has not kept pace with the rising cash flow.

Senator PROXMIRE. Do you have any very recent figure?

Mr. LANGUM. Not a recent figure in terms of this measurement. But when we consider what has happened to corporate profits, the total corporate profits after taxes in the first quarter of 1961 with 20.3 billion and with 25.6 billion in the first quarter of 1961, up a bit to about 26 in the second and third quarters.

Corresponding to that plant and equipment outlays have moved up but are lagging. In the first quarter of 1961, the SEC Commerce

series on plant equipment, was 33.9 billion and the estimated figure for the second quarter of 1962 was about 37 billion.

I think we have to look at these figures by years.

Senator PROXMIRE. McGraw-Hill estimated that they expected it to go up to 39 billion.

Mr. LIVINGSTON. Thirty-eight.

Senator PROXMIRE. Anyway, a relatively modest increase. In view of the billion and a half that is going to be an increment to the profit situation next year, it would seem that this ratio is going to drop further next year.

This investment credit proposal is very controversial. I think there is some chance we can beat it in the Senate. It seems to me you are giving us ammunition for it.

Mr. LANGUM. I think several things affect plant and equipment outlay decisions. One factor that does influence it is the amount of cash earnings. There is something else, too. That is the needs and views of business for additional capacity and equipment and the recent timing of corporate plant and equipment expenditures.

Senator PROXMIRE. McGraw-Hill after a survey found that this would only increase it \$300 million a year. The cost in lost revenues would be a billion dollars. The Wall Street Journal in a survey queried 68 of the biggest firms in the country and found only one that would change its investment policies because of this advantage.

Mr. LANGUM. I would give weight to those surveys. They are well done. However, there are other factors involved that tie into the particular point I was about to make.

In 1955 the American economy moved up sharply over the recession year of 1954 largely because of the automobiles and housing.

In 1956 and 1957 American business went on a major plant and equipment outlay spree. The fact is that was an era when some corporate executives got so enamored about growth in the economy that they were making speeches about GNP in 1975 and the year 2000 but forgot about the extremely important years they had to live in 1958, 1959, and 1960.

Business overdid it on plant and equipment spending in 1956-57. That was one of the reasons for the emergencies of overcapacity. So that having overdone it, these ratios are somewhat lower in more recent years, in my judgment, for that reason.

We are at this stage in time, it seems to me. We have had several years where the whole private durable sector in real terms has moved sideways. Plant and equipment, residential construction, consumer spending on automobiles and other durables.

This is without precedent in the history of our economy. I think that is partly because we overdid it in 1955 and 1956 and 1957. But now I think time is starting to be on our side. Things wear out and become obsolete.

I think we are in a situation on plant and equipment where businessmen, with some renewed confidence, with less worry about things they should not be worried about so much, with looking ahead to future markets and expansion of markets, I think we have the ingredients here for a spark for real expansion and growth.

In these circumstances, even though there is not the immediate comparative problem as you rightly point out from these figures, I

think both the depreciation reform and a tax cut are useful in adding to that spark and interesting businessmen.

I would venture the opinion, even though I highly respect those surveys and would give real weight to them, that surveys of businessmen, economists, and everybody else at times have been very wrong.

The surveys of businessmen about future plans in 1957 in terms of the general outlook of the economy were very wrong. I think at this stage many businessmen are a little too much concerned and too much worried and I think a spark, something that will light things up and get things moving in this area is desirable.

Senator PROXMIRE. They say this is not what they want. It is a giveaway. It means we have made another loophole in the law.

You can extend this to other persons. If you let corporations do this, why not let individuals do it, and so forth. The bill as it passed the Senate committee, as I understand it, even included furniture in motels as plant and equipment.

Mr. LIVINGSTON. Are newspapermen allowed to take credit for their typewriters?

Senator PROXMIRE. Maybe they ought to take credit for what ability they have. You know that wears out; they buy education and so forth.

Mr. LANGUM. It seems to me that the tax credit is desirable. I think that or any other proposal must be put in terms of proper perspective in a group of things or package of proposals.

I think certainly that basic tax reforms along the lines Mr. Livingston was talking about are very much more important than just a tax cut alone and certainly any hurry to cut taxes now because of an alleged recession.

Senator PROXMIRE. That was a Senate rollcall, so I have to go. Before I yield to Congressman Curtis, I did want to ask Dr. Hagedorn about his statement, if he could present a statement for the record of any studies on the exodus of capital because of a change in interest rates.

We have asked others who advocate this policy to prove it and they have not been able to do it. Statements by Chairman Martin and other economists indicate quite the contrary, that we are not and are unlikely to lose either gold or much capital as a result of a differential in interest rates.

Furthermore, and you can put this in the record later, isn't it a fool's errand to raise this country's interest rates, not only because of the facts adduced by Congressman Reuss but other countries have a reason to hike theirs and maintain the differential.

They have a shortage of labor. They have a serious inflationary problem. We have neither of those things. Their interest rates are bound to be higher. They also have less political stability than we have.

Finally, there is the argument that these countries have no incentive for bankrupting this country or creating a big drain of gold.

It is within the power of our Government to correct this adverse balance, because the basic cause for the adverse balance of payments is our foreign and military aid programs which help pull these other countries' chestnuts out of the fire.

It would be insane for any of these other countries that have these holdings to precipitate a run on this country under these circumstances, when we have our troops over there protecting them and giving them assistance including military assistance.

I can't see any expectation that there is a real threat that we are going to suffer seriously because of the balance of payments situation. I hate to ask and run but you can put your answer into the record.

I would appreciate it very, very much. You have made many able representations to this committee and others and I am sure if there is a good answer to this you may have it.

Mr. HAGEDORN. Before you do run, Senator, may I say I simply didn't want to say that this was an ominous threat hanging over our heads at this moment. I tried to choose language which would not create that impression.

I said, a situation of this type is not necessarily dangerous or inherently disastrous. I was simply pointing out that when you are in the situation of being a banker for other parts of the world that you don't have the degree of freedom that you have when you are not in that situation.

As I said in answer to Congressman Reuss, certainly I won't expect that we should look at all types of interest rates for all kinds of loans in all parts of the world and then take the largest of those figures and match that as the short-term interest rate.

Senator PROXMIRE. England, Holland, and Switzerland are all lower than ours.

Mr. HAGEDORN. Certainly you can't do it that mechanically. It is equally true that we can't forget about the necessity for maintaining some relationship between our interest rates and those abroad.

Perhaps I can clarify my position this way. I don't really think it is disastrous or ominous for us to have one deficit or even a series of deficits in our fiscal accounts. I don't think it is necessarily disastrous for us to have much easier money conditions for a short period.

What I think is dangerous is for us, in discussions of just this type, to come to the conclusion that the way to keep the country prosperous is always to turn to fiscal and monetary policy because that means we are going to turn to deficits to pull us out of whatever difficulties we have.

If we create that impression around the world and at home, that is the real danger. The real danger is that in meetings of this type we would come to that conclusion. That is what I have been trying to protest.

Senator PROXMIRE. I wish I could carry on. I have a 100 percent rollcall record so far and I am afraid I may lose it. Congressman Curtis will take over.

Representative CURTIS. Thank you very much, Senator, all I wanted to do was to pick up on the question of the civilian labor force which I think is one of the unique economic phenomena of today.

I have the tables back to 1929; 1962 will be the first time that the labor force in peacetime—the civilian labor force—has not increased.

As a matter of fact, since 1955 it has been increasing at the rate of a little less than a million a year. Before that period it had been increasing about 700,000. Even in the depression in the 1930's it continued to increase, although I want to put a caveat. One of the

staff tells me that before 1940 those figures are interpolations. But the figures that are put out by the Labor Department show a continued increase each year. This deserves real attention, I think.

In light of Senator Proxmire's speculation and also the speculation of Mr. Heller, I want to call attention to what is the cause of it. I regret to say that the figures do not indicate that it is in any particular age or sex group.

In the July 13, 1962, U.S. Department of Labor news in this table D, "Labor force participation rates, by age and sex, showing comparisons of second quarter averages from 1957 to 1962," shows the breakdown by age groups and by sex.

The very interesting thing is that there are two areas where there have been increases. One is "Female, 14 to 19." This is a real poser. Females from 55 to 64. That has been the biggest increase.

In every other bracket there has been a decrease. Every single one including the 25 to 54 male, which is the bulk of our work force declined from 97.2 to 97.1.

I had requested the chairman of the committee to have Dr. Ewan Clague as a witness next week, and he will be with us to go into some of this problem. He has reassured us that he has rechecked the methods of computing the employment and unemployment data and they have not changed and it is not in the compilation of these figures.

I raised the question, had someone been jockeying with the figures or had they changed their techniques. But apparently we have a new phenomenon that needs interpretation.

It has fallen on my shoulders to announce that we will adjourn and reconvene Monday morning at 10 o'clock and will hear the Central Director of the Banca del Lavoro of Rome and others and continue on Monday afternoon.

Thank you, gentlemen, for a very valuable contribution to our hearings.

(Whereupon, the committee recessed at 1 p.m., to reconvene Monday, August 13, 1962, at 10 a.m.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

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MONDAY, AUGUST 13, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, Griffiths, and Thomas B. Curtis; Senators Sparkman, Proxmire, and Bush.

Also present: Wm. Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

## PROCEEDINGS

Chairman PATMAN. The committee will please come to order. The committee has been engaged in a series of hearings on the state of the U.S. economy and on possible changes in policies of the U.S. Government, which would help us to achieve a higher rate of utilization of our labor force and our productive capacity, and also achieve a more rapid rate of economic growth.

Such improvements are desirable for obvious reasons. First, to raise the level of living of American families, many of whom have many unsatisfied needs and wants; and second, to be better able to help the underdeveloped nations of the free world, and to meet our other commitments to the defense and advancement of free and open societies.

Accordingly we would hope that any changes in policy or technique we might recommend, will be compatible with the economic policies of the other free world nations.

This morning we are honored to have with us a panel of distinguished experts from three European nations. Prof. Alan Day, professor of economics, London School of Economics, London, England; Dr. Ettore Lolli, executive vice president, Banca Nazionale del Lavoro, Rome, Italy; Prof. Jurg Niehans, professor of economics, University of Zurich, Switzerland.

We are happy to have you with us. Our usual procedure is to have each member of the panel make an opening statement. Then the members of the committee put questions to the panel. Each member is limited to a 10-minute questioning period, in rotation. The committee always invites free expression on the part of the witnesses and we do so now.

A panelist may reserve comment on any question asked. Our usual procedure, also, is to have the panelists begin in alphabetical order of

their names. Prof. Day, if you are ready, you may proceed in your own way.

**STATEMENT OF PROF. ALAN DAY, PROFESSOR OF ECONOMICS,  
LONDON SCHOOL OF ECONOMICS**

Mr. DAY. Mr. Chairman and gentlemen, I am very happy and honored to have this opportunity to appear before the Joint Economic Committee. In this statement, I propose to discuss the economic situation of the United States and, in particular, the implications of the present situation where economic activity appears to be slowing down at less than full employment levels, but with a continuing balance-of-payments problem.

Despite the immense wealth and prosperity of the United States, there have been, in the past decade, increasing signs of certain weaknesses in her economic position. None of these appears to be insoluble, and since some of them are somewhat similar to weaknesses that have existed in the British economy for an even longer period of time, it does seem that British experience can be helpful in the determination of the strategy of American economic policy.

It cannot, of course, be claimed that Britain has herself solved these problems, largely deriving from her early industrialization and from the widespread international use of her own national currency. But it is sensible to try to prevent the United States from making mistakes which have long caused difficulties for Britain.

In particular, I would like to mention two: The first is that of the complacency of a country which has led the world in industrial techniques and productivity—as Britain did in much of the 19th century and as the United States does now. This complacency tolerates a slow growth of productivity in comparison with other countries, such as Britain has tolerated through the 20th century and the United States is in danger of tolerating now. The second mistake is that of giving undue importance in the determination of economic policies to the maintenance of the international status of one's national currency. Repeatedly since the First World War, Britain has restrained domestic expansion in order to maintain international confidence in sterling. Until recently, the strength of the dollar has been such that no such problem has arisen for the United States. But now, the same problem has arisen here. The maintenance of the international use of one's national currency as a reserve and trading currency, in the way that sterling and dollars are used today, can impose significant restraints on a country's domestic freedom of action.

In the past decade, the U.S. economy has experienced a slower growth of industrial production and of industrial productivity per man-hour than any other major country, in either the Western World or the Soviet bloc—with a single exception, namely the United Kingdom. The growth which has taken place has been marked by a series of minor trade cycles.

It has been accompanied by a modest degree of inflation of consumer prices; the rise has been rather under 14 percent in 10 years, which is considerably slower than most European countries and indeed is probably not excessive in view of the failure of the index to take adequate account of quality improvements and in view of the almost inevitable

rise in the price of services as rising prosperity leads to rising wages. The American economy has, through most of the last decade, experienced relatively high levels of unemployment, which showed a trend increase through the decade. It is an unnecessary waste of national resources and probably an unnecessary cause of personal suffering, that even in the recent recovery, unemployment was still well over 5 percent of the labor force.

All of these domestic difficulties would almost certainly be relieved by a more expansionary domestic economic policy, designed to run the economy with an average level of unemployment somewhat nearer to those which are regarded as satisfactory in Western Europe. Perhaps an average of 3 to 3½ percent over the swing of the trade cycle might be regarded as a satisfactory target.

Such a policy would make considerably fuller use of the Nation's present productive resources. It would also make possible an increase in investment to increase future productive capacity at a higher rate—and by increasing present capacity utilization, it would make such an increase in investment attractive to businessmen.

If a faster growth of capacity can be achieved, the problem of the swing of the trade cycle would also be reduced. No country has solved the problem of achieving perfectly steady growth and it is probably inevitable that there should be some fluctuations from year to year, connected with things such as changes of inventories and the inability of economic forecasters to provide perfect forecasts to the policy-makers.

But European experience suggests that these fluctuations are much less disturbing if they take place around a rapidly rising trend than around a slow upward trend of production and incomes. If they are around a rapid trend, as has happened in most of the continental European countries, the periods of setback are merely periods of relatively slowly rising output; if they are around a slow trend, the setbacks involve longish periods of stagnation of output, as in Britain, or actual declines, as in the United States.

At the same time, there is little evidence to suggest that a reduction of the average level of unemployment of the magnitude recommended here would have a significant effect on the rate of inflation in the United States. There can, indeed, be no doubt that the rate of increase of money incomes does tend to be the greater, the nearer an economy such as ours is working to full capacity. But this effect is probably relatively weak until an economy is quite close to full capacity operation, as Britain's is, but that of the United States is not.

In its effect on price inflation, it would almost certainly be offset by the fact that a faster rate of growth of output would permit faster rises in money incomes without causing any increase in the rate of inflation.

In the immediate situation facing the United States, it is clear that the above analysis implies that deliberate policies designed to encourage an expansion of demand are justified now. There is no doubt that the economic expansion which started early last year has been disappointing, as is indicated by the July unemployment figure of 5.3 percent of the labor force. Still more disturbing are the numerous indicators which suggest that little further expansion of demand or output is likely during the rest of this year. At best, output seems

likely to level out again in the latter part of this year; quite conceivably, there may be another minor setback in late 1962 or early 1963.

In these circumstances, with output currently perhaps \$30 to \$40 billion below what could be produced with an unemployment rate of 3 to 4 percent, and with the clear prospect of a widening gap between actual output and potential full capacity output as potential output increases as a result of rising productivity and a rising labor force, the need is for a sharp expansionary stimulus.

The question remains of the form which this stimulus should take. It could either be introduced by monetary measures or by fiscal measures; the latter could take the form either of tax reductions or of increases in Government expenditures.

In the present situation where a substantial and quickly operating stimulus is needed, the choice should be for tax cuts. The effect of increases in Government spending would be slow to operate, because of the lengthy legislative and administrative procedures. It is doubtful whether monetary measures, such as interest rate reductions, could have as large an effect as seems to be necessary. The important need is to act in time. If action is delayed until a downturn has started, the necessary measures will have to be all the stronger.

And it is clear from British experience, where fiscal measures have been used on many occasions since the war to influence the domestic situation, that tax changes do have a marked and relatively rapid effect in altering expenditures particularly by consumers.

It, therefore, seems to me most unfortunate if no decision is taken to reduce taxes substantially and immediately. It would be unfortunate in terms of the American domestic situation. It would also be unfortunate for the rest of the world, whose economic growth and prosperity is closely dependent on that of the United States. There is evidence to suggest that, in present circumstances, the prices received by the underdeveloped countries for their own material exports show a tendency to fall, unless production in the advanced countries as a whole is rising at around 5 percent a year.

If American production, which accounts for about two-fifths of the total, stagnates or declines, it is most unlikely that this average of 5 percent can be achieved, since it would imply phenomenally rapid expansion in the other industrial countries. Rather, the effect of a slowdown in the United States would be to slow down growth of production in the other industrial countries.

Certainly, I should expect that a new setback to American expansion would greatly reduce the chances of expansionary policies in the United Kingdom, because of our heavy dependence on import earnings from the North American market. It seems clear, then, that if nothing is done domestically in the United States, the effect will be further declines in primary product prices and a new upset to the precarious payments position of the underdeveloped countries, together with a slowing down of industrial expansion in Western Europe.

None of this would be in the interests of the free world. We have learned to run our economic system well enough to disprove the Marxian thesis of the inevitable capitalist crisis; we must now learn to demonstrate that it is also wrong to suppose that our economic system suffers from chronic anemia.

There appear to be two main arguments against a decision to take this expansionary domestic measure in the United States. One of them is wholly illogical and unjustified; the other does possess a certain logic, but it is still bad. The first argument is that a budget deficit must be avoided at practically any cost. The second argument is that domestic expansion would further weaken the international position of the dollar.

The budget deficit argument is wholly unjustified. It is difficult to understand why it still has such a stronghold, except on those people for whom all Government expenditure is wholly bad. Other transactors, such as industrial firms, are perfectly willing to run budget deficits and to increase their debt if the purpose is worthwhile.

Equally, there is no reason why the whole of Government spending should come out of current Government income; after all, much of it is devoted to strengthening the future of the country's economy, by building roads, providing education, and acquiring technical knowledge on matters of defense. And when the effect of an increased budget deficit would be to increase total spending in the country and so to use the whole of the Nation's productive resources instead of leaving many of them underutilized, the effects of the outworn and irrelevant dogma of balanced budgets is wholly to the bad.

The correct rule is to insure that the budget deficit is not so large as to increase demand to the point where there is overstrain on the Nation's capacity to produce. Of that, there is no current danger.

The second argument against increasing domestic expenditure, income, and output is that of the danger to the balance of payments. This argument has a certain logic, but is still not defensible. It can be developed in four possible ways. One is that expansion would reduce international confidence in the dollar. The second is that one of the ways of inducing expansion, namely reduction of interest rates, would increase the net capital outflow from the United States. The third is that expansion would increase American exports prices, and reduce the competitiveness of American exports. The fourth is that expansion would increase American demand for imports.

The first line of argument—that about confidence—is of relevance in a world where many people are not as sophisticated as one might hope. There are, indeed, many people who would believe that a budget deficit in the United States automatically implies that the dollar is suspect. As has been argued, the question of whether or not to have a deficit depends not on dogma, but on circumstances. But while many people are not so enlightened as to see this, the right policy is to carry out the correct domestic policies and at the same time to take other steps, which I shall consider later, in order to restore confidence.

Let us turn to the second question, that of the effect of interest rate reductions on capital movements. It is, in fact, true that a cut in American interest rates would almost certainly increase the net capital outflow, and this is strong reinforcement to the argument that domestic expansion should be encouraged by tax cuts rather than interest rate cuts. Already, the general level of interest rates, particularly on short-term paper, can be seen to be low in the United States compared with Europe, if account is taken of the choices effectively open to commercial operators.

Admittedly, official discount and Treasury bill rates in several continental countries, for example, Germany, Switzerland, Netherlands, are lower than in the United States, although in Britain they are higher. But the official rates in these continental countries are not as accurate as a guide to market rates open to commercial operators as in the United States, or Britain. In some cases, for example, Germany, the official rates cover a very narrow and rather unrepresentative market, and rates on prime commercial paper are significantly higher than in the United States.

In another case, Switzerland, access to the domestic market is partly restricted for foreigners. A better guide to the relationship of American and European rates is provided by the active market in Eurodollars, which are a means by which North American funds can be loaned to Europe at higher rates than are available domestically in North America, and without exchange risk.

A large volume of funds has been attracted to Europe by the higher rates available there; it appears that the major American source has been from banks in centers, notably New York, with extensive international connections and that banks and firms in other centers have made little use of other facilities.

If they were more widely used, the strain on the U.S. payments position from an outflow of short-term capital might greatly increase, precisely because of the interest rate differential in favor of Europe. At least it seems that it would therefore be unwise to cut rates sharply in the United States, unless European rates fell sharply.

The international capital market is now so unified that no country can, while allowing effective freedom of capital movements, safely allow its interest rates to be far out of line with those in other major centers. Moreover, it seems likely that for some time ahead, shortage of capital will keep European rates relatively high. Indeed, purely on balance-of-payments grounds, there is a case for arguing that American rates should be raised.

I must hasten to add that I would not begin to recommend this as a policy. But this is one way of highlighting one of the major dilemmas of policy in our present international currency system. This system, which finally became established with the restoration of convertibility at the end of 1958, is a restoration of the gold standard as we knew it in the 1920's and before the First World War.

The rules of this system are simple. Each country maintains fixed exchange rates with all other members; except in extreme circumstances, exchange rate charges, beyond very narrow margins, are ruled out.

In order to maintain balance-of-payments equilibrium, those countries find themselves in payments deficit which deficit improves contractionary domestic policies, including high interest rates which also serve as a palliative to the payments deficit by attracting foreign funds. Countries in payments surplus should introduce expansionary domestic policies, even to the point of inducing a degree of price inflation, although this prescription is rarely emphasized by proponents of the gold standard.

The virtues of this system include the maintenance of stable exchange rates and the simplicity of the basic rules. Its major disadvantage, which is well exemplified by the present U.S. situation and

by repeated British experience, is that it may tend to a conflict between the requirements of domestic and international equilibrium. At the moment, domestic considerations suggest that American policy should be expansionary.

But the deficit in the balance of payments suggests that the right policy, under gold standard rules, is one of domestic contraction. The dilemma is emphasized if one considers what would happen if expansionary policies were taken, as suggested above, and demand were increased by, say \$30 billion a year. Some of this demand would take the form of a rise of imports; the net effect would be less than this direct effect because the extra demand for foreigners' goods would raise their prosperity and so increase their demand for American goods; but on balance there can be little doubt that the net effect would be a sharp deterioration of the U.S. balance of payments. And if it should happen, though this seems unlikely, that the domestic expansion led to a faster rate of price rises, then the situation would be made all the worse by the reduction in the competitiveness of American exports.

Here, then, lies the source of the present dilemma about policy. Ultimately, there may be a way out, if the competitors of the United States, and Britain, inflate faster than we do so that their exports become less competitive and our balances of payments improve. But, at best, this is likely to prove a fairly lengthy process.

It is the logical basis of current British policy and would be the only logical basis for an American decision to accept a new period of domestic stagnation or a renewed minor recession. The immediate effect of such a policy is a waste of unemployed resources. The longrun effect may also be that the deflation may inhibit investment and innovation and so reduce the potentialities for future growth and for future competitiveness in world markets.

Short of changing the rules of the game and developing an international financial system with greater exchange rate flexibility, which I would consider the most desirable policy, there are still a few things that can be done. Some are already being done with considerable effect, such as the steps taken to reduce Government expenditures overseas.

In addition, action might be taken more forcibly to restrain speculative pressures on the dollar during the period of payments weakness. For example, that part of the gold reserves which is now tied as currency backing might be released; the U.S. reserves are still very large by world standards, in relation to deficits, and it would be worthwhile to take measures such as this to emphasize the fact. Again, the present system of swap agreements, whereby the United States and other countries have agreed to hold stipulated amounts of one another's currencies, might usefully be expanded.

Beyond this, it is desirable to take steps to deal with two interrelated problems which greatly exacerbate the difficulties of working the present gold-standard system. One is the system's dependence on the two key currencies—dollars and sterling—which serve to act as a substitute for gold, of which the amounts available for use as intercontinental reserves is now quite inadequate, taken alone. The other difficulty is that of the overall shortage of international liquidity.

The main disadvantages of the key currency system are that it provides a particular inhibition to the policies of the countries whose currencies are so used, because the risks of speculative withdrawals of funds are so great, that the system is weakest precisely at the times when it needs most strength, namely when one of these major countries is in payments difficulties.

This happens because, at such time, confidence in one or other key currency is reduced, and there is a flight either into the other or into gold. A good deal could be done to reduce these difficulties, if the United States and the United Kingdom were, preferably jointly, to offer a gold guarantee on foreign balances held with them, to reduce the risk of speculative movements of funds.

Beyond this, there is a pressing need for a further creation of international currency. The strongest evidence in favor of this need is the fact that very few countries ever act in a way that suggests that they regard their reserves as excessive, so following the rules for surplus countries under the gold standard, while many countries act in a way which is dictated by what they regard as the inadequacy of their reserves.

Most of the burden of the deficit is thereby thrown on the deficit countries. In simple terms, there is just not enough internationally acceptable money to go around. As a result, a deflationary bias is introduced into the world economy, as by the restrictive domestic policies in Britain and the danger that expansionary policies will not be followed in the United States.

This is happening now, at a time when the world payments system is in a sense nearer to equilibrium than at any time since the war—there are now almost no large-scale surplus or deficit countries. The danger is that the equilibrium will be at an unnecessarily low level. All of which is reinforced by the tendency for an increasing amount of gold to disappear into private hoards, so reducing the available supply of international currency at a time when the need is for an increase.

The right answer is then to create an international reserve currency in adequate quantities. Many proposals have been made along these lines. In an attenuated form, they were to be found in the revision of the IMF in September 1961, but the improvements then made are already proving quite inadequate.

In the absence of an adequate and effective plan along such lines, in place of the present tendency for policies to drift toward a more rigid gold standard orthodoxy, the dilemma for American policy will in time become even more acute.

On the other hand, the United States may find itself sliding farther down the path which has been followed by Britain—that of repeatedly following policies of deflation in order to maintain the strength and prestige of sterling at a fixed exchange rate, with the long-run effect of holding back our economic progress and allowing ourselves to be overtaken industrially by rivals with no better natural resources than we possess.

On the other hand, the United States might find itself with no sensible alternative to causing unnecessary restraint on the growth of the economics of the Western World, than raising the price of gold and thereby increasing the supply of international currency.

If this painful choice is to be avoided, action must be taken very soon to create adequate supplies of a new reserve currency, to use that currency to replace the international use of sterling and dollars for reserves, and, preferably, to introduce a greater degree of exchange rate flexibility.

Chairman PATMAN. Thank you, sir.

Our next witness will be Dr. Lolli. Dr. Lolli, we are glad to have you, sir.

**STATEMENT OF ETTORE LOLLI, EXECUTIVE VICE PRESIDENT,  
BANCA NAZIONALE DEL LAVORO OF ITALY**

Mr. LOLLI. Mr. Chairman, members of the committee, it is a proof of the existing international cooperation that the United States, the outstanding teacher and example of economic growth and full employment, should now be asking some of its pupils and followers in Europe, to tell the United States what was so recently learned from it.

It is with humility, and as an act of appreciation for all that you did so generously to help us effectively, that I will try briefly to return a little of what we learned:

1. The difference in basic resources, stages of development, industrial organization, and other key factors between the United States and Europe are so great as to make their problems of economic growth fundamentally different.

A higher rate of growth can be achieved more easily if the starting level is lower; and so in the European countries, either destroyed by war or not so highly developed, industrially and economically, as the United States, it was relatively easier to achieve a higher rate of growth in the postwar years. But to the extent that there are some basic common factors I will try to mention them.

2. First, it must be clearly understood that after a certain stage of economic development in a so-called affluent society the problem is not of output, but of disposal of output.

The action of the Government, therefore, should aim not at increasing output but at disposing of a naturally increasing output.

As far as personal consumption goods are concerned, the Government cannot do much. Food consumption and durable and non-durable consumer-goods consumption has reached in the United States such levels that they practically cannot be increased further (except of course, inasmuch as population increases).

The Government might buy surplus production and distribute it abroad (as is done in a certain measure for food) but this is only a negligible palliative.

The Government's action, then, should be directed toward the disposal of the output of investment goods. This can be done by financing better housing, better roads, better schools, better public transport, better health services, and so forth.

This means, physically, a shift of employment patterns from output producing employment to output consuming employment.

3. The picture seems clear from a physical point of view. But what is to be done practically, in terms of monetary and fiscal policy?

I do not think that one should be afraid of a budget deficit within certain limits and provided that it is financed from savings with little resort to bank credit.

In the conditions described above, which are the U.S. conditions at present, the danger is not inflation, but deflation, in spite of any contrary appearance.

The immense productive capacity of U.S. industry lies, at the moment, for a large part idle because it is geared to produce goods whose supply is already abundant. The Government should help to deblock this situation by starting a large program of output consuming activities, even at the cost of a budget deficit, at the beginning. Later this deficit will be reduced or disappear automatically, as increased economic activity will bring in large revenues.

4. However, by so doing, the international position of the dollar, already weak, might be weakened even more. So one must turn now to this other aspect of the problem and if possible find a way of separating the effects of domestic fiscal policy from the international position of the dollar.

5. The dollar at present is weak on the international markets. This is a fact. But why is the dollar weak? Is its weakness justified?

In my opinion the weakness of the dollar is entirely artificial and stems exclusively from the fact that, in spite of any denials, many people believe that the dollar price for gold can and may be raised.

In this country I know that every President and administration since 1934 has said that without an act of Congress your price of gold cannot be changed and that they were all against a change in the price of gold.

In the minds of people who deal in your dollars the risk does exist. They feel that if you do not change the price of gold you may refuse to exchange gold for dollars. Many of those who hold your dollars feel that history teaches that all devaluations have been officially denied up to the last moment.

So denials are useless and perhaps even have a contrary effect. Since, on the other hand, there is no risk that the price of gold will be reduced by you below \$35 an ounce, it is natural that people should tend continuously to change some of their dollars into gold.

If this is true, the only way to strengthen the dollar is to dispel as definitely as possible, by some deeds, rather than mere denials, the fear that there will be an increase in the price of gold.

Until this fear about the increase of gold is definitely dispelled, any other attempt to correct the balance-of-payments situation will probably remain unsuccessful.

What could be done then? We must distinguish at this point the possibility of a devaluation of the dollar against all other currencies from the possibility of a general increase in the price of gold, leaving the exchange rates between currencies unchanged.

The first case, the devaluation of the dollar against all other currencies, is very unlikely to happen as a devaluation of the dollar would be followed almost automatically by similar devaluations of all other currencies.

However, even if we assume that it could happen and the United States were prepared to guarantee the present exchange rate to the foreign holders of dollars, this would not solve the problem. For it

would not eliminate the relative disadvantage of holding dollars in the (more likely) case of a general increase in the price of gold.

To dispel entirely and definitely the pressure on the dollar of the fears of a general increase in the price of gold, the United States should, in some practical way, guarantee the gold price of the foreign holdings of dollars.

There are several ways in which this could be done, and I submit, as an example, for your consideration the following way:

(a) The U.S. declares itself prepared to exchange foreign dollars, official and private, into special gold certificates for any amount, practically as it does now;

(b) The release of these special gold certificates, however, would not mean, as at present, a legal transfer of gold from the United States to the foreign buyer and therefore a decrease in the gold stock of the United States, but merely a legal promise by the U.S. Treasury, to buy them back for dollars at any moment, at the price of gold at the time of the purchase back by your Treasury.

Thus, for instance, if the price of gold were doubled, those certificates which could not in any case be changed into gold, would be, however, worth twice as much in dollars; and

(c) These gold certificates would, of course, not carry any interest.

6. What would be the cost of such a guarantee for the United States? None at all, and perhaps it could result in a net gain.

At present, official dollar holdings outside the United States amount to about \$11 billion; probably a little more. These figures are 1 or 2 months old. And another \$5 billion are held by private foreign banks.

In total, the dollar holdings outside the United States amount to about \$16 or \$18 billion. If all these dollars were converted into special gold certificates and then the price of gold were raised by 50 percent, the maximum cost of the guarantee for the United States would be \$8 billion, or less than 1.5 percent of the GNP.

But, of course, apart from the fact that the value of the gold held by the United States would be higher, foreign dollar holdings would never be entirely converted into special gold certificates, and anyway, if the United States really means to keep unchanged the price of gold, the guarantees would cost absolutely nothing.

It would, on the contrary, yield a profit, as dollar balances bear interest, whereas the special gold certificates would not carry any interest.

This proposed solution is not, of course, a panacea, but something for you to consider in dealing with the problem of confidence; and that is primarily the psychological and practical problem of the international position of the dollar.

In many ways gold is a symbol, and if that symbol can be effectively used more correctly to mirror the mighty strength of the United States and to restore confidence in that strength, I think it should be done not only for the good of your people, but for your close and loyal friends as well.

(Mr. Lolli submitted on August 22 a supplementary statement, which appears in the appendix at p. 982.)

Chairman PATMAN. Thank you, sir.

Prof. Jurg Niehans, professor of economics, University of Zurich, Switzerland. We are glad to have you, sir. You may proceed in your own way.

**STATEMENT OF JURG NIEHANS, PROFESSOR OF ECONOMICS,  
UNIVERSITY OF ZURICH, SWITZERLAND**

Mr. NIEHANS. Mr. Chairman, it was with some hesitation that I accepted the invitation to comment on the state of the U.S. economy for my great respect for my American fellow economists makes it difficult for me to believe that I have to offer anything which they could not offer as well and perhaps better.

In any case, I shall concentrate on one or two aspects of the problem in which I can hope to have perhaps a fair chance to have some comparative advantage.

The American economy today has two overriding problems; one is the unsatisfactory rate of economic growth, the other is the deficit in the balance of payments, and the shaken confidence in the dollar.

None of these problems can be really solved without regard to the other. Whatever is done to balance international payments, there will be no confidence in the dollar if the domestic economy is stagnant.

If, on the other hand, domestic economic policy is at the expense of confidence in the dollar, the present international economic system would eventually collapse with dire consequences, for all Western economies, including the American one.

Unfortunately, the two ills have opposite cures. The classical prescriptions for stimulating the domestic economy would be easy money and easy taxes, implying possibly a budget deficit. The classical balance-of-payments policy, however, would be tight money and a stiff budget.

In such a dilemma there is obviously no perfect solution. The task of the policymaker is to devise an optimal compromise.

**THE DIMINISHING AVAILABILITY OF MONETARY POLICY FOR DOMESTIC PURPOSES**

The early 1950's witnessed a remarkable revival of monetary policy for domestic purposes, be it to combat inflation or to stimulate business. However, when most European currencies became convertible at the end of 1958, things began to change.

Capital was now moving freely from one country to another. Any tightening or easing of credit conditions for domestic purposes thus called forth large capital flows. When in 1960 Germany tried to restrict internal demand by tight money and high interest, she was at once faced with such an influx of foreign money that the hoped-for effects were largely nullified and she had to abandon the policy.

European countries were thus forced to recognize that under present conditions the scope of monetary and credit policy for internal purposes is very limited. A system of free international exchange and capital movements seems to be incompatible with primary reliance on monetary instruments to combat inflation or stagnation. I believe this experience is relevant for the American economy, too.

**THE CHOICE OF AN OPTIMAL STRATEGY**

**Under these circumstances the most promising strategy seems to be as follows:**

Concentrate your monetary weapons on the balance-of-payments problem and take care of domestic problems, if necessary, by fiscal and possibly other measures. If monetary policy is, so to say, mortgaged to the international problems, the logical answer would be a revival of fiscal policy for domestic purposes.

This seems to be recognized by a growing number of international observers. There is a problem of timing, too.

The balance-of-payments deficit is an immediate, and, in view of the surplus on current account, I hope a short-term problem. Stimulating the rate of economic growth, on the other hand, is a long-term proposition and the threat of real depression still seems to be potential rather than actual.

A promising strategy would thus consist, I feel, in fighting, first, a rather short but decisive battle on the external front by restoring international confidence in the dollar. Success on this front will then free forces for the domestic front where the struggle might take much longer.

#### INTEREST RATES

Such a policy would require somewhat higher interest rates, both on long and on short term, perhaps not for very long but for a certain time. The effects of higher interest rates seem to come in two stages.

The immediate effect is mainly on the balance of payments; European experience seems to show that this effect is quite prompt and strong. This is partly because in a free market money, particularly bank money, goes where it earns the most.

At least as important, however, is the psychological effect, for a tightening of money is taken as a sign that one means business and thus helps to restore confidence. At the moment I am under the impression that it will be very difficult to say the least, to stop the international drain on the dollar without a certain, if perhaps modest, rise in interest rates.

There is, it is true, a second stage where credit restrictions begin to affect domestic demand for commodities, particular housing. In Switzerland this effect of credit conditions on construction activity could be observed quite clearly and I do not want to minimize it. But this effect takes several months, perhaps a year, to be felt, and it could, in principle, be neutralized by appropriate fiscal measures, if necessary.

An effective restoration of confidence in the dollar by a temporary tightening of money may even make it easier to maintain moderate interest rates in the long run.

#### THE QUESTION OF ALTERNATIVES TO HIGHER INTEREST RATES

Isn't it possible, it may be asked, to solve the present problems without resorting to dearer money, even in the short run? Theoretically there is, of course, the possibility of a devaluation of the dollar. It seems to be generally agreed, however, that this is not a practical solution. In fact, it would be the ultimate expression of the failure to find a solution.

Since in all probability most other currencies would follow suit, there will be no net gain for the dollar. While in some limited sense devaluation would increase international liquidity by making gold do

double duty, so to say, it would at the same time reduce liquidity by robbing foreign exchange, including the dollar, of its quality as currency reserves.

Going for a moment beyond strict economics, it could probably be said that it would considerably weaken U.S. international leadership, in general.

Fortunately, there are other ways to reduce the required increase of interest rates. In general, it must be recognized that international capital flows do not depend just on interest rates, but on interest rates plus the state of confidence in the currency concerned.

If this confidence is high, a country may be able to sustain very low rates, thus Switzerland probably has about the lowest interest rates anywhere.

If, on the other hand, this confidence is shaken, even rather high interest rates may be insufficient to stabilize capital flows. In fact, some of the money the United States has been losing in recent months was going to a country with even lower rates, that is, Switzerland. Conversely, Germany found in 1960-61 that low rates did not stop the influx of foreign money.

The most effective alternative to undesirably high interest rates, thus, is restoring confidence in the dollar. I cannot go into all aspects of this problem here. In particular, I do not want to comment on the possibilities of further reducing military and other assistance or of making it conditional on purchases in the United States.

While in a state of confidence in the dollar, it may even be desirable for the United States to maintain a moderate deficit in her balance of payments in order to supply dollar reserves to the rest of the world, for the time being the deficit should be eliminated as far as possible. My following remarks will focus on two specific points.

#### EXCHANGE GUARANTEES BETWEEN CENTRAL BANKS

In past months central banks have been very active, bold and imaginative in devising new ways and means of assisting each other. Among these arrangements the recent dollar-franc swap between the Federal Reserve Bank of New York and the Swiss National Bank is of particular significance in this context.

On the surface it looks highly complicated and technical indeed. But the basic idea is quite simple and as far as I can see, it has not found the attention it deserves. It consists, in fact, in creating a new type of dollar, that is, dollars free from exchange risk. This means that 50 millions of "normal dollars" in the hands of the Swiss National Bank are replaced by the same amount of dollars carrying no exchange risk.

The Swiss commercial banks, in turn, have shown by their action that they are quite willing to take over these risk-free dollars at interest rates at which they could not be induced to hold the "normal dollars."

This operation killed two birds at one stroke: On the American side it prevented a further loss of gold because Switzerland is now willing to hold more dollars. On the other hand, liquidity in the Swiss market could be reduced because the Swiss banks are now holding U.S. Treasury bills instead of central bank deposits.

The present operation is limited in scope, though. It cannot be easily enlarged indefinitely. It shows, however, that the idea of exchange rate guarantees between central banks should be given very serious thought.

Central banks, in general, are loath to expose their reserves to exchange risks except perhaps in common emergencies. This is true for the Federal Reserve as well as for European central banks. As soon as confidence in a currency becomes doubtful they will withdraw from it. If central banks under the gold exchange standard are expected to hold each other's currencies, ways and means must be found to eliminate the exchange risk.

If central banks go on in their present imaginative spirit, I do not doubt that suitable techniques could be developed.

I personally feel, with respect to the gold certificates which were mentioned before, that such techniques may be an essential prerequisite for the continued functioning of the gold exchange standard. At the same time they will permit United States to balance her accounts at somewhat lower rates of interest than would otherwise be required.

#### POSSIBLE LIMITATIONS OF ACCESS TO U.S. CREDIT MARKETS

The second point has to do with possible limitations of access of foreign borrowers to the U.S. credit markets. One of the bigger drains on American reserves, amounting to hundreds of millions of dollars in the first half of 1962, is from foreign bonds issued in the United States.

At present, access to this market is perfectly free. Foreign borrowers were repeatedly urged to develop their own facilities instead of having recourse to New York, but gentle admonition does not always seem to be effective enough.

Now it is true that any form of exchange control or any lapse from convertibility would do much more harm than good to international confidence in the dollar. There are, however, certain ways of restricting access of foreign borrowers to credit markets which are usually considered to be entirely compatible with free exchanges and full convertibility.

I am sure nobody would accuse Switzerland of practicing exchange control. Still under present banking legislation all foreign bond issues and similar transactions of more than 10 million Swiss francs have to be submitted to the central bank.

The central bank may refuse approval depending on the state of the credit market, of international payments, and of the economic situation as a whole. In general, the national bank exercises this control in a rather gentle way in close cooperation with commercial banks.

Restrictions take the form of a stretching out or spacing of planned issues over a longer period rather than of an absolute veto. On the whole, this arrangement is now working to the satisfaction of all parties concerned for almost three decades, even if there may be occasional differences of opinion in individual cases.

It is agreed to be one of the most useful instruments of Swiss credit policy. It might be worth while thinking about the possibility of

applying something of this sort to the American credit market, too. Some people's confidence, it is true, may be further disturbed by such a measure. Against this risk, however, must be held the great gain in confidence which can be expected from some temporary restriction of long-term capital outflows in times of strain.

In a widely publicized statement one of the directors of the Swiss National Bank recently remarked that if this kind of an arrangement had been in operation in the United States, we would today have a worldwide dollar shortage. It may well turn out that in the long run it would not only be compatible with free exchange but even its prerequisite.

At the moment the prospect of a forceful policy to restore confidence in the dollar seems to be good. The current balance of payment continues to show a considerable surplus. Prices and wages in Europe have risen fast and thus the American economy has gained in competitive strength.

Though I would refuse to predict it, I would not be surprised if in the months to come the tide could be turned in favor of the dollar. It may well be that the American troubles of today are the European problems of tomorrow.

Confidence in the dollar cannot be restored by words only. Certainly strong statements on the maintenance of the present dollar parity are more effective than weak statements. But the effect of even the strongest statement will fade away within a couple of weeks unless it is supported by forceful action.

If such action is taken, perhaps by combining the required credit restraint with certain fiscal concessions, there seems to be a fair chance that within a matter of months, thanks to restored confidence in the dollar, the United States can afford to give much more potent stimulus to domestic economic growth than if the present situation is permitted to drag.

Chairman **PATMAN**. Thank you, gentlemen. Your statements have been most constructive. It is interesting that Mr. Lolli and Professor Niehans, have both suggested a way of assuring confidence in the dollar and have both made the same suggestion; and Professor Day, I believe you also made essentially the same suggestion.

Mr. Lolli, your suggestion is that we issue a certificate to foreign central banks which would guarantee the gold content of the dollars they hold. In other words, as I understand it, you feel that notwithstanding the fact that the U.S. Government has no intention of devaluing the dollar, a lot of people in Europe feel that the dollar may be devalued anyway, and that is the source of the trouble.

Your suggestion is, I believe, that our Government issue to foreign central banks a certificate which would guarantee that if we do raise the price of gold the certificate would be redeemed at any time in new dollars, equivalent in value to the old dollars.

Then you feel that such certificates should be issued without interest. Professor Niehans' suggestion is the same but you feel, I believe, that such certificates might be issued to bear a small rate of interest. You mention also that this has already been done in one case where we made a contract with the Central Bank of Switzerland.

**When was that?**

**Mr. NIEHANS**. About 3 weeks ago.

Chairman PATMAN. Professor Niehans, do you know if that contract contains a two-way guarantee?

Mr. NIEHANS. Yes.

Chairman PATMAN. It does?

Mr. NIEHANS. Yes.

Chairman PATMAN. That is, should the Swiss franc be devalued those francs which we hold would be convertible at the old rates?

Mr. NIEHANS. That is right.

Chairman PATMAN. The suggestion you have made appeals to me very much. Later this week we will have Secretary Dillon here before our committee and also Mr. Martin, the Chairman of the Federal Reserve Board of Governors, and Mr. Hayes, president of the New York Federal Reserve Bank.

We will ask them about this suggestion of yours and if they agree to it, it would be my prediction that they would have no difficulty obtaining whatever legislation might be needed to put the suggestion into effect.

The problem of the trading nations, as I see it, is to create enough acceptable money to permit us to carry on the volume of business which our increased productivity makes possible. I am not even sure that it is correct to say that the United States has a deficit in the balance of payments.

Historically, a nation was considered to have a deficit in its balance of payments, only if it was going into debt to other countries on the basis of its trade balance, and that is not our problem. Our assets abroad are a great deal more than our liabilities to foreigners, and our assets are still growing more rapidly than our liabilities, but we are like a commercial bank that has to maintain sufficient liquidity, Mr. Lolli, don't you agree?

Mr. LOLLI. Yes, sir.

Chairman PATMAN. The problem is that, whereas our assets are long term, our liabilities are short term, like demand deposits. If we devalued the dollar we would not gain anything. We would be canceling a debt owed to us which is payable in dollars. Since the dollar is so widely used as reserve currency, if we did devalue the dollar then the other countries would devalue the currency.

So there would be nothing to gain for anybody except possibly the Russians who hold a lot of gold. Mr. Lolli, let me ask you a question or two about another subject. The Central Bank in Italy, is that publicly owned and is it recognized to be publicly owned?

Mr. LOLLI. Yes.

Chairman PATMAN. In other words, the private commercial bankers do not operate it?

Mr. LOLLI. No.

Chairman PATMAN. And do not fix policy?

Mr. LOLLI. No.

Chairman PATMAN. How about Switzerland?

Mr. NIEHANS. It is a mixed corporation in which the Government has a dominant influence but it is not influenced by private bankers.

Chairman PATMAN. It is not influenced by private bankers?

Mr. LOLLI. You asked me about the Bank of Italy. The Bank of Italy is the Central Bank and I said yes. You are not referring to the commercial banks?

Chairman PATMAN. I am talking about the central bank like our Federal Reserve. Compare the Bank of England.

Mr. DAY. The Bank of England is nationally owned.

Chairman PATMAN. Do you know any country in the world where the central bank authorities have as much power as they have in the United States?

Mr. DAY. I doubt whether we have in England. I don't know of any other that is comparable with the Federal Reserve.

Chairman PATMAN. What about you, Dr. Niehans?

Mr. NIEHANS. I wouldn't have a specific comment.

Mr. LOLLI. I would say the Central Bank of Italy has similar powers to the powers of the Federal Reserve Bank.

Chairman PATMAN. Does any other central bank in the world have as much power as the central banks of England and the United States?

Mr. LOLLI. I would not be able to answer. In Italy the Central Bank has, I think, almost the same powers.

Chairman PATMAN. What about the independence of the banks from the government? Your bank is publicly owned. It is directly connected with the government.

Mr. LOLLI. It is in the sense that the government, take the crisis that happened in 1929 or 1930, has the majority of the capital of all major Italian banks. But as a matter of policy the government does not interfere in any way with the operation of the commercial banks. We are only under the control of the central bank the same way as the commercial banks in the United States are under the control of the Federal Reserve.

Chairman PATMAN. I would like to ask each one of you to briefly answer this question, if you please.

We have a bill pending. It has been reported by the House Banking and Currency Committee, to provide higher interest rates for foreign accounts.

Do you believe that will be of substantial help in our difficulty?

Mr. LOLLI. Personally, no.

Mr. NIEHANS. I don't believe in interference in the interest rate structure. It might help on the short-term, but it is not a fundamental remedy.

Mr. DAY. I believe it might have some effect, but I think it would be extremely difficult in practice to separate foreign-held accounts from domestically held accounts.

Chairman PATMAN. This would only apply to the central bank accounts?

Mr. DAY. For central bank accounts I can see this working quite successfully, although I would prefer the idea of the gold exchange guarantee.

Mr. LOLLI. May I comment? My answer "No" was based specifically on the fact that all major New York banks and all major American banks, I would say, have branches in Europe and in London, particularly, where they are free to pay any interest that they want. So they are in a competitive position, if they want to be, with any other European bank.

They don't need any specific legislation to pay a higher rate if they want. As far as I know, they are not paying now, for long-term

money, for 1-year money, let us say, the maximum which is allowed by regulation "Q."

Chairman PATMAN. Much of our gold has been distributed to other countries of the world during the last few years.

Has that been good for the countries of the world and good for the United States, or has it been harmful?

Mr. LOLLIE. Personally, I think it is good for the European countries to have a strong dollar. Anything which is weakening the dollar is bad for the European economy in general.

Chairman PATMAN. That helped us as well as the other countries.

Mr. LOLLIE. It did not help, I would say. It weakened the dollar. The fact that the gold reserves of the United States are now at \$16 billion, only \$4 billion from the minimum of \$12 billion which, by legislation, is considered the minimum available for currency coverage, I think is a dangerous situation; not because the dollar is weak in its substance, but because any time that the newspapers publish in Europe, and every newspaper publishes it, that the U.S. Treasury has lost \$50 million of gold or \$60 million of gold, the confidence declines.

It is unjustified.

Chairman PATMAN. It is psychological.

Mr. LOLLIE. It is a psychological crisis. Something should be done to restore the confidence, and to have faith in the dollar.

Chairman PATMAN. What about you, Dr. Niehans?

Mr. NIEHANS. I think a certain limited redistribution of gold was to everybody's advantage. I think it went too far in part for the reasons mentioned by Mr. Lolli. In part, also, because some European countries were quite embarrassed to get this influx of gold. As far as Switzerland is concerned, we would like to have somewhat less. We have to find ways and means to deal with excessive domestic liquidity.

Chairman PATMAN. What about you, Mr. Day, would you like to comment?

Mr. DAY. I would broadly agree with Mr. Niehans. I think the redistribution of the gold and the decrease in the dollar liabilities of the United States was, for many years after the war, to the benefit of the United States and the rest of the world economy.

But the limit of this redistribution has been reached and probably passed. Our need now is for some other way of increasing the reserves of the rest of the world—some way other than acquiring gold from the United States.

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

Representative CURTIS. Thank you, Mr. Chairman. Let me join the chairman in his remarks of appreciation to you gentlemen for your very fine papers and stimulating discussion.

I was very interested in seeing this dilemma posed to us. I agree that one horn does exist, the balance-of-payments problem. But the way I see our way off the other horn of the dilemma is that it does not exist. We have a very strong economy. I think it is growing, and growing rapidly.

But I think we have been missing the ways one measures the growth of an economy such as ours. I was particularly interested, Mr. Lolli, in your paper where you make this one point, among others.

The immense productive capacity of the U.S. industry lies, at the moment, for a large part, idle because it is geared to produce goods whose supply is already abundant.

I could not agree with you more. I would likewise say this relates to the skills of our labor force and lies underneath the unemployment.

You then go on to say that the Government should help to deblock this situation by starting large programs of output consumption activities.

I don't know that the Government needs to do that because I think if we examine our economy and look at the right indicators, we will see that is exactly what has been going on. It doesn't show up, I might say, in the gross national product, which is the usual indicator that is used to measure economic growth because a good bit of this shows up in increased leisure time.

It shows up in the increased amount of time, the ordinary American spends in education and in training. It shows up in the shift in employment from manufacturing to services. We see that in the employment and distribution services. We see it in our employment figures. We see it in the shift in the manufacturing sector from blue collar workers to white collar workers.

Actually, our employment in manufacturing has been declining, although our production has been increasing. Within the manufacturing sector of employment the blue collar is the one where the real decline is, while there has been a slight increase of white collar.

There has been a real shift of employment into services and distribution. We likewise see traditional inflation in the price indicator in the field of services. The health field is one.

We also see, which we don't have any measurement for and we should have, the jobs that are going begging in the United States. The jobs we can't fill because we don't have the skills. I estimate about 900,000 jobs are going begging right now in the health field, doctors, hospital technicians, and so forth, social workers, teachers, and so on.

So I do believe that a good bit of the difficulty lies in the fact that our own American economists have not been looking at the right indicators, and have not analyzed this.

They have been the very ones who have been talking about U.S. economy being tired and sluggish. I don't believe that this is true. It is not the thesis that I would advance.

There are so many things that indicate that this is not so. To me another test—and the thing I would think is important to look at as to whether an economy is really growing—what is the amount of new goods and services that are available to the consumer in the year 1962, let us say, compared to 1957.

We have testimony, although we don't have adequate statistics, that what statistics there are indicate 25 percent of the goods and services available to the American consumer were unknown 5 years ago.

We can see it in an individual company, Monsanto Chemical, one of our biggest. I happen to know it because it is in my district. Ninety percent of their dollar sales are products that 10 years ago they were not even manufacturing.

I see the indicators, as best we can follow them, of the amount of money we are putting into research and development. I again emphasize this area of retraining. One of our private companies, IBM, spends \$40 million a year on retraining. One other thing I would point out. We are a society of 180 million, and more than that, and we have done very little toward developing regional accounting in economic statistics.

We are trying to move into that area. I honestly believe if we will direct our attention to seeing what is really going on in this dynamic economy, where this very rate of obsolescence, the fact that a large part of our plant is geared to produce goods whose supply is already abundant, nothing could be truer than in our agricultural sector.

We could not produce any more and have it consumed. We can produce more wheat. We are putting land out of production. We are trying to stop the flow. We could not sell it. No one wants it. So I appreciate very much this emphasis and wish that others would start looking into this dynamic economy here because this is new, I think.

I don't think any society has been where we are right now. We have got to think in terms of whether or not this might be something new that has come about rather than a repetition of what has been going on before or elsewhere.

If that is true, then I think we have a job to do. I think we can help deblock the situation, but not by starting large governmental programs. I think we have them already. I should point out, too, that our expenditures in education and health are largely at the State and local level.

We don't have statistics in the field of health on what we are doing at the local level. The only thing we have is at the State level, and our Department of Health, Education, and Welfare, after years of my requesting that they get some statistics of what is being done at the local level in the health field, still have no conception.

Yet here is where we are doing most of it. Every indication we have is that we are increasing expenditure rates, doubling and tripling in the period of 5 or 6 years. It is the development and study of this phenomenon that I think will lead us to discover whether we need to do anything other than examine and deblock the things we are doing which are impeding this business of training, retraining, and developing our leisure time properly.

Then on the foreign area, I am very much impressed and interested in the suggestion made. I have one question that I want to ask of Dr. Niehans. This really is for all of you. It is a question that I have been asking our economists. On page 2 you say that to concentrate your monetary weapons on the balance-of-payments problem and take care of domestic problems if necessary by fiscal and possibly other measures.

Here is the problem as I see it. We have a heavy governmental deficit this year. We are experiencing difficulty in our people cashing in their E-bonds. If we cut taxes by \$5 or \$10 billion and then turn around and try to market \$10 billion worth of bonds, we are bound to impinge on monetary policy and we are going to create some real problems.

We already have them in debt management. Why do people assume in this kind of thing that cutting taxes, if we are simply going to sell bonds and take it back from the private sector, would in any way stimulate an economy under any circumstances?

Mr. NIEHANS. The two things are interrelated in quite a few ways. It is true that if a budget deficit is financed by selling bonds this must have an effect upon the credit market. The effect would normally be that interest rates would have to be higher than they would otherwise have been.

This ties in with the suggestion I made in another spot that interest rates should be somewhat higher than they are today. The two approaches are tied in very nicely with each other.

Representative CURTIS. Raise interest rates, you say?

Mr. NIEHANS. That is right.

Representative CURTIS. That would tend not to stimulate the economy?

Mr. NIEHANS. That is right. My approach was: Concentrate the monetary means on the external front and the fiscal measures on the domestic situation.

The two things are interrelated because by taking fiscal measures on the domestic front you are getting some credit strength on the external front. I think it is not quite true that taking money away from people by taxes amounts to the same thing as taking money away by selling bonds.

These are different types of money. One type shows up in the balance sheet, the bond money, and the other does not. It cannot, therefore, be argued that financing a deficit out of bonds sales amounts to the same thing as financing expenditures out of taxes.

The greater part of the effect will still remain though the deficit may be financed by selling bonds.

Representative CURTIS. In other words, the distinction you are making is that a tax reduction would go to people, and they would have the cash and that is it. If we then took it back from them by selling them bonds, although they would have the security that takes the place of that it still would mean that money would not be spent for consumer goods.

The theory of deficit financing of those who advance it—I disagree with them—is that this would stimulate consumer spending. That is what I don't understand in this syllogism.

My time is up. We have a time schedule where we go back and forth.

Chairman PATMAN. We will get back to Mr. Curtis later.

Representative REUSS. I was fascinated, Dr. Niehans, by your account of the agreement made 3 weeks ago by the Federal Reserve Bank and the Swiss National Bank. I gather from what you say that the agreement between these two institutions specifies in effect an exchange guarantee so that if the United States, for example, should raise the price of gold, the Swiss National Bank would be entitled to a greater number of dollars.

Is that the nature of the agreement?

Mr. NIEHANS. Yes, in a way. Maybe it is better described in the following way: The Swiss National Bank placed at the disposal of the Federal Reserve Bank of New York 216 million Swiss francs. The

Federal placed at the disposal of the Swiss National Bank 50 million American dollars for 3 months each.

Both sides have to be reversed in kind after 3 months. So there is no exchange risk involved at all. Whatever happens to exchange rates the Swiss get back their 216 million Swiss francs and the Americans get back the \$50 million. So there is no particular hedging operation necessary in this form of a transaction.

The Swiss National Bank already held a considerable amount of dollars. The American Federal Reserve Bank used the 216 million Swiss francs to buy normal dollars from the Swiss National Bank, so that 216 million Swiss francs immediately flowed back to Switzerland. The net effect you just have replacement of normal dollars which will be replaced? After 3 months in kind in dollars which, in effect, carry an exchange rate guarantee.

Representative REUSS. The United States and particularly the Federal Reserve has over the last year entered into various swapping agreements with various foreign countries, including, I believe, an earlier agreement with Switzerland.

Mr. NIEHANS. Yes, but of a different type.

Representative REUSS. The agreement made 3 weeks ago which you have been describing to us is, I gather, a markedly different arrangement from previous swapping arrangements in that this one carries what amounts to an exchange guarantee.

Mr. NIEHANS. I would say in principle most of the swap agreements carry some kind of exchange rate guarantee. It is inherent in most, if not all, swap agreements. The recent one of 3 weeks ago was a further development of the techniques developed earlier, between the Bank of England and the Swiss National Bank and between other central banks, too.

Representative REUSS. I didn't really understand that these earlier agreements did have an implicit exchange guarantee. I would have thought that this country simply swapped dollars for French francs. If something happened to the dollar while the bank of France was holding it, that was tough luck for the Bank of France.

Mr. NIEHANS. It is inherent in the type of transaction because if A loans B an apple and B loans A an orange, and the transactions is reversed in 3 months, there is no price risk involved. That is the basic idea of the swap agreement.

Representative REUSS. Where did you get your information about this arrangement?

Mr. NIEHANS. In part from the papers and in part from the Swiss National Bank.

Representative REUSS. I think it is very ironic, Mr. Chairman, that we have to get our friend over from Switzerland to tell us what the American Federal Reserve Bank is doing. We have the greatest difficulty getting this information here. I should think that the people at the press table this morning would be interested in revealing to the American public the nature of the arrangement made.

It seems to me very interesting and sounds like a pretty good agreement, and I am delighted to hear about it even through the somewhat indirect channel (i.e., from abroad) that we have here this morning.

I would like to ask Mr. Day what he thinks of the point of view expressed by the Bank for International Settlements in their annual

report. It recommended to this country that because of balance-of-payments considerations we adopt a policy of high-interest rates and fiscal looseness, a proposition somewhat like you presented to us this morning, Dr. Niehans, except that he hedged a bit. At least, he held out a hope that one really didn't have to raise interest rates without limit and beyond endurance.

I want to come back to you on that. Let me ask Mr. Day what he has to say about this.

Mr. DAY. I think the main disadvantage with a combination of high-interest rates and a looser fiscal policy would be that this might demand a substantially large budget deficit.

The advantage of holding interest rates at something like their present level in the United States is that you would then need a relatively smaller budget deficit in order to achieve something like full employment.

I would therefore suggest that the right policy is to hold interest rates at something like their present level rather than tightening them. I don't think you could lower them from the present level because then you would be far too much out of line with the European level.

But to raise them would demand an even looser fiscal policy and an even larger budget deficit which presumably would be rather difficult politically in this country. As far as the international problem is concerned, the better recommendation would be that all three of us put forth here this morning, the gold guarantee.

Representative REUSS. You are a Daniel come to justice. I am glad to hear you reject what seemed to me a rather extreme reliance on interest rates by the BLS.

Mr. Day, you referred to the recent \$6 billion supplementary credit agreement of the IMF as an agreement where possibly something might be worked out to increase international liquidity and to avoid some of the balance-of-payments difficulties that we have been having.

Let me ask you whether you do not envisage the possibility that an expansion of that supplementary payments agreement might not hold the key to some of our troubles. Specifically, if the notes issued by the IMF under this agreement came to be accepted by the various participating countries as a new international currency, and, if in time, the IMF or a similar agency would create a few of these notes on its own initiative as any national central bank creates money, might not these two evolutionary steps be a way of getting us out of the bind we are now in?

Mr. DAY. They would. They would be admirable developments. My worry about the \$6 billion of bonds is the discretionary way in which they are made available. They are not made available automatically. They are at the discretion of the granting country which, I think, is unfortunate because the countries which are likely to provide help in continental Europe understandably have a certain feeling that they have respectable policies. Why therefore should they help the United States or United Kingdom whom they sometimes accuse of having careless inflationary policies? Unjustly I think, but there is always the sense of self-righteousness.

I would agree that the principle of the Fund ultimately issuing its own notes which will be a new sort of international currency is a thing we should move toward as fast as possible. I don't see this as a practi-

cal possibility in the very near future. I would nevertheless like to see more automatic drawing on the Fund. The drawing rights should be variable and quite automatic ultimately to the limits of the quotas of the participants in the Fund.

Once more I suggest it should become accepted practice that all countries use these drawing rights fairly automatically to deal with the normal swings in their balance-of-payments rather than simply turning to them to deal with critical situations such as Britain's last year.

Representative REUSS. Thank you.

Chairman PATMAN. Senator Sparkman?

Senator SPARKMAN. Mr. Chairman, my question will be rather brief. First I would like to join with you and the others in expressing appreciation to these gentlemen for the very fine papers they have given us.

I take it from something that the chairman has said that none of the witnesses who have been before us until today has expressed this idea of gold certificates as advanced here this morning.

I think it will be most interesting to have comment from the Secretary of the Treasury regarding them.

Mr. Lolli, in your paper you brought out a very interesting point, and that was that we should aim not at increasing output, but at disposing of a naturally increasing output. You suggested that the Government's action should be directed toward the disposal of the output of invested capital. I quote from your article—

this can be done by financing better housing, better roads, better schools, better public transport, better health services—

and so forth. The question that came into my mind when you made that proposal was: Are we able to expand much further into those fields? We are building housing at the present time, for instance, at quite a high level—not our record high level, but almost up to that. In the case of public health expenditures, I think the recent appropriations have been most generous.

There is something that could be done in the field of better transport. A great many of us feel there could be a great program carried out in the field of schools. But do you believe that there is much room, actually, for us to expand those programs safely and quickly?

Mr. LOLLI. Senator, as you mentioned, the last item, schooling, I want you to know that I don't know much about the United States. But from what I hear, there is a terrific shortage of school space in the United States. So, in some areas schools have to create two or three shifts because there is not enough space for children to go to school. An investment in education is the best possible investment in the future of the United States, just as an example.

I know that housing is going on at a considerably high level. So, probably not much more could be done, except possibly, in rebuilding cities or parts of them where that is needed.

Senator SPARKMAN. The same thing is true of highway construction.

Mr. LOLLI. I am not expert in that. Anyway, in some types of public works something could be done, I imagine, to absorb this output which is not immediately utilized by the private section of the economy.

Senator SPARKMAN. Now, Mr. Niehans, you and Mr. Lolli both made this gold certificate proposal and I believe Mr. Day gave his approval to it, also. Would there have to be a limit on the amount issued? Would there have to be a limitation put on?

Mr. LOLLI. The limitation is only the amount of foreign holdings in existence.

Senator SPARKMAN. There would be no limitation. It would be whatever was required?

Mr. LOLLI. Exactly. I would not even limit the offer of the certificates only to official foreign holdings, but would extend it also to private foreign holdings. I suggest that at the moment they were offered, probably not many would be taken. But the very fact that they were offered would give the foreign holders of dollars confidence in the dollar and they would not probably take them, because according to my scheme, they would not carry any interest.

Probably people would prefer to keep their dollars invested in some way where they can earn some interest rather than to have some certificates which do not carry any interest. It would only be an offer that would create confidence and dispel the fears.

If I may quote from the last issue of *The Economist*—I don't know if you gentlemen have seen it. There is a very interesting article which appeared in the August 4 issue, "Reappraisal for the Dollar." It asks [p. 458].

How else can one persuade monetary authorities to hold each other's currencies when there is a genuine fear of their depreciation? Is it desirable that, let alone feasible, to rely on good neighborliness and all kinds of semipolitical pressures as permanent features of a world currency system? Must the French Finance Minister always have to undergo a barrage of questions at Idlewild about a minor conversion of dollars held by the French into gold? Must the German Bundesbank always have to wrestle with its conscience in reconciling help for the dollar with its duty to the Federal Republic? The granting of gold value guarantees, guarantees, that is, to secure that any depreciation in the gold value of currency balances held by central banks would be made good—should immediately transform the relative attractiveness of gold and currencies.

In other words, once the offer was made, people would not take advantage of it.

Senator SPARKMAN. I may say personally I am intrigued by the idea, although it seems to me a little strange that the guarantee should be required after such strong representations have been made by our Government.

The President has, on more than one occasion, made very strong assurance that we would not raise the price of gold and that our dollar would not be devalued. I am not certain whether he has the power of devaluation without legislation. I don't believe he does. Certainly there is no move, and has been no move in Congress toward devaluing the dollar.

In other words, every action that has been taken by this Government, every expression by this Government, both the legislative and the executive, has been to negate the idea of devaluing the dollar. I just wonder if there is any way that assurance can be given, even by the use of the gold certificates.

Mr. LOLLI. Senator, everybody in Europe is sure that the President is in good faith, the administration is in good faith, there is absolutely no intention on the part of the United States to increase the

value of gold. But on the other hand, the gold reserves of the United States have reached a low limit, not too far from what is the minimum established by legislation to cover the circulation. At a certain moment, the U.S. Treasury could say, from now on we are not going to sell gold anymore and this, without increasing the price of gold.

We stop selling gold. That would be absolutely equivalent to an increase in the price of gold because at that time you would see the London gold go probably to \$60, \$70, or \$100 per ounce. So it doesn't require an act of Congress to increase the price of gold, in fact.

Senator SPARKMAN. As long as we have the commitments outstanding against our gold supply, I don't see how the Treasurer of the United States could say that we would not supply any more gold. You mention this pressure on our gold being known by the people overseas. Isn't the fact that we also have an abnormally high reserve requirement known? In fact, I believe you mentioned that in your paper.

Mr. LOLL. Excuse me, Senator. At present the short-time liabilities of the United States toward foreign countries amount to \$16 or \$18 billion. The reserves of the United States in gold are \$16 billion. So, more or less they are equivalent. At present the deposits of foreign banks in dollars are not exchanged into gold because of more or less a gentlemen's agreement, I would say, among central banks not to do it.

In this situation, one cannot rely, forever, on gentlemen's agreements. So, at a certain moment the United States might be compelled, against their wish, to stop selling gold, and if this should happen you can realize how difficult it would be for the foreign banks to carry out their gentlemen's understanding if they thought they saw this coming.

Senator SPARKMAN. Isn't the International Monetary Fund available in such cases?

Mr. LOLL. Yes, up to, I don't know how much for the United States, \$5 or \$6 billion.

Senator SPARKMAN. I could go on. I am grateful to all of you gentlemen for very able presentations.

My time is up.

Representative REUSS. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much, Mr. Chairman. I, too, would like to thank each of you for your appearance here and tell you how much I have enjoyed your papers.

I would like to ask Professor Day—you point out that you feel that a tax cut would be a desirable thing for American economy and you point out the British experience. Would you explain in more detail the British experience. Is it a direct or indirect tax cut? Who gets the cut, how much is given, and what is the effect upon GNP?

Mr. DAY. We have had many different tax changes both upward and downward since the war. The general tendency has been downward, but on occasions we have had increases.

The changes have been both in direct and indirect taxation. The trend has been more sharply downward, I should think, in direct taxation than in indirect.

The effects have normally been remarkably rapid. It is difficult to do precise statistical work on this, but there is little doubt that the

effects of a change in taxation, either direct or indirect, is to change spending by some very high proportion of the change of taxes. Probably, for example, when income tax has been reduced by 50 million pounds a year, the net effect of this on consumer spending quite directly has been of the order of 40 million pounds of additional consumer spending. This has been the order of experience. The effect has usually come quite quickly.

Representative GRIFFITHS. If you reduced it 50 million pounds, with an increase of 40 million pounds in spending, there was no multiplying effect. Part of it was saved; is that right?

Mr. DAY. Perhaps 1 out of 5; 10-million-odd pounds would be saved. That would be the marginal propensity to save, roughly speaking.

I would not like to guarantee that figure precisely, but I have had some access to some fairly detailed research on this which has not been published, which suggests that the order of magnitude. 40 million sterling is spent, which, in turn, leads to a further round of multiplying effect and you get still more expansion as time goes on, as the result of that 40 million spent.

Representative GRIFFITHS. To whom were the cuts given? The people at the lowest level of taxation, or was it an across-the-board cut, or was it the highest level?

Mr. DAY. The biggest cuts of direct taxation have been at the highest levels. In particular, very substantial cuts were made in the budget of 1961, last year, which mainly benefited people with relatively high incomes, by British standards. At other times, the cuts have effected lower incomes, although, practically none of the cuts affect the lowest incomes of all. The cuts have simply affected people who were already paying tax, which in our system means people with incomes of more than 500 pounds or 600 pounds a year.

Representative GRIFFITHS. Were these cuts in taxes accompanied by increases in prices or interest rates, or did these follow, or not?

Mr. DAY. Almost invariably tax cuts have been accompanied by reductions in interest rates, loosening of monetary policy, and tax increases have been followed by tightening of monetary policy. Almost invariably there has been this sort of corollation. We have had a fairly steady inflation since the end of the war, and it would be hard to corollate the extent of the inflation with tax changes, except on the indirect tax cuts which sometimes have immediately affected the cost of living.

Representative GRIFFITHS. Would you think that a tax cut in this country, accompanied by lower interest rates, would adversely affect the balance-of-payments problem?

Mr. DAY. Yes; I am afraid it would. It would increase total spending, which would mean you would have an increase in imports because part of spending goes on imports.

Representative GRIFFITHS. So we are not in the same position. We could not lower the interest rates along with a tax cut.

Mr. DAY. This, I am afraid, is the dilemma which your economic policy must face. The dilemma is that if you have an expansionary domestic policy, the effect will to some extent be to weaken your balance of payments. Therefore, I would suggest that you simultaneously, with the expansion of the domestic policy, take steps of the

sort we have mentioned to increase confidence in the dollar. I wouldn't like to say "restore," because I think confidence is a lot higher than people pretend.

Representative GRIFFITHS. Thank you very much. I would like to question the gentleman from Switzerland. I understand that our Secretary of the Treasury, at the conference in Rome, pointed out that one of the real reasons for our balance-of-payments problem was because of the heavy borrowing by European American markets.

Mr. NIEHANS. That is right.

Representative GRIFFITHS. This was not because of our interest rates, but because we have a better market. I see you touched on that. Do you agree or disagree?

Mr. NIEHANS. I agree that this is one of the problems.

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

Representative REUSS. Senator Proxmire.

Senator PROXMIRE. Professor Day, you, together with the other two distinguished gentlemen, are deeply concerned with our international balance-of-payment problem and with the confidence in the dollar. Uniformly, you three gentlemen advocate a tax cut. Professor Day, you advocate monetary stability with what I regard at a high level of interest rates. You advocate a series of measures to cope with the international balance-of-payments problem which are aside and apart from the fiscal and monetary policy. A further reduction of Government spending overseas. No. 2, remove the gold backing for our currency; No. 3, expand the currency swap; No. 4, a gold guarantee; No. 5, international reserve currency. This gold guarantee interests me very much, because as Senator Sparkman said, the President could not have been more emphatic that we are not going to devalue our dollar.

Suppose we advance the classification from a guarantee to a super-guarantee or a superduper guarantee, and provide this kind of built-in protection against any possible devaluation for all obligations, would this be a practical possibility?

In other words, not limiting it to a certain amount of obligations, but all obligations held overseas. All dollars held abroad. In the event there should be a devaluation in the future, they will be fully compensated.

Mr. DAY. I think it should be extended to all short-term dollar liabilities of the United States. I see no reason for extending it to any long-term dollar liabilities of the United States. I would go further than Professor Niehans' suggestion that the gold guarantee should be offered to private holders of dollars overseas as well as to central bank holders of dollars. I think this would go a good deal further than the very firm promise made by your President recently.

But I am afraid that sort of firm promise does tend to evaporate in its effect, in time. I am afraid my country set a bad example. We promised extremely firmly up to the eve of devaluation in 1949 that on no account would sterling be devalued, and then we did it by a sharp amount.

Senator PROXMIRE. We are in a different position, as I am sure you appreciate. The President said there would not be any reason to devalue, because if we did, every other country would be likely to

devalue in about the same proportion and in a short time we would accomplish nothing.

Mr. DAY. I don't agree that the effects would be nothing. The total liquidity would be increased because each lump of gold would be worth more in terms of every national currency. At the same time, one of the effects will be to help the Soviet Union, which is questionable to say the very least. I don't agree that the effects would be zero. The effect in changing the relative exchange rates of the dollar and other currencies might well be zero, although it seems to me quite possible that if the United States should devalue the dollar, some of the continental countries might not follow the whole of the way.

They might realize their own balance-of-payments position was strong and might see prestige advantages of not going as far as the other countries in devaluation, and the net effect might be some relative exchange rate change.

This is a possibility. The basic thing is that I would not recommend devaluation of the dollar in the present situation. I see very strong arguments against it. But at the same time, promises not to do it are of a certain limited value. In particular, because of the point Mr. Lolli made that one of the great European fears is not actual direct devaluation, we know that this would have to go through a long legislative process. The fear is that the U.S. Treasury would cease to convert dollars into gold of foreign central banks.

Senator PROXMIRE. I have before me the Survey of Current Business latest statistics on U.S. balance of payments. It is very difficult for me to understand why people are so deeply concerned with our so-called adverse balance of payments. As I look at it, with the possible exception of Mr. Day, you gentlemen have been hitting so hard, the need of higher interest rates to protect our balance of payments seems to have been greatly reduced by the fact that the net outflow of short-term capital in the first half of 1962 was \$300 million. A very sharp drop. In spite of the fact there is still the interest rate differential, as you gentlemen have documented so well this morning, between our interest rates and the interest rates abroad.

Then, as you go further into the balance of payments, it is clear we have a \$4.8 billion surplus on trade. We have a \$1.7 billion surplus on services. The only place where we don't have a surplus is because of our military outlays, our economic grants, and our loans.

In the area of foreign aid and troops abroad—this is within the complete control of our own Government. This is for the purpose, very largely, of protecting the whole free world, including the countries which you gentlemen represent.

Under these circumstances, it would seem to me, since it is under the control of our Government, since, as Mr. Day has indicated this morning, we might wisely follow a policy of reducing our commitments abroad, it is difficult for me to see why there is this very serious problem involved, especially since we have \$16 billion worth of gold, a large proportion of all the gold in the world, more than twice as much as any other country has, and since we can easily knock out the backing of our currency, why is there this problem?

Mr. NIEHANS. There are two points I would like to make. First, we could argue among ourselves whether the dollar was shaky or not. I believe it is not. I agree with what you just said, at least in outline.

I certainly don't believe that the dollar will be devalued. The other question is whether financial people around the world have the same convictions we do. In this case, it doesn't help to argue about figures, but we have to accept the fact that they just don't have the confidence.

Senator PROXMIRE. One reason they don't have the confidence is perhaps they feel our economy has not been moving ahead. It would seem to me we have "Operation Spin Your Wheels," if we followed those advocates of a tax cut combined with higher interest rates. Particularly if we followed the policy of having a tax cut and finance it by selling bonds to the public. I can't get it through my head why this would not have the effect of soaking up additional money that would go to the public to expand our economy if the Government sells bonds to the public.

How can we make any advance this way? It would guarantee a heavier debt and a much bigger service charge on that debt as interest rates rise, and the economy would continue to move less rapidly than it should and confidence would not be built up.

The main way we build up confidence is by economic growth, expansion, and prosperity. This is the kind of confidence you are really concerned with.

Mr. NIEHANS. The international financial community is probably rather conservative. They seem to be quite firmly convinced that budget deficits have very positive effects on balance of payments.

Senator PROXMIRE. I hate to interrupt you when I ask you a question. Isn't it true that the international financial community, which has a very deep interest in high interest rates, in my judgment, also has failed to pay the kind of attention they should to the fact that we have balanced our cash budget about 50 percent of the time during the last 10 years, and other countries abroad have not done so? Our record of balancing the budget is much better than that abroad, if you put them on a comparable basis. On a national budget and accounts basis, our record is better.

The difficulty is that we have an administrative budget which other countries do not. We have no capital budget at all. The figures I have seen show that whereas Great Britain has had an unbalanced budget on a cash basis quite consistently, and this is true of West Germany, France, and Italy, our record is relatively very good. Why should there be this lack of confidence under these circumstances?

Mr. NIEHANS. The feeling seems to be that nothing really decisive was done on the American balance of payments and there seems to be a fear that things might go by default. The feeling is one of waiting for things to change and maybe they don't change, and that situation will develop in the way Mr. Lolli described it. We may argue among ourselves whether this is correct or not. I am mostly on your side. But we just have to accept the realistic fact that the international community does not share this confidence to the degree we would desire.

Second, several times the International Monetary Fund was mentioned, and the various measures which could be taken by that Fund. I take it that as prerequisite for these measures to take effect, the Fund and the countries concerned, will probably ask exactly the measures which were asked by the financial community today. The United States would not get the aid from the Fund or the 10 countries of

the Paris agreement, unless some steps were taken which would tighten a little bit the U.S. credit market.

If the United States is not willing to have this tightening, this help from the IMF probably would not be available either.

Senator PROXMIRE. My time is up, I see. I would just like to mention that Europe is not more conservative in one important sense. You gentlemen are coming to us asking for a tax cut at a time when we expect an unbalanced budget in the coming year, which will unbalance our budget even further. If I get time a little later, I want to talk to Mr. Day about his assumption that it is a wholly illogical and unjustified desire for budget balance. I happen to be very conservative in this regard.

Representative REUSS. Mr. Curtis.

Representative CURTIS. I had just one thing for the record, Mr. Chairman.

I would like to say the experience of this committee in getting information from the Federal Reserve, I thought, has been very good. I think they have gone out of their way to help us get this information. That very point that was under discussion earlier this year, and I thought we had a pretty good explanation of it. So, if the press has paid attention to the remarks made by the gentleman from Wisconsin, I hope they will go back to the record and I think they will find that the Federal has been pretty good in cooperating with this committee, and I guess others.

Representative REUSS. Would the gentleman yield?

Representative CURTIS. Yes.

Representative REUSS. Did the gentleman know about the agreement with the Swiss National Bank?

Representative CURTIS. I knew that there was an agreement made.

Representative REUSS. Did the gentleman know that it contained what is in effect an exchange guarantee?

Representative CURTIS. I didn't inquire into it, but I am sure had the inquiry been made, perhaps if the gentleman was interested, he could have obtained the information.

Representative REUSS. Is the gentleman aware of the fact that the House Committee on Banking and Currency, in its report on the bill authorizing the United States to participate in the new \$6 billion standby agreement of the International Monetary Fund requested the Federal Reserve to inform it of any arrangements that were made?

Representative CURTIS. I am not aware of that. I am not on that committee. I was referring to our experience here. I might say there is something pending right now that worries me greatly about our cooperation in the future in this area. There is one question I would like to ask Dr. Niehans or Dr. Lolli, or both. In our minority views this year on the President's economic report, we made a suggestion which in effect posed what would happen if the United States were no longer to guarantee that it would buy gold at \$35 or any other fixed price. Would this lessen speculation in the gold, or how would it affect confidence in the dollar? This speculation seems to have come from the fact that we actually set a price or if we were to buy at \$35 and sell at whatever. Is some of our trouble the fact that this is rigid and maybe that very rigidity creates confidence? Do you understand what I am getting at, this fixed price? The same question

might relate to our reserve requirement. Again that is fixed and people have used the adjective, "high reserve." What if we were to lower that because of a seeming fear that we are reaching that peak? Do those kind of fixed figures in our monetary policy create confidence, or what if we made them flexible, would that be a better system?

Mr. NIEHANS. I take it you are in fact asking about flexible exchange rates in effect?

Representative CURTIS. Yes, I guess it would amount to that.

Mr. NIEHANS. Without going through the whole debate, I would say, briefly, that if you advocate and wish international economic integration, exchange rates should be kept stable. If you are in favor of some amount of national insulation from international influences and if you want to be as independent as possible of foreign influences in your domestic economic policy, an argument could be made in favor of more flexibility. I take it that at the moment the trend internationally is more in the direction of increasing economic integration, and in this respect I believe that an increase of flexibility is more in the cards of general development.

Representative CURTIS. I must say I am rather inclined to agree with that position, although I went along with throwing out the suggestion. I was more interested in seeing what would happen in the way of comment than I was actually advocating the theory.

Mr. NIEHANS. I am quite sure it will not greatly increase confidence in the dollar.

Representative CURTIS. I am inclined to think so.

Mr. LOLL. May I say that I believe that the confidence would be shaken, although the present cover required by legislation for circulation probably is excessive. I would say that if, at this moment, that would be lowered, it would decrease confidence without any good reason. If it is at all possible, I would not change it at this moment.

Representative CURTIS. Thank you.

Representative REUSS. If the countries of Western Europe really wanted to restore confidence in the dollar, they could do so very quickly, could they not, by helping us remove our payments imbalance by a combination of such measures as picking up a larger share of our military burden abroad, picking up a larger share of our aid for developing areas, lowering their tariff barriers and quotas so that we might enlarge our export surplus, and refraining from floating issues in the American capital market. An example of the last is the recent loan floated on Wall Street by the European Coal and Steel Community.

Mr. LOLL. On this last item of floating foreign issues in the United States, I don't think that has too much of a bad influence because, according to what I hear from the New York issuing houses, the greatest majority of those issues are placed back in Europe—the greatest part.

Representative REUSS. I didn't mean to stress that unduly. The \$1.5 billion of U.S. defense expenditures in Europe is certainly a more important single item. But my central question was, if the problem is really restoring confidence in the dollar, isn't the way readily open to the countries of continental Europe to do this tomorrow?

Mr. LOLL. As far as restrictions are concerned, I think they have abolished almost all restrictions on imports from the United States. In

the case of Italy, there is complete liberalization. As far as participation in the foreign aid program, while it is not for me to discuss, what can be done is being done considering that we are still small things compared with the mighty strength of the United States.

Representative REUSS. Yes, but the fact is, is it not, that over the last few years the deficit in the U.S. balance of payments has been almost the exact counterpart of the surplus in the balance of payments of European countries?

Mr. LOLLI. Yes. It switched.

Representative REUSS. In the last 5 years the situation has become complementary.

Mr. LOLLI. Yes.

Mr. DAY. May I express what I think is perhaps a continental European reaction here? I say this with hesitation, not being a continental.

Representative REUSS. At least at the moment.

Mr. DAY. At the moment. The continental countries feel that they have, through hard work and through virtuous economic policies, achieved this relatively strong balance-of-payments position. They feel that the relatively weak balance-of-payments position of my own country and the United States has been the result of certain carelessness in our economic policy. They feel that if the price of virtue is that they have to pay out more money for defense, more money for aid to the underdeveloped countries, what is the point in being virtuous?

Representative REUSS. What are the vices, real or alleged, of U.S. economic policy? Alleged deficit spending?

Mr. DAY. I could think much more easily of the accusations that might be thrown against my country. I think they might well say American exports have not been competitive with those of the continental countries because of the slow rate of economic growth in the United States. Possibly a slower rate of innovation exists in the United States than continental Europe recently.

Representative REUSS. Do you gentlemen care to comment?

Mr. LOLLI. I would agree. On this question of the swap agreement, as far as I know, similar swaps have taken place, and were publicly announced in all the newspapers in the world, with other European countries. As in any swap, it carries a guarantee in the foreign exchange rate. It doesn't guarantee the gold. Swaps are going on, on a private basis, continually. The only difference between the swaps made by governments and private parties is that swaps made by the governments don't carry any premium. If private parties arrange for a swap, it is always to pay or to earn a certain premium according to the confidence that there is in other currency, more or less, and the different rates of interest on the two different currencies. That is why, in my presentation, I was saying the swap for me is not a sufficient thing to restore confidence.

Certainly that is done on a rather large basis now by the U.S. Treasury with several countries—Italy, Germany, Switzerland, and so on. But that is not sufficient.

Representative REUSS. Senator Bush?

Senator BUSH. Congressman Reuss mentioned the principal causes of our balance-of-payment deficit a few moments ago: the excessive military expenditures abroad, the economic aid expenditures particularly. I have had some correspondence with Europe on the latter question of the economic aid program and on the basis of why is not

Europe more interested in assuming a larger burden of this share of aid, especially to the underdeveloped countries? As a result of that, I get the feeling that Europe is not going to do it. I don't know whether they think our program is excessive or for some other reason they don't want to do it, but I have the impression that they are not going to do it. Do you think that is a correct impression or not? Let us be frank about it.

Mr. DAY. The answer, as far as aid is concerned, is that European countries, all of the major countries, are providing a very substantial amount of aid in relation to national income. There was a recent survey by the OECD, showing the proportions of national income going to aid and my recollection is that France was at the top of the list. Germany was quite high up, and the United Kingdom was quite high up. The United States was certainly very high. I think second, but this is simply from memory. In relation to national income, continental European countries are providing a very substantial amount of aid to underdeveloped countries.

As far as the military thing is concerned, I suspect there is a reluctance on the part of all the European countries to commit themselves to more military expenditures for quite understandable reasons.

I think it has to be said that if you did persuade the Europeans, all of us, to spend more on military purposes, one of the consequences would be a relative reduction in the political influence of the United States and the relative increase in the political influence of Europe, including presumably, Britain, because political influence, to some extent, is linked with military expenditures. This may or may not be a price that you here in Washington would be willing to pay.

Senator BUSH. I think that is a fair price.

I realize that you have spoken correctly and I am not inferring that there is no effort being made over there to assist in this program.

My point was that our balance-of-payments problem is affected by that item more than any other one, I would say, unless it be military.

What I was trying to get at is whether there would be any hope at all of the European countries, assuming as Mr. Reuss has suggested, a larger share of the present total burden or whether they think we are doing too much and for that reason do not feel they should do more and maybe we should do less?

Mr. DAY. I think my answer would be, that slowly you can expect the Europeans to assume a larger share. It is probably already happening. Insofar as this happens the European aid will go to countries in which the European countries are particularly interested. For example, most of the French aid goes to the former French colonies in Africa.

Senator BUSH. Where their trading is directly affected?

Mr. DAY. Exactly.

Senator BUSH. Do you want to comment on that, Mr. Niehans?

Mr. NIEHANS. I would not like to comment on military and other aid since Switzerland is in a somewhat different position here. I feel at the moment the willingness to cooperate with the United States in the solution of balance-of-payments problem in Europe is quite high. Actually, the European central banks are going out of their way to find new ways and means to solve this problem.

Usually there are no reproaches made and no recriminations unless perhaps the remark that most European countries by now have learned

that monetary policy has to be directed mainly toward external problems and has to be geared to balance-of-payments problems.

As long as the United States does not apply this experience to her own economy, they will probably feel that they don't have to go very far in assisting in some other ways until they see that the teaching of the last 5 years with regard to monetary policy would be applied here too.

Their willingness would be somewhat increased.

Senator BUSH. In other words, our interest rates are not high enough, is that right?

Mr. NIEHANS. Yes.

Senator BUSH. Did you want to comment?

Mr. LOLL. I wouldn't put it this way, that they are not high enough. They certainly are attractive to foreigners, so automatically it creates a switch. As far as foreign aid is concerned, of course, being a private citizen I don't know what the intention of the Government is.

I know there has already been a lot of complaint that the Government is going too far in foreign-aid programs. There are areas in Italy that are still underdeveloped such as southern Italy and where a lot of investment should take place.

The Government is extending credit for 12 or 15 years for building plants in Argentina and Brazil and other countries—it is said by some that is committing too much abroad. On the other hand, there is a definite officially stated intention of the authorities to participate strongly in any foreign-aid program.

That is the official policy of the Government. How much, more or less than the present the foreign-aid will be—that is something I cannot answer.

Senator BUSH. Thank you.

Senator PROXMIRE. Let me ask Mr. Niehans a question.

I heard we might be able to make a dent in our balance-of-payments if we provided numbered accounts and anonymity to those wealthy persons who wanted to invest in our own banks.

I do not want to be impertinent. I know you have done a fine job this morning. I am asking as a matter of real curiosity how significant is this in your own balance-of-payments situation?

Mr. NIEHANS. I would say the numbered accounts are of no significance in the balance-of-payments.

Senator PROXMIRE. Isn't it true that you do provide this advantage to investors and that there is a capital inflow or a substantial capital inflow because of it?

Mr. NIEHANS. I would have to put it in a general way. Numbered accounts are just a technique. If you speak of the confidential relationship between the banker and his client in general, I would say this has a certain significance, because it makes Swiss banks somewhat more attractive than they would be otherwise, no matter whether it is done by numbered accounts or in some other way. At the moment I have no way of knowing quantitatively what the importance of this relation between a Swiss banker and his client for the Swiss balance-of-payments might be.

Senator PROXMIRE. We hear many stories of very wealthy people in this country and South American countries taking advantage of

the anonymity which the Swiss provide and which other countries do not provide.

In a country which is relatively small like Switzerland, it seems to me this might be a significant factor. This might be one of the things that permits you to get along with a relatively low interest rate.

Mr. NIEHANS. In principle I agree that this fact has a tendency to keep our interest rates somewhat lower than they would otherwise be. I have no way of knowing how much this difference would be.

Senator BUSH. If the Senator would yield; is it not true that the attractiveness of Switzerland to capital around the world is due not to the numbered account so much but to the historic position of neutrality and inviolability of Switzerland. There is a haven of refuge that through decades and decades has impressed people.

So your country is regarded as a secure place for deposits of capital. That is the basic attraction that you have, is it not, rather than the secrecy?

Mr. NIEHANS. I certainly agree. Secrecy is one part of it; I would say it is only a fraction of the whole problem. To this aspect you would have to add stability of our foreign exchange. The fact that we have been at peace for a very long time. The fact of neutrality and some other factors of the Swiss banking system which has nothing to do with secrecy. Secrecy is one part but a minor part.

Senator BUSH. Also because you have an orderly government there. You have an orderly economy. You have missed the misfortunes that have plagued so many of our countries, particularly unemployment. You have a stability there that lends confidence to people who wish to place their funds in another country than their own.

Is that not true?

Mr. NIEHANS. I agree but I won't say that we have a monopoly on orderly governments.

Senator BUSH. I do not think you have a monopoly but you furnish a good example.

Mr. NIEHANS. I agree.

Senator PROXMIRE. Do you provide this anonymity for anyone? Suppose somebody is a known criminal or a person who is accused of being a swindler?

Mr. NIEHANS. No. The banker is in about the same position as a medical doctor and lawyer. He has to give information on criminal and police civil cases to the courts. He does not have to give information on tax cases since tax cases are treated in our legal system somewhat different from other criminal cases. So the banker does not have to give tax information.

Senator PROXMIRE. In other words, a tax dodger is given protection but another type of criminal is not?

Mr. NIEHANS. That is right.

Senator PROXMIRE. Mr. Lolli, you are executive vice president of one of the biggest commercial banks in Europe?

Mr. LOLLI. That is right.

Senator PROXMIRE. I am struck by this charming paragraph on page 3:

**I do not think one should be afraid of a budget deficit provided it is financed with savings with little resort to bank credit—**

which means high interest rates.

Mr. LOLLI. No.

Senator PROXMIRE. The U.S. danger is not inflation but deflation in spite of any contrary appearances. We don't have to fear inflation at the present time. I would agree with you we have little fear of any monetary inflation because we have an excess of capacity and an excess of labor seeking work.

Therefore, it seems to me we should use bank credit and we should take full advantage of any tax cut to expand our economy by stimulating it and keeping interest rates low.

Isn't it fair to say that a banker is in the same position as a farmer who likes high price supports in the way the banker likes high interest rates. You would expect bankers to testify in favor of policies which create situations in which his income is higher.

That is perfectly normal and natural.

Mr. LOLLI. I am not testifying here as a banker.

Senator PROXMIRE. I know you are not.

Mr. LOLLI. I am testifying what I feel in my conscience is in the interest of the United States.

Senator PROXMIRE. You and the other international financiers are surrounded by those whose economic well-being is served by following these policies.

Mr. LOLLI. May I say about the budget deficit, though a smaller sum, we had an experience in Italy that a budget deficit doesn't bring any harm. In the United States I think in 1961, the budget deficit was about 2 percent of the gross national product.

You may be surprised to know that in Italy in the best years of development and expansion we had in 1957 a 7-percent deficit.

Senator PROXMIRE. This is in a budget comparable to ours, an administrative budget?

Mr. LOLLI. Yes.

Senator PROXMIRE. Two percent would be equivalent to a \$10 billion deficit here, a 7 percent would be equivalent to a \$35 billion deficit?

Mr. LOLLI. Yes; 8.5 percent in 1958; in 1959, 9 percent. How did we get along without troubles? Because this deficit was not financed by printing paper except for a small portion but just by long-term savings.

The Central Bank would issue 9-year bonds and would call in the banks and say: "Here, 50 billion lire are being issued. You must take them one way or the other." Savings were taking care mostly of the financing of the deficit of the budget.

Senator PROXMIRE. Certainly the conditions were starkly different than in this country.

Mr. LOLLI. Absolutely.

Senator PROXMIRE. You have to worry about, as every European country does, inflation and too much money chasing too few goods because you have a shortage of labor and plant capacity. We don't have that at all.

Mr. LOLLI. Exactly. I started at the beginning saying that it is impossible to compare the situation in the United States with the situation in most of the European countries. But some basic principles can be used. If you arrive at an important deficit in the budget I imagine that cannot be financed exclusively by bank credit.

I am not an economist. I think the two gentlemen on the Panel are much more entitled to comment on this.

Senator PROXMIRE. Mr. Niehans has agreed with you already and Mr. Day more so than I would.

Let me ask you, Mr. Day, you call wholly illogical and unjustified the argument that a budget deficit must be avoided at practically any cost. Certainly I would agree in a serious depression or in a period of national military emergency budget deficits can be justified.

You seem to follow a line which would abandon the usual kind of compensatory fiscal spending notion, that is, that you balance your deficits in periods of recession with your surpluses in periods of prosperity.

You throw that aside, as I judge what you are saying. Instead of that you say the deficit should be strictly concerned with utilization of resources; is that correct?

Mr. DAY. With that and the point that I could not develop in the paper; namely, with the general desire of balance between how much Government spending you want to do, how much you want to spend on roads and schools and the desired level of taxation. But granted those things, I would say that the budget deficit depends simply how near you want to come to full employment..

If you are in an inflationary situation the right policy is to reduce the deficit. If you are less than fully employed the right policy is to increase your deficit or to reduce your surplus.

Senator PROXMIRE. But we have a larger national debt as you know than all the countries of the world combined by quite a margin. It is over \$300 billion now. Service costs on that debt is the second largest cost to the Government, second only to military costs. If you adopt this policy you propose we lose all effective discipline on spending and all real incentive for being careful in spending.

You also tend to have a misallocation of resources. As your debt gets bigger and bigger your Federal taxes become bigger. In one way or another you tend to discourage incentive.

Mr. DAY. You say there would be a misallocation of resources. I suggest that the most serious misallocation of resources is not to use useful resources. Indeed, it is true that your national debt is very large. Ours is as well in relation to our national income. The countries with relatively low national debts are the countries which in a sense had the good fortune to lose wars and, therefore, the debts were written off.

The source of large debts has quite predominantly been war, both in your country and mine, and I think this would be true of almost every other.

The increase of the national debt that would result from the sort of budget deficits that I would advocate, in the order of perhaps \$10 billion a year, the effect of this, considering the whole size of your national debt, would, in percentage terms, be trivial.

At the same time you say, well, the debt nonetheless is piling up. While the debt is piling up, your productivity is, however, rising 3 percent a year. A debt increase a fraction of 1 percent a year can easily be serviced where national income is rising perhaps at 3 percent a year.

Senator PROXMIRE. My time is up but I would like to ask one more question.

This has deeply concerned me. You gentlemen, as international experts, can help. Isn't it perfectly possible that by raising interest rates to cope with our balance-of-payments problem, we are on a fool's errand? As we increase our interest rates, there is every reason in the world why European countries would increase theirs, maintain the differential. They have far greater domestic reasons to do so.

Their price levels have risen more than ours, they have a shortage of labor and industrial capacity, quite the contrary to what we have. No matter what we do, isn't it likely that their interest rates are going to continue to be higher than ours, particularly since international trade is so much more important to all of these countries than to this country, and they have every reason to maintain this advantage? Mr. Niehans.

Mr. NIEHANS. I don't think it is quite true. If you look at statistics and graphs, you see that interest curves in different countries show quite different shapes. They do not move together at the same time.

If the U.S. interest rates should go up, this would have some repercussions on interest rates in other countries, too. But I believe it is very unlikely that even a large part of the whole effect will be lost this way and in some European economies the money liquidity is such that the repercussions will probably be very small indeed.

I believe that most of the effect will still remain in operation and will not be nullified this way.

Representative REUSS. Gentlemen, we are very grateful to you for your learning and clarity and your frankness and good humor and we thank you very much.

Mr. Day, I understand you have a statement of a colleague.

Mr. DAY. I have, sir. Mr. Chairman, Mr. Robert Neild of the National Institute of Economic Research in London was asked to attend these hearings and, unfortunately, was unable to do so. But he asked me to convey to you a copy of a statement that he has written on these topics which, incidentally, includes a recommendation of gold guarantee so that makes four; perhaps you would care to have it written into the record.

Representative REUSS. I am sure we would, and without objection it will be incorporated in the record.

(Statement of R. R. Neild follows:)

THE NATIONAL INSTITUTE OF ECONOMIC & SOCIAL RESEARCH,  
Westminster, S.W. 1, August 10, 1962.

HON. WRIGHT PATMAN,  
Chairman, Joint Economic Committee,  
U.S. Congress, Washington, D.C.

DEAR MR. PATMAN: I am very sorry that I had to refuse your committee's invitation to come and give evidence to them during their present hearings. I feel most honored to have been invited. Had it not been for the pressure of other commitments, I would most gladly have come.

In case it may be of some use to you, I have quickly set down my views of the present problems of the U.S. economy in the enclosed note. Please excuse the shortcomings of a note prepared in haste.

Yours sincerely,

R. R. NEILD, Deputy Director.

#### THE BACKGROUND

Over the past decade, the United States is conspicuous for its slow rate of growth, its poor employment record, and the deterioration in the position of the

dollar. The average rate of growth of production per head has been lower than that of practically any other major industrial country except Britain. There has been a series of business cycles, in which each upswing has tended to be weaker than the last: the recent recovery has not carried unemployment below 5 percent. The low rate of growth has tended to diminish the stature of the United States in the world. It has been a drag on world trade; if the U.S. economy had grown faster, world trade would have grown faster; the incomes of the primary producing countries would have been less depressed.

The poor production and employment record in the United States are the result, in the first instance at least, of an inadequate growth of demand in real terms. Production has not been limited by capacity; if demand had grown faster, production and employment would have been higher. In saying all this, I as an Englishman am painfully aware that our record is little better.

#### THE REGULATION OF DEMAND

The inadequacy of demand in the United States seems to have been the result of an excessively rigid fiscal policy. Credit policy has been actively used to regulate demand, but it has not succeeded in outweighing the restrictive effects of fiscal policy. This is not surprising. In the light of postwar experience, most European economists would now agree that fiscal policy, as well as credit policy, must be used to regulate the general level of demand, if full employment and expansion are to be achieved. Many of them, of whom I am one, would hold that fiscal policy is the more powerful of the two and must be the main instrument.

Present economic forecasts for the United States seem to suggest that the general level of demand and production will at best be stable in the period ahead and may well turn down. Since the economy is far from full capacity and unemployment stands at 5 percent, I would judge that a substantial cut in taxation and/or increase in public spending was needed now if full employment and expansion are to be achieved. As in steering a boat, it is generally best to take corrective action early, the more so if you are already some way off course.

The main objection to a tax cut appears to be the dogma of the balanced budget. The committee will be familiar with the fallacies of this dogma, based on analogies with individual housekeeping. Presumably, it can be successfully refuted only by education and courageous leadership. If reassurance is needed as to the effects of flexible fiscal policies, the experience of Europe in the past decade may be helpful. Most countries have pursued flexible fiscal policies, more or less explicitly. They have mostly achieved higher rates of growth than the United States, and the degree of inflation they have suffered has not been substantially different from that in the United States.

This is an important issue. It would be distressing if the United States were to suffer a recession and if the economic progress of the West were to be impeded by popular adherence to a defunct dogma. The attraction of the dogma is its simplicity. Like other false dogmas of ravishing simplicity—the world is flat, the sun goes round the world—it may be hard to unseat. But it must be unseated if the world is to progress.

#### THE EXTERNAL BALANCE

The only argument of any force for opposing reflationary action seems to be that it might worsen the balance of payments and so lead to a flight from the dollar.

Seen from Britain, the present external position of the United States does not look too bad. There has been a sizeable current surplus during the recovery, despite the fact that there was probably some stock building of imports. Government expenditures abroad are still being pruned. The export drive got underway only recently. Moreover the gold reserves of the United States are still very large if one counts in the large part of the reserves that is formally tied as currency backing. This is true whether they are judged by absolute size, by their relationship to imports or their relationship to foreign liabilities. The trouble is that the effects of an overall deficit are liable to be vastly amplified by speculation. That threat considerably nullifies the value of the reserves. And there is little doubt that an expansionary policy which carried the U.S. economy closer to full employment would have an adverse impact on the foreign balance—and even a small impact of this kind, unless compensated by other developments, would be enough to excite the speculators.

## DEFLATION AND THE BALANCE OF PAYMENTS

The prevalent view at the moment is that, faced by a situation like this, the deficit countries—recently Britain and now the United States—should act broadly according to the rules of the gold standard. If they hold back home demand, so this argument runs, they will reduce imports and expand their exports. They will also slow down the rate at which prices rise, and so make exports more competitive. The surplus countries will do the opposite, and so the balance of payments disequilibria will be restored. There goes with this doctrine the view that capital as well as current transactions should be liberalised and that interest rates should then be changed in response to movements of short-term capital. On this view, the United States should now raise short-term interest rates to attract foreign capital; she should perhaps have a modest tax cut sufficient to counteract the effect of higher interest rates and to prevent a bad recession. But no more. She should be cautious in her pursuit of full employment and expansion.

This view of the way in which deflation can improve the balance of payments is open to a number of objections:

(a) Surplus countries will not necessarily expand. Governments do not always respond to gold flows. When it comes to an outflow they nowadays are forced to do so by the activity of speculators and by the conditions with which loans from the IMF and from central banks are circumscribed. But there is no such compulsion on the side of an inflow. And on either side, policy measures are likely to influence the course of demand quite slowly.

(b) Although restricting home demand will have an effect on imports, its effect in squeezing out more exports is much more debatable. There is no evidence that the "deflationary" countries in the last decade—notably the United Kingdom and the United States—have had any success with these policies. It is the deflationary countries whose share in world exports of manufactures has fallen. It is the countries with rapidly expanding home demand whose share in world trade has risen.

(c) The effect of policies of deflation on prices is also debatable. There is some evidence that lower demand slows down wage increases: the work undertaken by various economists, including some at this Institute, has confirmed that there is a relationship between pressures of demand and the rate of advance in wages. But the relationship found is not, on the whole, a very close or certain one. That is not surprising. It is clear that monopolistic wage negotiations, which are characteristic of all industrial countries, can at times be pretty insensitive to the climate of demand.

But lower demand may also slow down the rise in productivity. In particular, the rate of innovation and improvement in products, which is not always measured by ordinary statistics, may be sensitive to variations in the pressure of demand. In periods of deflation, productivity increases may be lost.

On balance, there is no clear evidence that countries which have held back home demand have a better price record than countries which have not.

At best, deflation is likely to be a slow mechanism for putting right a disequilibrium in the balance of payments. At worst, it will not work at all. In any event, the adoption of deflationary policies would presumably mean continuing with the present system of national reserve currencies which is inherently unstable and difficult to enlarge. It would mean continuing with a drift of policy which places national economic policy increasingly at the mercy of international pressures and speculation. It would mean accepting a mechanism which makes it likely that at any time in the future some group of industrial countries will be holding back production and employment in the hopes of restoring its competitive position vis-a-vis others. That is bound to impede the overall growth of production in the West, and to prejudice economic relations with the underdeveloped countries. Indeed a check to progress of the U.S. economy will do that now.

## ALTERNATIVE POLICIES

The alternative policy would mean aiming at a reform of the international reserve system and the rules surrounding it. The main objectives would be:

(a) To provide much more liquidity in the world and to provide it in forms which are less exposed to exchange risks than national reserve currencies. The obvious way is to replace national reserve currencies by an international reserve unit along the lines suggested first by Lord Keynes, and subsequently by many others.

(b) To provide for greater flexibility of exchange rates so that international disequilibria, which are bound to arise in the world, can be corrected without resort to deflation with its attendant damage to economic growth.

(c) To take international action to limit the amount of private short-term international capital movements. These serve little or no productive purpose and are liable to be disturbing to orderly exchange arrangements—except possibly in a world of floating exchange rates. (It may be noted that in Europe moves toward greater freedom of short-term funds in exchange markets were put forward by Britain at a time when she was aiming at the adoption of flexible exchange rates. We now have freer short-term movements without the flexible exchange rates, possibly the worst of both worlds.)

The object of all these is essentially to allow a country with a reserve currency to adopt a more independent domestic policy—to concentrate on the development of real economic resources at home and abroad.

Proposals along these lines have been discussed at length in the past. The main points—more liquidity, exchange rate changes in the event of disequilibrium and restriction of capital movements—were incorporated in attenuated form into the statutes of the IMF. But since then the drift of policy has been in the opposite direction.

It might not be possible to get any quick international agreement to a move along the lines suggested. The nations in surplus always oppose moves of this sort which ease the lot of the nations in deficit. At the present moment, the surplus nations are those of continental Europe which are seeking to consolidate their economic and political position vis-a-vis the United States and Britain. They are not likely to be eager to lose the extra bargaining strength which they derive from their present position of surplus.

A lot could, however, be done in the meantime by the United States, partly in conjunction with Britain, the provider of the other main reserve currency:

(a) A gold guarantee might be introduced into officially held foreign balances. It would probably be best to introduce a guarantee simultaneously into dollar and sterling balances so as not to induce a move from one to the other. Such guarantees should alleviate the risks of movements of official funds out of either currency into gold or other currencies.

(b) That part of the U.S. gold reserves, which is now tied as currency backing, might be released.

(c) Restrictions might be applied to capital movements into and out of the United States, similar to those applied in other countries. [The Japanese regulation on inward movements, whereby funds invested in Japan cannot be removed in less than 2 years, is an interesting example.] And international agreements might be sought as to ways of limiting short-term capital movements.

(d) The Present system of swap agreements, whereby the United States and other countries have arranged to hold one another's currencies in stipulated amounts, might be expanded, so as to provide an interim expansion of liquidity.

Measures along these lines might reinforce liquidity and reduce the risks of speculation, official and private, sufficiently to permit the United States to calculate her policies in a mood of greater confidence. Above all, the effective reserves would look very large in relation to the possible calls on them.

It would then be easier to run risks for the sake of expansion—and, because of the inevitable difficulties of forecasting the balance of payments, they are only risks. If balance-of-payments troubles did persist, the United States would face the choice between reverting to deflation and taking more direct measures to correct the deficit—export subsidies, import taxes or quotas, or exchange adjustment.

The choice between these alternatives is a matter of values. Deflation gives priority to fixed exchange rates and to the absence of restrictions on the international movement of goods or funds, regardless of the rate at which they move or the purposes for which they move.

Direct action to correct international disequilibrium gives priority to full employment and economic growth. It can still be compatible with freedom of trade if the price mechanism—in the form of exchange adjustment (or export subsidies and import taxes)—is the weapon used.

When it comes to this choice, there is one argument that is usually put forward in the end by those who uphold the gold standard mechanism. That is the argument that this mechanism imposes discipline on nations and prevents them from following policies that lead to price inflation. Whatever the validity of this argument in the past, it is difficult to accept it as regards the major indus-

trial nations today. In these countries the people and their political representatives have become increasingly conscious of the disadvantages of inflation. They have come increasingly to identify the cause of inflation in the system of wage negotiation by large power groups in our societies; and they have begun to press for some modification of this system. This is an encouraging trend. A move towards greater national responsibility seems more important than international pressures which treat inflation as a purely monetary phenomenon.

My personal view is that expansion should have priority. The growth of production and living standards is the ultimate object of economic activity. Only in conditions of growing demand and production can international trade expand and fulfill its proper function. International reserve and exchange policy must aid expansion, not frustrate it.

As an Englishman I perhaps feel this with particular force. Nearly a century ago Britain was the greatest industrial nation in the world. In 1870 her industrial production was larger than that of the United States. Other nations were bound to catch up, but it was not inevitable that we should fall so far behind. One reason why we have done so is that over the years we have repeatedly adopted policies of deflation and have arrested our industrial progress on the grounds that this would strengthen the balance of payments and permit the maintenance of sterling as an international currency at a fixed exchange rate. Britain is now having difficulty in maintaining her position in the ranks of the European industrial nations.

The United States has been losing her lead in the past decade. I would hate to think that she was beginning to follow the same course as Britain.

R. R. NEILD.

Representative REUSS. Thank you again, gentleman.

The committee will now stand adjourned until 10 tomorrow morning in the caucus room of the Old Senate Office Building.

(Whereupon, at 12:40 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, August 14, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

TUESDAY, AUGUST 14, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, Thomas B. Curtis, and Widnall; Senators Sparkman, Proxmire, Pell, Bush, and Javits.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will be in order. We continue hearings on the state of the economy and on policies to achieve full employment, production, and purchasing power.

This morning we will consider monetary policies: what changes are needed to stimulate employment and to create a more rapid rate of economic growth. For this session we have a very distinguished panel of economists. J. M. Culbertson, professor of economics and commerce, University of Wisconsin; Lawrence S. Ritter, professor of economics, Graduate School of Business, New York University; and Beryl W. Sprinkel, vice president and economist, Harris Trust & Saving Bank, Chicago, Ill.

Gentlemen, we thank you for coming. We are very glad to have you. Our procedure is to have each witness make an opening statement, if he has one, and then the members of the committee put questions to the panel under a 10-minute rule for questioning by each committee member. Our usual procedure is to have the panelists begin in alphabetical order of their names. Professor Culbertson, if you are ready, you may proceed in your own way.

## STATEMENT OF J. M. CULBERTSON, PROFESSOR OF ECONOMICS AND COMMERCE, UNIVERSITY OF WISCONSIN

Mr. CULBERTSON. Thank you, Mr. Chairman. I have a prepared statement that I will summarize.

Senator BUSH. Mr. Chairman, may I have one word? I want to apologize to the panel for leaving this meeting this morning. We are having the Stockpile Subcommittee hearings and there is some very important testimony. This is one of these awful conflicts that I am sure my colleagues understand. But I do want to explain to these gentlemen my great regret that I won't be able to be here this morning.

Senator JAVITS. May I also apologize to the witnesses. Though I will stay a little while, I have an Appropriations meeting to go to.

Representative CURTIS. Ways and Means has an executive session, and we have bills. I will go there. I will read through the statements.

Chairman PATMAN. Stay as long as you can.

Representative CURTIS. I will.

Chairman PATMAN. I don't see how Senators attend all the meetings. It is hard enough on the Members of the House. But the Senators have so many committee meetings, and they are always having executive sessions and important meetings like Senator Bush's, it is just almost impossible to keep them at a meeting for any length of time. Fortunately the record contains everything that is said. Each member gets a copy of the record and although he may not actually read the record himself every time, he has someone read it for him, and his attention is called to the points that he should know about.

In that way they are kept informed. Of course, the record is printed and goes out to practically all the libraries of the Nation, and to people who are interested, so there is wide distribution of the information that we obtain at these hearings. You may proceed, Mr. Culbertson.

Mr. CULBERTSON. Thank you.

I am happy to have an opportunity to appear before you today, because I believe that our country is now at a crucial turning point in its economic policies. Continuation of the policies of the recent past will most likely lead to perpetuation of economic weakness and high unemployment, with the erosion of the prestige and economic and political power of the United States that this would entail.

A policy of more drastic monetary restriction, as has recently been urged upon us from several quarters, surely would make matters still worse and might have quite disastrous consequences. What is required to get the American economy once again moving toward full prosperity is nothing less than a total reorientation of the monetary and debt management policies of the Federal Reserve and the Treasury, coupled with an economically stimulating fiscal policy.

The Government evidently has been deterred from undertaking a thoroughgoing program for full employment in part because of the prevalent idea that this would be a violation of international morality, that the United States at this juncture owes it to the world to give its balance of payments position priority over domestic prosperity, to desist from undertaking the policies that would promote full employment, in a word, to deflate.

I believe that this is an entirely erroneous and dangerous premise. There are means of correcting balance-of-payments disequilibrium other than protracted deflation of the income or prices of any country. Students of such matters took it for granted that the postwar international financial system would explicitly avoid any such reliance upon deflation. However, the emotional gold-standard thinking that wrought such havoc upon the world in the 1920's and 1930's with its mystical attachment to high interest rates and deflation seems, despite the clear lessons of that period, to have reasserted itself with alarming force. The grip of this dogma and the habitual errors of Federal Reserve monetary policy are the principal impediments to the reachivement of full prosperity in the U.S. economy.

## THE PRESENT POSITION OF THE ECONOMY

Without undertaking any detailed review of the present situation of the U.S. economy, let me espouse the generally accepted interpretation that the economy has for some years had excessive unemployment of labor and plant because total demands for final output were insufficient to buy our full employment output at stable prices, that business investment expenditures have failed to show the growth that was expected and that our circumstances called for, and that the continued weakness of the economy is resulting in revision of those optimistic expectations and planning assumptions that underlay people's economic decisions in prior years and that was one of the foundations of our successful economic performance.

No economic crisis or collapse seems imminent, but just as our earlier successes fed on themselves, so failure could begin to feed on itself, with consequences that no one could predict with confidence. I agree with most observers, I believe, in judging that with continuation of present Government policies a spontaneous generation by the economy of expansive forces sufficient to move us speedily back to full employment seems beyond the range of reasonable probabilities.

## THE DEFLATIONARY NATURE OF RECENT MONETARY POLICY

The confusion and obscurantism that surround discussion of monetary policy may have concealed from many the fact that, at least as I see the matter, monetary policy in recent years has on balance been deflationary, has been of such a nature as to tend to produce just about the sort of economic weakness that has, in fact, developed. As we moved from the early postwar years to more normal conditions, as people's redundant balances of cash and liquid assets were used up and their urgent spending needs filled, we should expect that a more rapid rate of increase in the money supply would be required to sustain total expenditures at the full-employment growth rate.

What we have had is just the opposite. After increasing at an average rate of about  $2\frac{1}{4}$  percent from the end of 1950 through mid-1959, the money supply has shown virtually no net increase in the past 3 years (about one-half percent per year). During the past half year, in which our economic hopes have withered so rapidly, the money supply also showed no increase.

The economy is a very complex and interrelated behavioral system and I am sure that the absence of monetary growth is not the sole explanation of the short fall of our growth in national product. I am quite persuaded, however, that it was an important contributing factor. Given all of the surrounding circumstances, including the limited intensity of spending desires, such restrictive money behavior surely was not conducive to expansion of total expenditures at the full employment rate, and may have been enough of an impediment to preclude it.

The people of the Federal Reserve are a most public-spirited group and their failure is not due to any nefarious intentions but, I take it, to misguided conception of the objectives and guides of monetary policy. They tend to think of themselves as controlling credit conditions, rather than governing the Nation's money supply. They seem

to have some conception of the normal or proper credit conditions or degree of credit restraint that ought to prevail in the economy, and this they take it as their province to enforce.

Some of their statements suggest a curious fear of "sloppy money," of money market conditions easier than they take to be normal and proper. Therefore, when the economy weakens, when demands for credit fall off, interest rates naturally decline and banks insist upon having a more liquid balance sheet, the Federal Reserve frequently succumbs to the temptation to offset this by limiting the volume of bank reserves, thus causing the money supply to stop growing or to decline.

This approach is inherently destabilizing, since under it the money supply tends to grow most rapidly when the economy is strongest and to level off or decline when it is weak. This preoccupation with credit conditions to the exclusion of money has characterized the Federal Reserve since its inception, and its current theory seems to be a modern descendant of an ancient fallacy of banking theory known as the commercial loan theory of banking or the real bills doctrine.

Another element in the interpretative muddle over monetary policy is the meaning ascribed to changes in the amount of commercial bank time deposits, which have been increasing very rapidly recently. The Federal Reserve seems to hold that changes in time deposits have about the same effect on the economy as do changes in demand deposits or the money supply, in which case its record is not so restrictive as it otherwise appears.

For reasons that are rather abstruse, I think that this is an erroneous interpretation. Time deposits, which bear interest and are not means of payment, and which arise out of the demands of the holders, seem to play a fundamentally different role in the economy than money and are best treated as similar not to money but to other liquid assets. It is relevant to observe that the rapid increases in time deposits since early 1960 and the extraordinarily rapid increases early this year had no noticeable effect in strengthening the economic situation.

Since liquid assets, although not identical in their impact upon the economy with money, are a significant variable that the Government, through debt management policy, does influence, it is useful to observe that on a liquid asset criterion also, Government financial policy has been restrictive. The ratio of money supply plus liquid assets to current gross national product now is lower than it was earlier in the decade, and the ratio if computed against full employment gross national product would be lower still.

In short, on any reasonable criterion, the Federal Reserve, exercising the Government's power to regulate the Nation's money supply, has done so in a manner that discouraged full employment, if it did not make it impossible.

#### DEBT MANAGEMENT POLICY AND FEDERAL RESERVE "NUDGING"

A great deal of publicity has been given to Federal Reserve open-market purchases of Government securities other than short-term as a force for reducing long-term interest rates and contributing to economic expansion. In truth, an effective policy of reducing the volume of long-term Government securities in the hands of the public

and increasing the volume of short terms can be a useful part of an overall policy program to promote economic expansion. It increases the liquidity of the public, tends to reduce interest rates in the capital markets where the most interest-sensitive private borrowing is done, by maintaining yields on liquid short-term debt it provides incentives for people to avoid hoarding cash, and since international mobility of funds is greater in the short-term area it somewhat aids the balance-of-payments position.

The crucial fact to have in mind regarding such a policy is that it has not been undertaken during the past year and a half. On the contrary, the Treasury has been more active in drawing funds from the intermediate and long-term capital markets than during most of the earlier postwar period. The highly touted Federal Reserve purchases of securities other than short term did nothing more than buy back a part of the illiquid debt that the Treasury was selling. To argue that selling two bonds with one hand and buying one of them back with the other hand would raise bond prices has always seemed to me rather silly, and I see nothing in recent experience that requires a change in that view.

Actually to increase the volume of liquid short-term Government securities outstanding and limit or reduce the volume of long-term securities would have some favorable effect upon domestic economic developments and the balance of payments. Such actions should be a part of a total Government program to achieve full employment. Obviously, the major responsibility for such a program must fall upon the Treasury, since its financing operations dwarf Federal Reserve operations in Government securities, and it is futile and confusing to have the Treasury and the Federal Reserve busily engaged in offsetting one another's actions.

However, the Treasury has not followed such a policy in the past, and I have heard no intimations that it intends to do so in the future. It again entered the long-term market within recent weeks. In the debt management as well as the monetary area, what we need is a complete reorientation of policy.

I think it important to observe that our present economic weakness does not seem to be episodic or temporary, but rather appears as a continued tendency toward insufficient dollar demands for the final output of our economy. Thus, it is just the sort of condition that we should expect to be produced by monetary and debt management policies that were over a period of time steadily too restrictive.

By the same token, we evidently should assume that what the economy will be needing from policy is not a temporary, one-shot upward push, but rather the continued maintenance of an environment more conducive to economic expansion. For this purpose, fiscal policy is evidently not a fully satisfactory answer. If large Government deficits had to be expected to persist over a considerable period of years, even the most enthusiastic admirer of fiscal policy must regard the prospect as something of an embarrassment, and as limiting the economic efficacy and political attainability of the required policy.

On the other hand, placing under the economy a foundation of money and liquid assets consistent with full employment levels of expenditures will help not only to bring the economy to full employment, but to maintain it there indefinitely thereafter without problems

or embarrassments. In attacking protracted conditions of excess or deficiency of total demands, stock adjustments through monetary policy and, in a secondary role, debt management policy are immensely more suitable than flow adjustments through fiscal policy.

For these reasons, it seems to me that a reconstruction of our monetary and debt management policies presently must be the foundation of an effective policy for full employment. We have very little experience with such a constructive venture, and I am sure that we cannot hope to achieve policy actions precisely optimal in timing and degree. But I am nevertheless confident that we shall greatly improve our fortunes if we stop pushing in the wrong direction and turn around and begin pushing in the right direction. The amount of ammunition potentially available to monetary and debt management policies is, in relation to conceivable needs, virtually unlimited. I see no reason whatever to fear that we cannot keep the demands for the output of our economy on the average over periods of years within the zone consistent with acceptable full employment and price stability.

Future failures, like past failures, will result not from any flaw in the basic logic of the market economy, but from the failure of Government to make effective use of its inherent powers over the money supply, the Government debt, and the Government fiscal position.

#### WOULD MONETARY RESTRICTION PLUS TAX REDUCTION PRODUCE PROSPERITY?

Since our present situation seems to impose upon us a conflict between policy objectives, it is now commonly suggested that we, in effect, mount our charger and ride off in both directions, that we maintain our restrictive monetary policy—or go further and set about to raise interest rates—in deference to our balance-of-payments disequilibrium, while reducing taxes in the hope that this will improve employment. The chances that such a program would bring us to full employment seem to me extremely small, and the chances that it would lead us to an intolerable plight seem rather substantial.

I think that the implications of any effort through Federal Reserve policy to raise U.S. interest rates are not widely appreciated. One reason for this is the difference between the financial system of the United States and those of some other countries, in many of which interest-rate manipulation seems to be carried on without any drastic effect upon domestic investment and economic activity. In many other countries, capital markets are extensively regulated and dominated by formal or informal credit rationing. Interest rates are administered prices not closely related to true supply and demand. Thus, the central bank may be able to raise its discount rate and induce an administered increase in other interest rates, while credit rationing is sufficiently eased that total domestic investment is virtually unhurt.

In the United States, we are in precisely the extreme opposite situation. We have built up a system of free credit markets that are, I think, unparalleled in their integration and responsiveness to supply-and-demand forces. The Federal Reserve has no magic wand that it can wave at these markets in order to raise interest rates without affecting investment. If it were to seek to raise interest rates above

present levels, it could do this only by enforcing a liquidation of money and bank credit, by reducing bank reserves and the money supply. The economy would suffer not only the direct effects of the reduction in the volume of bank credit, which would be transmitted throughout credit markets, but also the persisting effects of the smaller money supply, which would be a continued drag on the economy until it was again increased or until incomes were reduced to conform to it.

Those who propose that we take the great risks that such a policy of monetary contraction would entail for our economy in order to achieve an adjustment in the flow of international funds into New York, one that might be generously appraised as amounting to something on the order of one-tenth of 1 percent of our gross national product, could hardly be further from the domain of reasonable policy suggestions. This would be a case not of the tail wagging the dog, but of the tail of the flea on the dog wagging the dog.

As a means of calling to your attention the lessons of an episode so closely parallel to our present situation that I am surprised that it is not more commonly referred to, I am moved to quote from the argument that Keynes made in "The Economic Consequences of Mr. Churchill" in opposition to England's ultimately catastrophic defense through deflation of its overvalued pound during the 1920's:

Credit restriction is an incredibly powerful instrument, and even a little of it goes a long way—especially in circumstances where the opposite course is called for.

I appreciate that on economists' simplifying assumptions there is no combination of restrictive monetary policy and other adverse circumstances so bad but that it could be offset by a Government deficit sufficiently large. But practical policy appraisals must take account of the fact that many businessmen and other people feel in their bones that large and prolonged Government deficits are improper, and thus will respond negatively to them both in their economic and political behavior.

Even if it made sense to try, which it surely does not, I doubt that fiscal policy could enlarge the Government deficit in the near future fast enough, far enough, and long enough to bring us to full employment in the face of a deflationary monetary policy. Much more likely, we should find ourselves at the end of another year with an even weaker economy, a very large deficit, shattered confidence, and—since we should erroneously feel that policy had already done what it could—at a loss as to where to turn next.

#### IS "A LITTLE DEFLATION" A TENABLE POLICY?

Even those gentlemen who feel most piously that a little deflation is good for a nation's efficiency and moral fiber do not propose that we should be given more than a modest dose of it. This is anomalous, to begin with, for if our balance-of-payments problem is purely temporary, deflation is not necessary or called for by any reasonable rules of the game, while if our payments deficit reflects fundamental disequilibrium there is no reason to expect that a couple more years of moderate deflation of income and of high unemployment would solve the problem.

Beyond this, however, a little deflation may be a most touchy and uncertain thing to manage. On economists' blackboards, economies are docile creatures that sit politely in one equilibrium position until they are asked to move over to another. But actual economies show none of this tractability, but behave like the unruly and unpredictable creatures whose affairs they organize, basing today's actions on yesterday's experience, suffering sometimes from an excess of animal optimism and then excessively abandoning faith, naively extending current trends into the future.

All economic decisions rest upon a framework of planning assumptions as to the nature and future of the economy, which themselves rest upon an interpretation of the meaning of past economic experience. So long as experience remains within usual bounds and these planning assumptions are not overturned, behavior may be reasonably predictable. But if an extended period of deflation forces people to a reinterpretation of the future of the economy and a new set of planning assumptions, no one can pretend to predict with any confidence how they will behave and what the consequences will be. However, we can expect that failure would tend to breed failure, and that the further deflation goes the more difficult it would become to correct it and the more unpredictable the environment in which policy would have to operate.

We must keep in mind also that the cost of deflation goes far beyond that real output that might have been consumed but was not. Indeed, that may be the least part of it. The heavy and perhaps unbearable cost is the loss of prestige of the Nation, and of the system of the free economy, the uneconomic habits of make-work and job-sharing that then persist on, the loss of the sense of achievement and pride, the turning to illiberal and extreme political doctrines, the impulse to international irresponsibility. We have known these things well enough in the past. We see incipient signs of some of them now. With a few years of yet higher unemployment, the crop would grow rapidly.

These are the costs of deflation that the United States cannot afford if it is to meet the enormous challenge of leading the free world through a successful competitive struggle for survival. These are the most compelling reasons why a continuation of deflationary policies ought to be entirely outside the bounds of consideration. We have had too much unemployment and paid too dear a price already.

#### SOUNDNESS VERSUS REALISM IN STABILIZATION POLICY

There has always been an approach to economic policy that is more psychological or emotional than logical in character, that judges policies not in terms of their probable effects but of their absolute soundness, and that tends to see soundness and moral virtue mainly in policies that are deflationary in effect. This ideology gained an unusual ascendancy in this country in the latter 1920's and had much to do with causing our great depression to be what it was.

The policies of soundness were then consistently applied. We raised taxes sharply in 1932. The Treasury burdened the market for long-term debt with a very large volume of issues while permitting a shortage of liquid short-term debt to develop. And the Fed-

eral Reserve, in 1931, with catastrophic effect, applied a large dose of credit restriction to cure a speculative outflow of gold. Each of these policies was applauded as eminently correct by adherents of the soundness approach, but very little applauding was being done by anyone a few years later when the country was enjoying their cumulative effects.

With the eventual development of prosperity and the dimming of these memories, the soundness doctrine seems to have arisen again. Again, it sees soundness exclusively in policies that are deflationary: "Defend the dollar by economic restriction, accept the discipline of the balance of payments, fund the Government debt, do not 'force credit upon the economy' and avoid 'sloppy money,' balance the budget in bad times as well as good."

It is difficult to see policy discussion in perspective without recognizing the existence, the historical lineage, and the essentially emotional basis of the soundness approach. One dimension of policy controversy involves whether we shall approach matters in a businesslike and pragmatic way, realistically appraising the probable effects of alternative policies, or whether we shall invoke an emotional formula that sees moral virtue in policies that lead to deflation.

#### DOES INTERNATIONAL COOPERATION REQUIRE U.S. DEFLATION?

The free world does need an orderly system of international trade and finance. If a U.S. policy of continued deflation of incomes and high unemployment were the only way that such a system could be maintained, doubtless we should be willing to make the sacrifice, and the free world would be willing to suffer the resulting impairment of our capacity for leadership.

Actually, the situation seems to be quite the reverse of this. The rules of the game that would call for U.S. deflation are an unreasonable and illogical set. Solidifying them will only multiply the damage that they will do before they are, as ultimately they must be, discarded. Rather than invoking archaic formulas for deflation, the United States should be contributing imaginative and creative leadership to the development of an international financial system that will make sense and will prove viable in the long run. Our fulfillment of this responsibility recently seems to be somewhat wanting.

Let us consider the essential elements in our problem. We assume that the deficit in our balance of payments and the corresponding surpluses in the position of other countries may be of a fundamental and persistent character. If they were taken to be purely temporary and subject to reversal, the proper course would be simply to let our gold flow out to reduce our liquid reserves. That is what liquid reserves are for. If we lack the courage ever to use them, they are of no value to us.

If the disequilibrium in international payments appears to stem from fundamental causes, then there are six major types of measures for correcting it: Devaluation of the dollar, appreciation of the currencies of countries experiencing balance-of-payments surpluses, tightening of U.S. trade restrictions and controls on capital export, easing of the trade restrictions and capital controls of countries experiencing surpluses, restriction of incomes and reduction of wages

and prices in the United States, expansion of incomes or increases in wages and prices in surplus countries.

Having excluded U.S. deflation as a way of correcting the disequilibrium, let us tentatively make three more exclusions. Leading surplus countries are not in a position sharply to increase their domestic incomes and expenditures without causing inflation, and a burden to inflate ought also to be excluded from our rules of the game. U.S. devaluation is a step to be avoided, if this can be done without deflation, because of the status of the dollar as the leading international reserve currency, as the pivot of the international financial system. Finally, we are reluctant to impose trade and exchange restrictions, as that goes against the trend toward liberalization that we have fostered.

Still this does not leave us without resources to correct disequilibrium. Logic requires that if the dollar is the center of the universe and cannot be devalued, or its access or use restricted, then the adjustment must be made on the other end. If we can make no adjustments to combat payments deficits because we are the center of the universe, then the planets must adjust to us.

If we cannot impose trade restrictions, then other nations must ease their import restrictions and export subsidies sufficiently to restore equilibrium to the system. If we cannot tighten capital restrictions, then others can achieve the same effect by easing theirs. If we cannot devalue, then surplus countries can increase the values of their currency in relation to the dollar. To achieve such adjustments will not be an easy political task, for not only the existing system but the gold standard in practice had a deflationary bias in that surplus countries were disposed to avoid adjustments, putting the full burden on the deficit countries.

But the logic of the system requires this approach. If the surplus countries will not so behave as to keep the system in equilibrium, then the key currency countries when in deficit must be expected to devalue, or to impose trade and exchange restrictions. In the absence of this, the system would impose a systematic burden of deflation on the key currency countries. If other countries when they have a deficit can devalue against the key currency countries and can impose trade and capital restrictions, and then can neglect to make any adjustment when they have a surplus, obviously the cumulative effect of these actions must be offset by deflation in the key currency country. Such a system surely is not going to work, and the sooner the issues are faced, the better.

It has not been past practice for surplus nations and those in a balanced position to assume responsibility for making adjustments to bring the system and the position of the key currency into balance. The United States has at times in the past been a very bad offender in this regard. However, it is only through this means that a more drastic reform can be avoided. If such a reorientation of the system is to be achieved, this can be done only through forceful U.S. leadership.

In recent statements by U.S. policymakers, I do not see a recognition of the necessity for this. Rather, they seem to have acquiesced in and supported the asymmetry and illogic of past arrangements by proclaiming that the major responsibility for correction of the U.S. balance-of-payments deficit lies with ourselves. A reorientation of the

U.S. Government position on this matter seems indispensable to any constructive policy program.

#### TOWARD A VIABLE INTERNATIONAL FINANCIAL SYSTEM

The immediate problem of correcting the disequilibrium in the international financial balance, in which the U.S. finds itself on the deficit end, should be regarded not as a unique incident—one in the correction of which we ask other countries to do an unreasonable favor for us—but rather as a step in the building of an international financial system that is viable, that will stand the tests of the future. A system imposing a burden of deflation on key currency countries will not do so.

More broadly, we should see our present position not as one of defense of a finished and satisfactory international financial system, but rather as a stage in a process of experimentation and development. The system built up since the war, a system in which many experts always have seen grave defects, is only now being tested in the sort of open international financial interchange that we expect to maintain in the future. We must be ready pragmatically to assess the lessons of that experience and to revise the system on the basis of it. What is needed is imaginative leadership in economic architecture, and not resolutions to do or die for the institutions that now exist.

In this connection, it is essential to keep in mind that not only is our present international financial system in some respects anomalous and defective, but that we have never had a system that was satisfactory. Enough time has now elapsed since its failure and ultimate collapse that some people seem to take the gold standard of the 1920's as a proper guidepost for our future development. However, it was not so regarded when the experience was fresher. Some of our difficulties stem from the fact that the well recognized flaws of the gold standard have been built into the system with which we are now working: the instability of the gold exchange standard, the disruptive influence of unregulated short-term capital movements, the excessive rigidity of exchange rates, the asymmetry of the system and the deflationary burden that it sometimes implies.

Thus, it behooves us to keep our minds open to the possibility that experience will indicate the necessity for substantial changes in the present system along the several dimensions that past discussion has clearly delineated, principally: (1) Greater flexibility of exchange rates as a way of maintaining payments balance; (2) further internationalization of the responsibility for management of the international money, to limit the instability of the key-currency system and the burdens that it sometimes imposes upon the key currency countries; and (3) regulation or better considered rules of the game for international capital movements.

Since this last point is a fundamental one perhaps neglected in recent discussion and quite relevant to the present problem of the United States, let me make a point regarding it. I do not have at hand any suggested set of rules of the game for international movements of private capital in the modern world, but I am very doubtful that the situation of *laissez faire* now evidently taken as the goal of policy development makes any sense. I think that this whole matter needs a fundamental rethinking. Consider these points:

(1) It has long been recognized that short-term speculative international capital movements are a disruptive force ordinarily lacking economic function. Since improved communications have brought nations closer together, these are likely to prove more troublesome in the future than in earlier times. Some things have been done to limit and offset these, but very likely not enough. Interestingly, much current discussion takes it for granted that in determining U.S. domestic policies for full employment we should avoid doing anything that would offend the ideas or the prejudices of the currency speculators.

(2) Recent experience has illustrated the systematic tendency for capital to escape from a country experiencing recession, where interest rates are down and investment prospects temporarily unattractive, to a country with a boom, where the opposite conditions prevail. Obviously, this is destabilizing to both countries.

(3) A general system of free international movement of capital implies equal freedom and equal development of the domestic capital markets of the various nations. Otherwise, the nation with the freest and best developed capital market becomes the dumping ground for issues that are excluded from or cannot be serviced in their home market. Since many nations now evidently do not intend to have free domestic capital markets, it is not reasonable to require that those that do have them permit capital outflows rising out of this discrepancy.

(4) Long-term international private capital movements in the modern world have political implications different from those of the last century in at least two respects: (a) In the ideological struggle for survival that now dominates the world, in which growth in economic strength is crucial, a nation may not be able to ignore the cost to its own economic growth and standard of living that results from the export of its capital. (b) Private investment abroad often damages the lending country in international political terms because of suspected "imperialism," because the investments arouse antagonism among inhabitants and lend fuel to antidemocratic forces, because the government of the lender later feels impelled to defend the investments against expropriation at political cost to itself, et cetera. In this political environment, to pretend that international capital movements are purely a matter of private concern may turn out to be a costly oversight. In considering what are reasonable rules of the game for capital movements, we should perhaps be doing more looking ahead and less looking backward.

#### A PROGRAM FOR U.S. POLICY THIS YEAR

Since it may be useful for discussion and for evaluation of the actions that the Government does finally take this year to have some concrete suggestions as to a course of action, let me outline a set of policies that I think would lay the groundwork for a prompt movement of the U.S. economy toward full employment.

I should emphasize the importance of beginning constructive policy actions immediately. The present position of the U.S. economy is such that the prevalent forecast of a recession next year is not at all implausible. A recession, once permitted to begin, has a momentum of its own that precludes its immediate correction. If recession is per-

mitted to get underway, the timetable of possible progress toward full prosperity in this country may be set back by a full year, and this even if one makes the most optimistic assumption regarding the resulting deterioration of people's expectations and planning assumptions. If, as I think may be quite possible, the prompt and careful application of more stimulative Government policies can prevent our turning around that corner to recession, this will be immensely advantageous to us.

My program for prosperity—which is not meant to be exhaustive—has five points:

1. Every effort must continue to be made to restrain increases in wage rates and to discourage unreasonable increases in administered prices. In the present setting of policy, larger wage increases will almost certainly have to mean larger unemployment in the short run and other unattractive adjustments in the longer run.

2. The Federal Reserve must immediately cease its moratorium on monetary growth. While I think that the rate of money increase can and should be flexibly adjusted about its normal value in response to changes in economic conditions, a reasonable starting point for policy now would seem to be a presumption for an increase in money supply on the order of a 4- or 5-percent annual rate.

3. Until economic conditions strengthen, the Treasury should severely limit its issue of securities other than short term. It should freely increase the economy's supply of liquidity instruments.

4. I believe that a moderate tax reduction this year would be a wise policy. Because our limited abilities at economic forecasting create the need for flexibility of policy, the President's proposal that he be given limited power to change tax rates for economic stabilization reasons also should be passed this year.

5. Further revision of the tax system to encourage business investment, as through the investment credit proposal, also seems desirable.

If it uses its principal powers thus in a coordinated way, rather than using some of them to oppose others, I am confident that the Government has ample ammunition to prevent accumulation of either deflationary deficiency or inflationary excess of total demands. We surely shall not be able to manage these powers perfectly and get exactly what we want in every year, but I think it is extremely important to be able to feel that our system of policy use will never permit the economy to get very wide of the mark, to again get really out of hand.

Achievement of progress toward full prosperity in the United States doubtless in the short run will act to aggravate the balance-of-payments deficit, although some forces will work in the opposite direction. Nothing will retain and draw capital to the United States like prosperity and the attractive yields that it entails. Also the high levels of investment by which it is hoped that our productive efficiency may be increased and the payments position improved in the longer run can hardly be conceived as occurring except in a prosperous economy.

However, any weakening of the balance of payments that occurs as a result of prosperity without price inflation need not, I think, be feared. We have resources that, if properly used, suffice to ride

through the period. Indeed, concealing the nature of the world's payments disequilibrium by continued U.S. stagnation will make it more, rather than less, difficult to get a proper diagnosis and the action that is required to correct the matter.

Many devices available to U.S. policy to improve its balance of payments have been dealt with in fruitful discussions before this committee, and many are embodied in the Government's program. I should like only to mention several measures on which I should put more stress than they ordinarily receive :

1. The United States should lead an international reconsideration of the rules of the game of our international financial system with a view to relieving the deflationary burden on key currency countries by primary assumption of responsibility for adjustments by surplus nations, thus mutualizing the responsibility for maintaining the present dollar parity as the focal point of the system.

2. Abolish the gold reserve requirement for Federal Reserve notes and deposits and stand ready to effect some additional redistribution of the large gold stock still held by the United States.

3. Insofar as their prosperity and income levels make it appropriate, urge assumption by other nations of a larger share of the defense and foreign aid costs now borne by the United States on behalf of the free world.

4. Develop a Government program to speed the rate of improvement in efficiency of U.S. business by selected applied and technological research and informational and educational services.

5. Stimulate exports through tax advantages or other such means insofar as this is consistent with what other nations are doing.

6. So far as practicable under the developing rules of the game, discourage the export of U.S. capital where it does not offer any net advantage to the Nation and the free world, especially speculative flows, movements stemming from our temporary stagnation and unattractive yields, flows arising out of the restrictions existing in foreign capital markets, et cetera.

7. Proceed with a continuous reevaluation of the logic and workability of the international financial system, drawing from this guidance as to the direction in which to move in solving the short-run problems that arise.

8. Last, but perhaps most important, seize every opportunity to spread understanding that wage increases must be confined to bounds consistent with price stability and maintenance of reasonable profits, and that the structure of wages must not be deprived of all equity and reason by the exactions of groups with superior power or inferior conscience.

I should be quite hopeful that a combination of policy measures such as this could put us a year from now in a position to feel that the U.S. economy was once again moving toward the kind of record that we could take as a source of pride and other nations as an example.

On the other hand, I am no less fearful that without such constructive application of policy, we could quite possibly find ourselves a year from now in a position that had deteriorated to a surprising degree.

Chairman PATMAN. Thank you, sir.

Our next witness is Mr. Lawrence S. Ritter.

Mr. Ritter, I believe you have a statement.

**STATEMENT OF LAWRENCE S. RITTER, PROFESSOR OF FINANCE,  
GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, NEW YORK  
UNIVERSITY**

Mr. RITTER. I have a brief statement which I would like to read.

Chairman PATMAN. You may proceed in your own way.

Mr. RITTER. Mr. Chairman and members of the committee, I appreciate the opportunity and I am honored to appear before you today to discuss the general subject of monetary policy. I would like to say a few words in this introductory statement about the kind of monetary policy we should have today, in light of the sluggish behavior of our economy since 1957 and in light also of our balance-of-payments deficits and our gold losses.

In February of 1961, almost a year and a half ago, the Federal Reserve was in the process of supplying member banks with a large volume of reserves. This was being done in order to lower interest rates and increase the availability of credit, hoping of course to thereby encourage an expansion in economic activity. Then on February 20 of last year the Federal Reserve officially announced that the "bills only" policy was being abandoned; it explained that while it wanted to continue a policy of easy money, because domestic business conditions were far from satisfactory, at the same time it did not want to lower short-term interest rates because of the danger of short-term funds moving out of the country to obtain higher yields abroad. Thus it supplied reserves by buying long-term securities, and simultaneously sold some shorts to keep the short rate up.

To most of us this appeared to be a rather reasonable thing to do, and I have no quarrel to find with it, although it isn't quite as easy to pull off as some people seem to think. But, after all, most of us think the short-term rate isn't nearly as important in its impact on domestic business conditions as the long rate might be, so if the Federal Reserve wanted to keep the short rate up, why not. It wouldn't interfere with business recovery and it might do some good for the balance of payments.

In recent months, however, I sense a feeling on the part of some in the Federal Reserve, and in the Treasury too, that just keeping the short rate up isn't enough; that perhaps we need higher long-term rates as well. If such a view is indeed gaining ground, then we may be in for trouble: Should our monetary policy be decided on the basis of the needs of our domestic economy or on the basis of our balance-of-payments position and gold stock, which many evidently see as requiring higher short- and long-term interest rates?

I must repeat that I am not sure that such views, that is, about the need for higher long rates on balance-of-payments grounds, have actually gained much currency. But I sense that they may have from the evidence of the long bond that the Treasury floated 2 weeks ago and the recent statement of Chairman Martin that a current budget deficit should be financed out of savings. On domestic grounds alone, it seems to me, neither of these actions can be justified very easily.

If the Federal Reserve and the Treasury are indeed inclined to formulate monetary and debt management policies in terms of balance-of-payments considerations, then I think they should at least say so and open the subject to debate before rather than after the fact. When it was short rates that were involved, the reasoning of the

monetary authorities was promptly made public, for all to examine. It is even more important to do so when it comes to the issue of long rates.

Of course, I am assuming that the level of long-term interest rates does have some effect on domestic spending decisions and thereby on the level of employment and the rate of growth. It may not, in which case it may very well make sense to raise it to assist in correcting our balance of payments. This only emphasizes our need for further research in this area.

In my opinion we will be making a mistake if we hastily decide to formulate our monetary and debt management policies in terms of their impact on our balance of payments and our gold stock. There are possible alternatives which should first be thoroughly explored. One is the Triffin plan. Another is the adoption of flexible instead of fixed exchange rates.

In any case, neither the state of our balance of payments nor our gold stock would appear to warrant the pursuit of policies that may sap the vitality of our domestic economy. We will surely be doing no favor for the many nations that depend on our economic strength if we deliberately, because of international considerations, take steps that may decrease our rate of production or retard our rate of growth. I am inclined to think that what we need today, on both domestic and foreign grounds, is exactly the opposite.

We seem to be living in an "Alice in Wonderland" world, to judge from statements by eminent financial authorities which appear almost daily in the press. I read over and over again that we must impose "the discipline of the balance of payments" in order to "defend the dollar" or to "maintain the integrity of the dollar."

I have great difficulty in understanding exactly what this means. Does it merely mean preventing inflation? But this already was one of our primary aims long before our balance-of-payments deficit and our gold outflow came into prominence. So evidently those who continuously reiterate these slogans, and who seem to suggest that "maintaining the integrity of the dollar" is something new, must mean something more than just preventing inflation.

I sense that they may have in mind something like the classic gold standard adjustment mechanism: that because of our gold outflow we should actually try to lower our domestic price level, in an effort to restore external equilibrium. But the rigidities in the U.S. economy obviously make this impossible unless we have at least two or three times as much unemployment as we have now. Is creating a depression maintaining the integrity of the dollar? We would hardly be helping our friends abroad by this process.

If we concentrate now on preventing inflation and maintaining high employment, just as we should have been doing all along, and also open our thinking to the possibility of freely flexible exchange rates as an adjustment mechanism, we can solve our balance-of-payments problem without tears.

I am afraid that our fetish regarding the almost mystical significance we attach to gold, and our unquestioning assumption that fixed exchange rates are beneficial, may be bringing us perilously close to some very foolish actions.

**Chairman PATMAN.** Thank you, sir.

**Mr. Sprinkel,** I believe you have a prepared statement, too. You may proceed in your own way, sir.

STATEMENT OF BERYL W. SPRINKEL, VICE PRESIDENT AND  
ECONOMIST, HARRIS TRUST & SAVINGS BANK, CHICAGO

Mr. SPRINKEL. Yes, sir. Mr. Chairman and members of the committee, I am honored and pleased to have the opportunity to present my views on monetary policy to this committee.

### I. INTRODUCTION

There is general agreement among students of money that monetary change is capable of affecting total spending upon goods and services. But the intensity of the effect, the timing of the effect, and the channel through which monetary change works remain in dispute. Since wages and prices are not, and never have been, perfectly flexible, changes in total spending in turn affect production and employment, in addition to prices.

Students of money frequently disagree on the appropriateness of a particular policy. Disagreement stems either from: (1) Disagreement as to the effects of monetary change, or (2) disagreement as to the social desirability of a particular result. A careful, dispassionate study of positive monetary economics should be capable of eliminating many disagreements of the first order, but different value judgments will make inevitable disagreement as to the desirability of a particular economic result.

Far too much time and talent has been devoted to argument over theoretical niceties of various monetary approaches and too little time and effort devoted to testing alternative theories against accumulated historical evidence. Unless it can be established, beyond reasonable doubt, that monetary change does affect economic activities in a predictable fashion, it is meaningless to talk about a monetary policy designed to facilitate achievement of widely accepted social objectives such as high employment of resources and price stability, since we cannot know what monetary action should be taken under particular circumstances.

I plan to present what I believe to be some empirically supported results of the effects of monetary change upon other economic variables, discuss some of the implications, and comment on some current monetary policy debates.

### II. EMPIRICAL STUDIES OF THE EFFECTS OF MONETARY CHANGE

In the writer's opinion, the most careful and exhaustive recent study of the effects of monetary change has been conducted by Prof. Milton Friedman and associates of the University of Chicago. A study entitled "The Relative Stability of Monetary Velocity and the Investment Multiplier in the United States, 1897-1958" by Professor Friedman and Prof. David Meiselman, will shortly be published by the Commission on Money and Credit.

That study contains the strongest available evidence of the close and consistent relation between the stock of money and income and between changes in the stock of money and income. The study supports the view that the quantity of money matters because: (1) Changes in the quantity of money do result in substantial changes in income, prices, and employment, (2) the relationships between the quantity of money and other assets and income are relatively stable

and, therefore, the effects of changes in the stock of money are, to a significant extent, predictable and, finally, (3) the quantity of money can be controlled accurately within narrow limits by monetary policy.

On a less sophisticated level than the Friedman-Meiselman study, analysis of the attached chart, relating monetary change to U.S. business cycles since 1918, suggests the following conclusions:

1. All economic declines were preceded by monetary restriction, that is, reduced growth in the money supply, thereby supporting the argument that monetary restriction leads to less spending.

2. All recoveries were preceded by monetary ease, that is, increased monetary growth, thereby supporting the argument that monetary expansion leads to higher spending.

3. The time lead of monetary contraction prior to declining economic activity is relatively long, averaging about 18 months, but is somewhat variable.

4. The time lead of monetary expansion prior to rising economic activity is relatively short, averaging about 9 months, but also somewhat variable.

5. Although the relation is not perfect, there is a noticeable correlation between the severity of monetary change and the subsequent change in economic activity. For example, the largest monetary contractions coincide with the largest economic declines, 1921, 1929, and 1937; and the largest monetary expansions accompanied the unusually sharp rate of recovery following each of those declines.

It is worth noting that the consistent relation between monetary change and spending change is not unique to the United States. I know of no foreign country that suffered significant inflation that did not experience a large growth in the quantity of money. Nor do I know of a country suffering serious deflation that did not have monetary contraction. Monetary change and, hence, monetary policy, can be a source for great good or great evil. It cannot solve all our economic problems such as encouraging greater investment and hence higher economic growth, or greater price flexibility, but it can and does exert important effects upon total spending.

### III. SOME POLICY IMPLICATIONS

Some of the policy implications that appear to follow from these empirical relations are:

1. Monetary change and hence monetary policy is an extremely potent economic tool capable of either increasing or decreasing total spending. Excessive monetary growth when the economy is fully employed can lead to increased spending and inflation. Too little money and liquidity is capable of reducing spending and initiating an economic decline.

2. The use of monetary ease for inducing expansion in total spending is not analogous to "pushing on a string" but is more nearly analogous to "pushing a ramrod." In fact, monetary policy appears to work with a shorter lag in inducing rising spending than in causing reduced spending.

3. Large variability in monetary expansion should be carefully avoided since business fluctuations appear to be more closely associated with the change in monetary growth than with the level of monetary growth. On the whole, monetary policies pursued since the "accord"

compare very favorably with those preceding 1951; first, because monetary fluctuation has been less, and second, those policies have been accompanied by lesser economic extremes such as inflation and deflation.

4. Adapting monetary change to the current economic trend may frequently prove inadequate and destabilizing because of the lag and variability in the effect of monetary change upon total spending. Until we understand more about the lagged responses, we may be better served to maintain a fairly stable rate of growth in the quantity of money, approximately equal to the average annual growth in the total economy. The only feasible alternative is to base current monetary actions upon predictions of future economic change, since action taken today will affect total spending at a later and partly indeterminable date.

Under certain conditions, economic forecasts can be made with a high degree of accuracy, but that is not always the case. Although we can determine the average lead between monetary change and spending change, the average may not apply to a particular instance. The Friedman-Meiselman study indicates the highest correlation is achieved with a two-quarter lag after monetary change.

#### IV. SOME COMMENTS ON CURRENT PROBLEMS

##### A. THE STATE OF THE ECONOMY

The economy is currently expanding at only a modest pace, at a level substantially below full employment of resources and there appears to be no sizable stimulus on the near-term horizon. Consumer outlays are high and rising but the recent Federal Reserve Board survey of consumer plans suggests it is unlikely that a substantial increase will occur in this area over the balance of the year. Business investment surveys suggest modest further increases in capital spending and construction contracts appear large enough to sustain the present high rate of construction.

However, a further rise in construction on the order that occurred earlier this year seems improbable. Also Government spending may rise modestly over the balance of the year.

Furthermore, weakness is now appearing in those indicators which in the past foreshadowed a later economic decline. The NBER indicators appearing in the July issue of the U.S. Department of Commerce publication, "Business Cycle Developments," were mostly in a downtrend even though in many cases they are not far from previous peaks. No one can know if the current trend is foreshadowing a recession within 6 to 9 months from now, but unless current trends are shortly reversed, such an eventuality is a good possibility. In any event, the possibility of achieving full employment of labor and capital resources in that time period appears remote.

##### B. CURRENT POLICY DEBATES

Under present conditions of a sluggish economy and a balance-of-payments deficit, it is frequently argued the solution lies in an easy fiscal policy (large deficits), and a tight monetary policy. It is felt that a large deficit would stimulate the internal economy while a tight monetary policy would raise interest rates, and reduce short-

term capital flows and gold drains. In other words, monetary and fiscal policies are considered to be substitutes rather than complements. Although this idea is intriguing, the assertion is not supported by the long-term evidence. Total spending on income has been in the past closely correlated with the money supply regardless of whether the monetary change came about through the private or public sector of the economy.

Income has been positively correlated with monetary change, not the size of the Government deficit. Unless a Government deficit is financed at least partly by new money, which is possible only by an expansionary monetary policy, it is unlikely to be a substantial and lasting stimulant to income.

Conversely, a budget surplus, unless accompanied by monetary restraint, will not exert a strong brake on total spending. The long-term record suggests monetary change is both a necessary and sufficient condition for bringing about a substantial change in total spending. The data suggest that monetary and fiscal policies can best be considered complements and not substitutes. A policy of substantial monetary restraint and temporary fiscal ease is likely to generate shortly a decline in total spending.

Several able observers of the U.S. economic scene have recently argued ardently that interest rates should now be raised in the United States in order to make our interest rates competitive with those abroad and hence reduce short-term capital outflows and the drain on the gold stock. I know of no way for the Federal Reserve to raise internal interest rates at present other than to pursue a policy of monetary restraint, thereby reducing reserves of the banking system. This action would inevitably reduce assets of the banking system by promoting loan and investment liquidation, and consequently, the stock of money would be contracted. Although such action would probably raise interest rates temporarily, it would also induce decreased economic activity unless we are to argue that the past provides no guidance for the future.

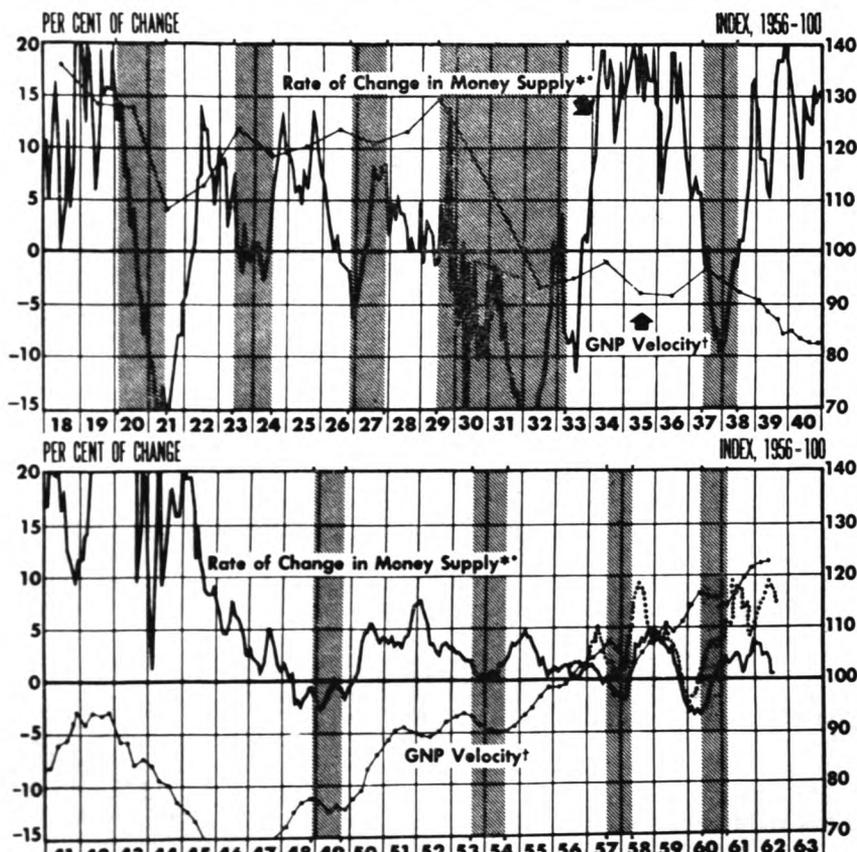
Declining economic activity would be accompanied by lower demands for funds and interest rates would decline sharply, thereby placing renewed pressure on the gold stock. It is generally true that high interest rates generated by rising demands for funds are symbolic of a healthy economy, but it is not true that high interest rates generated by monetary restraint during a period of economic slack will bring economic health.

Therefore, I emphatically reject a policy of monetary restraint under present economic conditions as a palliative for reducing our balance-of-payments woes. The cure might well be worse than the disease.

A partly analogous experience occurred in 1931. In September of that year, Great Britain went off the gold standard. Several other countries followed and many more imposed exchange controls. In 29 months the U.S. monetary gold stock dropped \$703 million to \$4.29 billion, or 14 percent. During October the Federal Reserve of New York raised the discount rate from  $1\frac{1}{2}$  percent to  $3\frac{1}{2}$  percent. Reserve balances of member banks declined 17 percent from July 1931 to February 1932.

(Chart referred to follows:)

### MONETARY GROWTH, VELOCITY & BUSINESS FLUCTUATIONS



Source: Dept. of Commerce, Fed. Res. Bd., Nat'l. Bureau of Econ. Research, Inc.

\*All commercial banks demand deposits adj. + currency (seas. adj.)

†Annual rate of monthly change, 6-month moving average

‡Annual data before 1939; quarterly since 1939

Shaded periods are contractions in business activity

..... Rate of change in the money supply (+ Time deposits)

HARRIS BANK



Mr. SPRINKEL. As indicated on the preceding chart, severe monetary contraction occurred during that period. Higher interest rates were successful in halting the gold exodus, but the resulting monetary contraction was responsible in the opinion of many observers, including the author, for substantially deepening and prolonging the great depression. Officially imposed higher interest rates at the present time would run the serious possibility of repeating the 1931 experience.

Fortunately, various measures taken in recent years plus rising costs and prices abroad are resulting in some current improvement in our balance of payments. If the deficit nonetheless persists, there are only five courses of action open to U.S. Government officials: (1) Using reserves to "buy" more time by permitting more gold to flow out and

if necessary borrowing reserves from the International Monetary Fund or other lenders; (2) tightening money and forcing a domestic deflation with its consequent unemployment of resources; (3) devaluing the dollar or permitting the exchange rate to float; (4) resorting to direct controls such as restricting imports, restricting foreign borrowing, restricting investment abroad, subsidizing exports; and (5) curtailing foreign aid or other foreign expenditures.

Perhaps none of these actions is pleasant to contemplate, but they represent the only alternatives available. Of those, probably the most costly in terms of employment, production, and income would be internal deflation brought on by monetary restriction.

A policy of monetary restraint is highly appropriate during periods of excessive spending and borrowing resulting in inflation. Rising interest rates during a period of rapidly rising demands perform the valuable function of rationing the limited supply of funds. Such is not the case at present nor does inflation promise to be a near-term problem.

A policy of monetary restraint under present circumstances would probably temporarily slow the gold exodus, as in 1931, but only at the cost of significantly reducing productive economic activity.

Chairman PATMAN. Thank you, sir. Senator Javits?

Senator JAVITS. Mr. Chairman, I am very grateful to you for allowing me to ask this one question, and I will not intrude on my colleagues by asking more. I notice that in only one of these statements is there a reference to a tax reduction, and that is in the statement of Mr. Culbertson in which he says, "I believe a moderate tax reduction this year would be a wise policy."

Mr. Culbertson, would you be good enough to give us your view, having heard the President last night—I assume you have, because you so indicated—as to whether you nonetheless think we should have a tax reduction at this session and if the other gentlemen feel inclined to comment perhaps they will do the same. That is my only question.

Mr. CULBERTSON. In some ideal world, Senator, I should like to see a tax reduction this year. I think the likelihood of there developing between now and next January or February such a gathering of expansive forces in the economy as to make such a tax reduction superfluous or harmful is exceedingly remote.

Therefore, from a strictly economic point of view there is very little reason for waiting. However, realistically there are some other considerations involved. It would be preferable that the tax cut should be in such a form that would keep us satisfied over a period of time. Also, I suppose that political considerations cannot be ignored. Across the country there seems to be a divided opinion as to the desirability of reducing taxes now. Perhaps on the basis of these considerations it is appropriate to wait until the first of the year.

I don't think we should wait any longer than that, and I would say if there were only economic considerations involved, and if you now had a tax bill that you were satisfied with and ready to move with, I should see no reason to wait on economic grounds.

Senator JAVITS. Are there any other comments from other panelists? If not, thank you, Mr. Chairman.

Chairman PATMAN. I want to invite your attention to testimony that we had yesterday that for some reason did not receive recognition from the press. I feel it must have been overlooked.

Yesterday we heard a very interesting recommendation for immediately relieving our balance-of-payments problem. We had three witnesses who came on the spur of the moment, from widely different parts of Europe, and without any prior knowledge of what the other witnesses would say, all three of them recommended that the United States should immediately issue certificates, at least to foreign central banks, which would guarantee the gold content of the dollar.

In other words, if the United States should raise the price of gold, notwithstanding the fact that we have no intention of doing so, these certificates would guarantee that we would pay to their holders enough dollars to make up the difference between the old price of gold and the new price of gold after the price is changed. Their argument was about as follows:

One, the dollar is fundamentally sound. Two of the witnesses even predicted that probably in a year the whole balance-of-payments matter would shift in our favor because prices in Europe are rising faster than our prices.

Two, nevertheless, many people in Europe think that we may raise the price of gold. Consequently, these people who have dollars, say in New York, exchange them for European currencies in which case those dollars flow into foreign central banks in excessive amounts, and are used to buy our gold.

Furthermore, many European firms and individuals are very desirous of borrowing dollars from the United States, not because the interest rate is lower, but because they think the dollar may be devalued in which case they would be able to repay their loan in cheap dollars. This creates pressure on the dollar.

One witness from Switzerland told us that dollars are flowing into Switzerland despite that fact that interest rates are lower than in the United States. In other words, there is a tendency for short-term funds to flow out of the United States and create a potential drain on our gold, no matter how high the Federal Reserve may raise interest rates.

I thought it rather remarkable that all three of these European witnesses felt the same way about the dollar and made the same recommendation.

Furthermore, one witness brought in a paper from Mr. Robert Neild, who leads the National Institute of Economic and Social Research in London, and Mr. Neild also recommends that we issue a gold guarantee certificate. I wonder if the members of the panel would care to comment on this proposal.

Mr. CULBERTSON. Thank you, Mr. Chairman. I wouldn't like to comment definitively in the sense that I would like to think about it some more, but I do see some negative aspects of it, I believe. To begin with, if our problem is purely a temporary one, as is implied in the suggestion that our balance-of-payments deficit may largely disappear within a year or so, then we don't need this. We can simply run on our liquidity, particularly as I think it is appropriate that we abolish the gold reserve requirements behind Federal Reserve obligations and stand ready to distribute some of that gold to the rest of the world.

The adverse thing I see about this, I think, is that it is a move toward additional general rigidity of exchange rates. The possibility

is that we will build up a system of these gold guarantees which will make it difficult to change exchange rates in the future. I don't think the dollar ought to be devalued now or probably in the near future. I think if there are revisions in the exchange parity they ought to be made on the other end, by countries that are not the key currencies of the system.

However, I think it important that the capability for exchange rate variation be continued as a part of the system. Establishing gold guarantees would seem to make it more difficult in the future to make changes in exchange rates.

Chairman PATMAN. Thank you, sir.

Mr. Ritter, would you like to comment?

Mr. RITTER. Yes, thank you. I agree more or less with what Professor Culbertson has said. It has certain attractive features, a gold clause such as this. However, I am not sure whether it would do the job. Presumably this benefit of always being paid a certain amount of gold for their dollars is supposed to make foreign dollar holders willing to hold dollars instead of holding gold. They may, however, react differently. I am not sure. I should say we should explore the possibilities.

They may fear, for example, that we would not be giving such a guarantee unless we were in fact in trouble. In which case, they may still prefer not to hold dollars, but to hold a foreign currency in anticipation of the time when the dollar would be actually devalued. They may also fear that we may not carry through such a guarantee if we make it, recalling that there were some legal difficulties with enforcing the gold clauses in 1934. These are possibilities.

I don't say they are necessarily going to be dominant.

Thirdly, to give such a guarantee does reinforce the present reliance upon tying national currencies to gold, upon fixed exchange rates, which I think we should consider modifying. Flexible exchange rates should at least be thought about in terms of the possible advantages they may have. This gold guarantee would only reinforce the fixed exchange rate system.

If we have decided we want fixed exchange rates for good and all, then this has intriguing possibilities. So I am not, by any means, saying this should be thrown out. But I think it should be thought about an awful lot more through with great care.

Chairman PATMAN. Thank you, sir. Would you like to comment?

Mr. SPRINKEL. Yes, I could not give a definitive statement without thinking about it some more. I would agree with the remarks made by both gentlemen. First, it looks to me as though it is a temporary palliative designed to solve shortterm speculation. It doesn't get to the basic problem we have, nor does it promise ultimately to get to the basic problem, even if they believed us when we issued such gold clauses.

It is a gimmick staving up a system which has some serious faults. It seems to me that our basic problem throughout the postwar period is that we do not have a mechanism which will automatically tend toward balance in payments once disequilibrium develops.

Under the gold standard we did have such a system but we ceased operating on a gold standard for good reasons. Namely, it forced deflation on the country and unemployment of resources and other

times might force inflation. Now we have fixed exchange rates between currencies with independent domestic monetary-fiscal policies with some countries growing more rapidly than others, and some inflating more rapidly than others.

It should not be surprising that from time to time many countries will run surpluses and others deficits. We need a system which will operate to eliminate that. The only one I know that I am aware of would be a system tending toward a flexible exchange rate system.

Chairman PATMAN. Thank you, sir. Mr. Reuss?

Representative REUSS. I can't find words to express the joy you three have given me by what you have said this morning. I think it has been a memorable presentation.

I am proud and I know Senator Proxmire is, too, that Professor Culbertson is from the University of Wisconsin. Would it be a fair statement, in which each panel member could join, that a sensible overall economic policy for this country in the light of present domestic and world conditions would consist of the following:

One, monetary policy should be easy until full employment is reached, or approached, and adequate additions to the money supply should be made, contrary to the monetary policy that we now have.

Two, there needs to be a coordinated and complementary policy of fiscal ease until full employment is reached or approached.

Three, the international balance-of-payments situation should be met, not by deflation and repressive domestic measures, but by constructive international measures. For example, we could do far more to expand our exports and to eliminate our present deficit through a larger trade surplus. We could work more purposefully to get agreement on a payments system which would better protect countries in temporary deficit positions.

This policy outline is quite at variance with the present economic policy of this country. We have apparently embarked upon a generally higher interest rate policy, with only that degree of fiscal ease which comes from unexpected reductions in revenue. We are not really doing very much about expanding exports or evolving a workable system of protecting international payments.

Who would agree or disagree with the proposal made?

Mr. SPRINKEL. I would agree if you would let me define a couple of terms in your statement.

Representative REUSS. Please do.

Mr. SPRINKEL. One, in referring to an easy monetary policy, in my terms I am speaking of monetary growth, increased additions to the money supply. This is not necessarily the same question as to whether or not there are already excessive funds available from a loan point of view, or whether interest rates are too high or too low, because changes in the money supply operate through the supply side and there are demand factors which influence interest rates beyond the control of the Federal Reserve in the short run.

It would seem to me under present circumstances, a larger rate of growth in the money supply would be clearly justified. As to fiscal ease, I presume here you might be referring to the possibility of a tax cut.

Representative REUSS. If I may interrupt at that point, I referred to fiscal ease because I didn't want to have this discussion bog down

into a controversy as to whether there should be a tax cut, whether there should be more spending or a combination of the two. So, let it go at fiscal ease.

Mr. SPRINKEL. If I were to subscribe to the statement, I would have to interpret fiscal ease as meaning a tax cut of the type which would stimulate investments and increase incentives in the Nation. It seems to me that monetary policy cannot really result in a resource reallocation toward more investment, higher productivity. This must be done largely through getting the present tax bite off that kind of activity so with the type of tax cut designed to stimulate investment which would result in fiscal ease, I would certainly be in agreement.

I would not be in favor of a vast increase of Federal spending at this time which would also be fiscal ease.

Representative REUSS. Thank you. Any other comments?

Mr. RITTER. Yes, Congressman. First, I don't know whether this panel has really done as good a job as you say, but in any case I do want to add myself along with Mr. Culbertson to the Wisconsin contingent, since I have my doctorate from Wisconsin and spent many happy years there.

Representative REUSS. That is why you are also good, one from Wisconsin and one from Chicago.

Mr. RITTER. I wanted that in the record. I agree by and large with what you say in your summary statement. I don't think it can be expected that you would get agreement among the four, yourself, and the three of us, on every point. By and large a program for increasing employment and growth through monetary-fiscal policy, improvement in our balance-of-payments adjustment mechanism, and so on, I go along with, I would say, 90 percent, if I had to give a figure.

I would like to add several brief amendments of my own that, for my part, I would emphasize slightly more, I think, than you have. I am not quite as critical of current monetary policy or recent past monetary policy as my fellow panelists seem to be. What I am afraid of is that monetary policy may become tighter than it has been.

I am not sure whether it has been tight. It seems to me it has been reasonably easy thus far. What I am concerned about is that it may become less easy. So I would not criticize the past behavior of the Federal Reserve quite as much as my fellow panelists, or as much as I think you might.

Secondly, I would stress that if we adopt easy-money policies—and I say we may already have had them, I find it hard to judge whether monetary policy has been tight or easy—and easy fiscal policies, then I would have to mention the danger of cost-push inflation.

Of course, this is a danger that we faced long before the balance-of-payments problem ever came into the picture. It was a thing that we were worried about back in 1955 and 1956, long before people started to worry about the balance of payments. This is a problem that has deep roots and I don't know how to solve it. As we expand, prices seem to go up long before we have full employment, and this worries me. If we could correct this, I think we would have no trouble on balance-of-payments grounds. This is our problem, not the balance of payments.

Third, on the subject of easy money again, I have no objection to rather high short-term interest rates, because I don't think they are too important. If they do affect balance-of-payment factors, I am perfectly willing to have them. It is the long-term rates that bother me. However, I don't think any of these points are major departures from your general position.

Mr. CULBERTSON. I am also in general agreement with your statement. I would like to associate myself with Mr. Sprinkel's definition of how we should measure what monetary policy is. It seems to me that the usual way of looking at it in terms of "easy money" is a very loose criterion and may be actively misleading, since, as he observed, when the economic situation becomes weak and demands for funds become weak interest rates naturally tend to go down. In this sense "easy money" always tends to arise when you have a weak economy and may, within rather wide limits, arise irrespective of what the Federal Reserve is doing or how badly it is governing the behavior of the variables that are within its control.

I think we should look to a money supply criteria more than we have in the past. Policy has suffered greatly because the Federal Reserve and other observers have not taken account of the extent to which interest rate changes are responsive to changes in credit demands in the economy.

With reference to your statement, I am generally in agreement and should like to emphasize your point that what is called for is a reversal and reorientation of the policy that we now seem to be following. The exception is fiscal position, for here the Government is thinking in terms of a tax cut. With reference to monetary policy, however, what we require is not only change in policy but—if we are actually to get a change in policy on the required scale—a change in the way the Federal Reserve looks and measures what it is doing. It is most unlikely that if the Federal Reserve sticks to an "easy money" criterion or a "reserve pressure" criterion or "credit available for reasonable credit demands" criterion we are in the present circumstances going to get the kind of monetary growth that we need.

In terms of debt-management policy, also, the Treasury seems to continue to be dedicated to the idea of maintaining the maturity structure of the Government debt and making strong demands on markets for intermediate and long-term securities.

With relation to the balance-of-payments situation, Government spokesmen seem to put a good deal of emphasis on reducing our costs by passing the investment tax credit. I think that stimulation of investment through something like the investment credit is a good idea. But such a marginal change in investment as we are likely to get out of such tax changes surely will not affect our production costs enough to have much effect on the balance-of-payments problem in the short run.

It is most disturbing that the Government seems to espouse the position that it is primarily our responsibility, through domestic policies, to solve the international payments disequilibrium. This disequilibrium is two sided. It has arisen essentially out of the whole post-war transition period in which we have arrived through a devious source at a set of exchange rates and a set of relative trade and exchange restrictions that at this point in time, as things have worked

out, doesn't produce equilibrium. We should not be in a position of taking to ourselves the burden of correcting the disequilibrium by our domestic policy.

More broadly and closely related to that, our Government ought to be exercising constructive and imaginative leadership in evaluating our whole international financial system and trying to build one that will prove usable.

What we now have is an experimental system. We have never had one that worked well. We should always be questioning and asking what changes are required. Yet we have given the appearance of being wedded to the present institutions, rather than providing the sort of imaginative leadership toward revision and change that is called for.

Representative REUSS. My time is up.

Senator PROXMIER. I want to join Mr. Reuss in saying this is a superb panel, not only being two-thirds from Wisconsin and one-third from nearby Chicago, and being highly competent but especially because it is so uniformly mirroring my own preconceptions and prejudices. I hope we can call to the attention of Chairman Martin, and other members of the Federal Reserve Board, the statements of this morning.

Mr. Culbertson, I want to repeat the things you said and then I want to ask you about them. You say a policy of more drastic monetary restriction, as has recently been urged upon us from several quarters, surely would make matters still worse and might have quite disastrous consequences. Then you talk about the mystical attachment to high interest rates and inflation. You say the grip of this dogma, and the habitual errors of Federal Reserve monetary policy are the principal impediments to the reachievement of full prosperity in the U.S. economy.

Then you go on with some other very emphatic statements:

Since our present situation seems to impose upon us a conflict of policy objectives, it is now commonly suggested that we mount our charger and ride off in both directions. We maintain our restrictive monetary policy and go further and set about to raise interest rates in deference to our balance-of-payments disequilibrium and reducing taxes in the hope that this will improve employment.

Then your second and third recommendations which pertain directly to Federal Reserve and Treasury policy, under present circumstances, would be that they immediately cease any policies tending to restrain the economy even further.

Two previous witnesses before this committee have referred to the money supply and in both cases they talked about its expansion. In both cases we were able to determine what they were talking about by finding they were evading the money supply definition and indicators which refer to supply money as currency, plus demand deposits, and they were talking about the money supply as currency, demand deposits and time deposits. One of them was Dr. Heller, who is the Chairman of the Council of Economic Advisers, as you know. The other was Dr. McCracken, from the University of Michigan. I want to know from you how you justify the position which you take, which is also the position I take, and the position the economic indicators take, that money supply should be defined in terms of currency and demand deposits, not currency, demand, and time deposits.

Mr. CULBERTSON. As you know, economists have been talking about monetary theory for hundreds of years and have not been able to arrive at a definition of what they ought to mean by "money," which is not a very creditable performance. There are several strands to the argument. The position I take in general is that time deposits are most closely similar to other liquid assets in the economy. They are like money chiefly in the quite unimportant fact that they are housed in commercial banks. The dimensions of the analysis that call for this sort of characterization, I think, are, first, that time deposits are not means of payment but are an interest-bearing debt, and, therefore, have a close similarity to other interest-bearing liquid assets, such as Treasury bills. Second, time deposits arise out of the demands of holders for them and do not arise at the volition of banks or the Federal Reserve System, but are a part of the endogenous working of the economy, as it were. The meaning of a change time deposits, thus, is ambiguous. An increase in time deposits can, under some circumstances, even be deflationary, as when it arises out of an increased disposition to save, and to save by putting funds in time deposits.

I would say, in a broader sense, that money's peculiar role in the market economy is such that with a paper-money system, the creator of paper money is in a position to exert a powerful force on the economy. The price system exercises some control over the behavior of ordinary debt, but it has no means of exercising discipline over the behavior of a virtually costless token money. Thus, the behavior of money is entirely dependent upon our institutional arrangements in this area.

Our money creation occurs through the banking system, which is unfortunate in that it muddles the water very considerably. But it still should be clear that money creation is a powerful exogenous force. The Federal Reserve could not, in any direct way, increase the volume of time deposits. But it can increase or decrease the volume of demand deposits.

Senator PROXMIER. Chairman Martin is constantly defending his policy by saying you have to take into consideration the increase in time deposits and to some degree they are a substitute for demand deposits.

You are absolutely right about the expansion of currency and demand deposits; they have not kept pace with the gross national product, whereas time deposits have expanded fantastically.

Since December 1953 they have more than doubled. They have gone from \$44 billion to \$91 billion.

Mr. CULBERTSON. That is true. I should take it that the fact that a time-deposit increase at something like a 25-percent annual rate had so little apparent effect on the economy is evidence that this criterion is wrong. I am quite sure that if the money supply had gone up at a 25-percent rate the effects would not be insignificant.

Mr. SPRINKEL. May I elaborate on that point?

Senator PROXMIER. I wish you would. Before you speak, from what you said so far, you are my banker. I think I will put all my money in the Harris Bank.

Mr. SPRINKEL. Thank you.

Senator PROXMIRE. It is wonderful to hear a banker who has no *idée fixe* on higher interest.

Mr. SPRINKEL. It depends primarily on the state of the economy. I am strongly in favor of higher interest rates when the economy is healthy and rising rapidly. I think it is an important factor in preventing inflation. That is not our situation at the moment.

In terms of how we should define the money supply, it seems to me it depends basically on which is most closely correlated with economic change in the past.

It is a scientific question. Can we find any significant difference between the broad definition of the money supply in relation to economic exchange and the narrow definition with relation to economic exchange?

The best study that I am aware of trying to test various definitions of the money supply was made by Prof. Milton Friedman at the University of Chicago. There was really very little difference between alternative definitions, including time and not including time. Over the long pull, it turned out that the correlation which is slightly higher, included time deposits. However, I would argue that in the present situation one could very easily make a mistake by looking at the time component for a simple reason.

There have been two occasions in recent years in which the Federal Reserve raised the ceiling rate on time money, and many banks promptly raised the rate they were paying on time money. This occurred effective January 1, 1957, when it was increased from 2½ percent to 3 percent, a 20-percent increase, and January of this year, when the rate was raised 33½ percent, from 3 percent to 4 percent. On both occasions, it was followed by very rapid rates of growth in time money. If you will look at the chart that I have attached to my testimony, you will see that on page 437 the money supply, including time deposits, in the first several months of 1957, the rate of growth rose very rapidly, whereas the narrow definition continued to decline as it had for some time. A perfectly analogous situation occurred in the first several months of this year when, including time, the rate of growth rose very rapidly, although even by that definition the rate of growth has declined in the past couple of months or so.

In view of the fact that the early experience was shortly followed by a recession, suggests to me that looking at the more narrow definition immediately following a period when rates are changed on time money is the more truthful way to look at the data.

I would agree with Mr. Ritter that this particular time is one of the few occasions, the other was the first half of 1957, when it is extremely difficult to be absolutely certain that you are interpreting what is happening to monetary policy, or has happened to monetary policy in the last few months. It would be my view that we would be better served to look at the narrower definition.

Senator PROXMIRE. Professor Culbertson, I think you, and perhaps other members of the panel, referred to operation "nudge." I am wondering whether buying long terms, in a substantial way, would rig the market in your view.

The objection which Chairman Martin has given to us is that the Federal Reserve has bought as much as 20 percent of the long-term bonds in various periods in the past and if they get into this to any

greater extent, they are interfering with the free forces of supply and demand in the market and they want very much to avoid that. They feel it is inadvisable and improper.

**Mr. CULBERTSON.** Senator, this episode has to me the quality of a "nightmare," I can't make any sense out of it. So much stress is put on the fact that the Federal Reserve has bought a couple of billion dollars of intermediates, but no one seems to pay any attention to the fact that the Treasury has been selling them in a very large volume.

As I gather the facts, Chairman Martin indicated that during 1961 the Federal Reserve bought something like \$2.3 billion in maturities outside of 2 years.

**Senator PROXMIRE.** Almost all under 5.

**Mr. CULBERTSON.** Mostly relatively short, yes. As I added up the figures, the volume of notes and bonds of 2-year or longer maturity that the Treasury sold in 1961, was about \$20 billion (total bonds and notes about \$40 billion). Wouldn't we have come to essentially the same point if the Treasury had sold only \$18 billion and the Federal Reserve had tended to its own knitting, rather than having the Treasury sell \$20 billion, and the Federal Reserve go to such fuss and bother to buy back \$2 billion of them?

It seems to me that if you want to alter substantially the maturity distribution of securities in the hands of the public, you ought to have the Treasury do it in its regular refunding operations and cash offerings. I don't really see the point in selling bonds with one hand and buying back a few of them with the other hand.

There is a school of thought that the Federal Reserve can control debt markets through psychological warfare, or as they put it in England, by making faces at the market, but I have not been persuaded of that and recent experience does not seem to support the view.

I think the behavior of the debt markets and the structure of debt yields depend upon the structure of outstanding securities. If the Government wants to do something about this, it should do it in a straightforward way, rather than doing something with one hand and undoing it with the other.

**Mr. RITTER.** I would like to add to what John has said. To return to your original question: Would the Federal Reserve by buying strongly in the long-term market return to a peg, and also wouldn't it be interfering with free market forces?

I think it is important to reiterate that the Federal Reserve, no matter what it does, is interfering with free market forces. The Federal Reserve's function is to interfere with free market forces in the monetary area. That is why we have a Federal Reserve. We don't want a commodity standard. We want monetary management, and monetary management has to be management, and therefore interference with free market forces.

Furthermore, this is not returning to a peg, because by definition, at least in my book, a peg means maintaining a structure of interest rates through thick and thin, regardless of economic conditions. It is not a peg to deliberately try to lower rates in a recession and raise them in a boom.

**Senator PROXMIRE.** Thank you very much. My time is up. I have some more questions.

**Chairman PATMAN.** Senator Pell?

Senator PELL. I thank the panel very much, indeed. I would like to congratulate Mr. Ritter, particularly, in doing what is so necessary, making something complicated more simple and comprehensible. I would like to get the reaction of each of the panelists as to their opinion as to the real importance of interest rates to the question of whether we have a recession or a boom, in simple terms. Do you think it is an essential factor, it is important, or merely a subsidiary factor in producing a recession or an upgrade?

Might we start with Mr. Ritter?

Mr. RITTER. I am afraid when you get into this subject, you start to divide the panel. I am also afraid that none of us, no matter what we tell you, have really too much confidence in the evidence behind our remarks. I think we are all rather openminded on the subject, although I can't speak for the panel members, besides myself.

There is a desperate need for us to know more about the way monetary policy works. We really don't know very much about it. As you may have sensed, I am much more a defender of the Federal Reserve than my colleagues. But I would say it has neglected its responsibilities in the field of basic research.

It goes about from day to day largely on the basis of ad hoc decisionmaking. Perhaps not entirely. I don't want to overstress this. But it does not do enough research in the field of fundamental inquiry as to how monetary policy works. How important are interest rates? How important is the availability of credit? We just don't know too much about it.

Senator PELL. To interpolate here, the reason for my question is that we have recently been through a series of hearings on the effect of inventory on upgrades and downgrades in the economy. I think some of us started out thinking that it would be proved very important and perhaps causative.

We ended the hearings realizing that inventories merely exacerbated the up or down swing, and were not causative.

My question here, that I want to draw you out on, is whether you think interest rates are causative or exacerbative?

Mr. RITTER. I think really the question gets down to what effect changes in long-term interest rates have on economic conditions. If higher long interest rates cut back on spending, then we know pretty much where we stand.

I would say that interest rates and monetary policy, in general—I hesitate to confine it just to interest rates, but monetary policy, in general, including credit availability and the stock of money—I would say these have some effect.

I would not, I think, go so far as perhaps my fellow panel members in saying they have too much effect. I think they have some effect.

Senator PELL. Thank you.

Mr. CULBERTSON. I would say that you have to quantify the question. You are asking how much effect on economic activity will be produced by some unspecified change in monetary policy. To say that the effect is "a little but not very much," is perhaps an expression of feeling rather than a statement of any objective meaning. I think that the importance for the economy of our choice among the

alternative monetary policies presently within the realm of possibility is very great, and may be decisive.

I would make the point, again, that exploring the matter in terms entirely, of interest rates may be misleading. If the Federal Reserve maintains a continuously restrictive policy in the sense that we have a reduction in the money supply and if, as I think would be the case, this caused continued weakening of the economy, a bearish situation, a falling off of investment demand, we should necessarily have weak demands for loan funds. So, interest rates, over a period of time, would not necessarily go up at all. They would go down. Ultimately, they would have to do down.

The lowest interest rates we have had in this country were in the early 1930's, when we had just reduced the money supply by something over a fourth, and had a great period of liquidation of credit. During most of the 1929-33 monetary contraction the interest rates were down. They were down because the adverse effect on the economy and the demand for funds of the monetary contraction (in conjunction with other unfavorable factors) more than offset the reduction of bank supply of loan funds on the other side.

So, interest rates are a very slippery criterion. In a very immediate sense, a more tight monetary policy would tend to push them up. But over a period of time you will find rather monetary contraction associated with low interest rates and economic stagnation.

MR. SPRINKEL. I think the evidence is not 100 percent, but all of the evidence that I have read strongly indicates that the factor we should concentrate our attention on is monetary growth and not interest rates. Let me look at it in this way. Frequently we find these two criteria in somewhat conflict. If, for example, we have ample money in the sense that monetary growth may be growing at a certain satisfactory clip, it may appear in the credit market as if there is not enough money, because the ample money in the money supply sense has generated increasing demand for funds.

The increased demand for funds is resulting in higher interest rates and it looks like you have a credit shortage, even though you have ample money, unless you want to inflate the economy, which could be the result of increasing the money supply faster. On the other hand, in periods when monetary growth may be nonexistent, it may appear in the credit market as if we have a situation where there is plenty of money available. This could well be due to the fact that the restrictive monetary policy has resulted in slower economic activity, reduced demands for funds, and, even with the restricted quantity of money that is in the system, nonetheless interest rates are tending downward. So you will get conflicting directions depending on which you watch.

I would argue that historically, in my mind, the one criteria is monetary growth and not interest rates. I would also cite the period of the 1930's when, beginning in 1929, interest rates declined very sharply until the gold scare in 1931. Yet we know that monetary restrictions during this period were indeed severe.

I would not argue that we had lots of money and plenty of money because interest rates were going down in the early 1930's. I think that is entirely the wrong clue. I would argue we had insufficient money because the monetary growth was nonexistent during this period.

Consequently, watching interest rates, either on the upside or the downside can be very misleading as to the adequacy of monetary policy.

Representative REUSS. Mr. Culbertson, I would like to resume our earlier discussion. With respect to the balance-of-payments disequilibrium, in which this country is involved, you stated that it is up to the United States to exercise some leadership with our friends and allies abroad, and not to act as if this were something we could solve all by ourselves. You particularly mentioned that other nations must ease their import restrictions on our goods. That is perhaps the single most constructive way of breaking out of our balance-of-payments difficulties, is it not?

Mr. CULBERTSON. In a sense, that is true. Almost anything you could do has a bad side to it as well as a good side. If we have a situation of imbalance, if we can asymmetrically make an adjustment in trade and exchange restrictions that goes in the right direction, toward easing, and that corrects the imbalance, there is no bad side to it, except that it does force some structural adjustment on the countries involved. It seems to me that especially insofar as the imbalance has arisen out of the postwar transition period, the recovery—with our help—of Europe, and the development of a new structure of costs and industrial capabilities, a combination of U.S. deflation with maintenance by other countries with trade and exchange restrictions is simply an intolerable combination of policies.

Representative REUSS. This, however, is close to describing the fact, is it not?

Mr. CULBERTSON. I should say so. It is very difficult to summarize the level of trade and exchange restrictions, but there are many countries in the world that have more severe ones than we do, and I think there is a considerable amount of room for adjustment in the right direction. In achieving this, clearly the responsibility of leadership must fall upon this country.

The surplus countries are not likely to take the initiative to a sufficient degree. Perhaps to get the job done would take a good deal of pushing. I think what is really required is the understanding on the part of our leadership that this is the right thing to do, that we should be contributing to building up a set of rules of the game that makes sense and is viable and will continue to work. A set of rules, according to which the surplus nations do not adjust, and deficit nations suffer protracted unemployment, is not going to last.

Representative REUSS. The fact is, is it not, that this country has not called our friends and allies to their higher duties in the premises?

Mr. CULBERTSON. I don't know what they do in the closed rooms, but the public statements of our people don't give the impression that they are carrying the ball in the right direction.

Representative REUSS. Would you agree with me that the State Department, for example, which is in charge of our foreign relations, has tended to be very polite and not sufficiently aggressive in its remonstrances to those countries with which we deal?

Mr. CULBERTSON. I couldn't say anything specific, sir. I can only go on the basis of the public statements that I have seen of our leaders in the area of financial policy. Judging from them, I feel we have not exercised the strong leadership in this area that is called for.

Representative REUSS. Let me give you an example of this. As you are perhaps aware, the Trade Expansion Act, which is now before the Senate Finance Committee, is, in its present form, so arranged that if the United Kingdom does not join the Common Market, or is delayed in joining, we won't have any powers under the act to eliminate Common Market tariffs. This provision was put in there, as I understand it, largely at the request of the State Department.

Does it seem sensible, in view of our balance-of-payments difficulties, to penalize our ability to expand exports just because the timetable of United Kingdom's entry into the Common Market does not happen to go as well as is hoped?

Mr. CULBERTSON. I am not acquainted with all the political considerations that may be involved in that. I think that the Common Market does represent an additional challenge to our position in that if things move as we hope they will for Europe, this could tend to strengthen its position relative to ours.

So it is particularly important, I think, in making the adjustments in the trade and exchange restrictions there that they should be asymmetrical in our favor. It is quite important that we, one way or another, manage to achieve that end.

Representative REUSS. Mr. Sprinkel, in your excellent paper you made a point of saying that you spoke only for yourself and you dissociated the institution of which you are an officer from your remarks, quite properly and naturally.

I join with Senator Proxmire in agreeing with you that an adequate secular increase in the money supply is a necessary precondition for a maximum employment economy. Let me go beyond that and ask you this: Even from the standpoint of the banking community—from the standpoint of making the greatest profits over a long period of time—do you not think that our banks would be better off if the monetary authorities created adequate additions to the money supply over the years even though this meant that interest rates in some periods would be somewhat lower than they otherwise might be?

The banking system, I should think, would do better by making more loans at a somewhat lower rate of interest than sitting around in a continuing, stagnating recession making fewer loans because business was not very good.

Mr. SPRINKEL. I find absolutely no conflict between my interest as a banker or bankers' interests as bankers and my statement concerning the economy. It seems to me that banking will prosper as the Nation will prosper. If the Nation does not prosper, then the banking industry and other industries will not prosper.

I would add that in the very short run, an adequate increase in the money supply might very well lead to temporarily lower interest rates, but this will almost certainly, if we are to believe the evidence of the past, generate increased spending, increased demands for funds, and ultimately higher average interest rates.

We find that countries that are healthy and growing at rapid paces without inflation typically have relatively high interest rates. That has been the case of our own history. It is in periods of economic depression or stagnation that interest rates are low for long periods of time.

A policy of higher interest and lower monetary growth at the present time might temporarily benefit bank earnings, but almost inevitably it would promote a recession and lower rates and hence, lower bank earnings. I say yes to your question, I find absolutely no conflict and I think it would be in the interest of banking as well as other segments of the economy to get better economic performance than we have over the last few years.

Representative REUSS. I am very glad to have that statement. Even though I am supposed to be an advocate of low interest rates, I would say that, in a full-employment economy with abundant loan demands, I would be perfectly prepared for whatever levels of rates the economy required, consistent with the maintenance of prosperity and growth. I think that the emphasis you gentlemen have placed upon the need for an adequate money supply, and upon interest rates appropriate to current economic conditions, is a very healthy one and one that some of the people in government would do well to note.

In the light of your analysis, Professor Culbertson, of the action of the monetary authorities, would it be an unhealthy condition if there were a showdown within the executive branch of the Government on this point? Or, do you think it is healthier that what many of us suspect is a dispute between the White House, on the one hand, and the Federal Reserve System, on the other hand, be kept under wraps?

Why would it not be constructive in our economy, granting the independence of the Federal Reserve, if the President would state whether or not he agrees or disagrees with the recent policies of the Federal?

Mr. CULBERTSON. It does no violence to the idea of Federal Reserve independence for the Government to express its opinion on a matter of public policy. Until now, I have not seen any expression from the Council or the Government in this area that was markedly out of line with what the Federal Reserve was saying.

I think it is an extremely crucial issue and that it ought to be brought out and discussed in the open. I would go so far as to argue that if over a period of years in the future we do not get adequate growth in money supply, I doubt that such policies as could conceivably be adopted could themselves achieve full employment. If the Government accepts this position, it surely must bring its opinion to the attention of the Federal Reserve.

Representative REUSS. Thank you; my time is up. Before calling on Senator Proxmire, I will announce that the afternoon hearing will take place at 2 o'clock, not in this chamber as originally scheduled but in the Capitol in room AE-1.

Senator PROXMIRE. I would like to say to Mr. Ritter, to follow up what Senator Pell was saying, it seems to me that separating interest rates and money supply is very proper and I approve. But you put a politician in a difficult position. Constituents understand interest rates because they pay them. Monetary supply is something they do not understand. Most of them do not care very much. It is technical and requires a certain degree of specialization.

For that reason it is hard to communicate and get your point across unless you know what you mean by monetary supply. By and large with the very appropriate and proper exceptions which you gentlemen have given this morning there is a tendency when the money

supply is contracted, at least in the short run, for interest rates to go up, and vice versa, although the conspicuous exception from this situation in the late twenties or early thirties certainly dramatizes how deceptive the relationship can be.

Is this a generally correct observation?

Mr. RITTER. I would agree with that. In other words, the money supply has a great deal to do with what interest rates are. When the money supply is reduced, there is a good chance we will get higher interest rates and when the money supply is increased, there is a good chance we will get lower interest rates. Money supply and interest rates are pretty closely intertwined. There are other things, however, that also help to determine interest rates.

Senator PROXMIRE. As professors of money and banking, I suggest that you can make a marvelous contribution to this whole subject by trying to work out some way in which this can be made clear and simple and understandable to the public. The trouble with economics is that so much of it seems to be complex and hard to understand.

Mr. CULBERTSON. On that point I would like to observe that the relationship between money supply as a causal agent and interest rates seems to be a good deal looser than is commonly assumed.

In the postwar experience you will note that the most extreme departure in money behavior was the reduction of money supply from mid-1959 through mid-1960. This did not produce any apparent aberration in the behavior of interest rates. The interest rates continued to go up for half a year until the economy hit a peak and then went down for half a year as we went into a recession.

If a departure of money behavior of that amplitude doesn't produce a marked change in the interest rate, the short-run direct effect of money supply changes on interest rates must be much less than is commonly supposed.

Senator PROXMIRE. I take it that none of you gentlemen differ from Mr. Sprinkel's support of Dr. Friedman's suggestion that we should have a regular increment in the money supply whether it be 3 or 4 or 5 percent to correspond roughly with the growth of our gross national product and then let the free forces of the market determine interest rates.

This provides an automatic stabilizer which seems to me most attractive because then you would get it out of the political realm and out of the realm of the self-interest of bankers who may have a special interest in keeping the money supply small.

It would seem to me that this is a very attractive method of proceeding because you do have a situation which under these circumstances would permit interest rates to rise when they should rise, that is, when the economy is expanding too rapidly; and conversely they would drop when they should drop, when there is less demand for funds and you need a little stimulation for the economy.

Mr. CULBERTSON. I don't think that we will all go along with Professor Friedman's formula. I think he can make an effective case when he says, "With my rule you should have done better in the past than you have done."

Senator PROXMIRE. Let me interrupt to say that he also has a very interesting reason for this, and that is a lag between the decision on monetary action and its effect, a lag which goes from 18 to 22 months.

That crystal ball of economic forecasting is mighty cloudy on the basis of the experience I have had since I have been on this committee and previously. It seems to me that our economists cannot see very clearly in the future and can't really foretell.

This way you avoid any concern about trying to predict the future and adjust your money supply accordingly.

Mr. CULBERTSON. Professor Friedman's doctrine of the long and variable lag in effect of monetary policy is far from universally accepted. I think it is wrong. Many people are undecided. This has not been demonstrated. So that particular argument is not necessarily applicable to policy judgments. The other relevant argument is that money managers are not likely to do anything intelligent so you had better give them a formula. On this point, I still—despite the gloomy record of experience—manage to be optimistic. Thus, I should like to retain some flexibility in the control of the Nation's money supply.

Senator PROXMIRE. How much time did you spend on the Federal Reserve Board?

Mr. CULBERTSON. I was on the staff for 7 years.

Senator PROXMIRE. You are eminently qualified on this subject.

Mr. CULBERTSON. Thank you.

Mr. RITTER. May I join Professor Culbertson in my dissent from the Friedman rule as an appropriate monetary policy. I think what Professor Friedman has to say is very relevant and important. He is one of the few institutions that does serious research in monetary matters. I think we can call him in a sense an institution.

But I don't think it follows from all we have said that the rule would be an improvement.

In other words, we recollect that when we took an elementary economics course they talked about both the money supply and the velocity of money, as both being important. I think that velocity may change rather drastically, and then the Friedman rule loses much of its attractiveness. We do not know enough about the future behavior of velocity to simply institute such a rule and then forget about monetary management from then on. Remember that this rule is supposed to be for all time.

Senator PROXMIRE. I certainly would get off the bus at that point. I do not think it ought to be for all time. I think it ought to be under constant review. At the same time it is hard for me to see how the Fed could have done much worse at least many times in the past than they have done.

Mr. RITTER. Yes; that is true. But Professor Friedman doesn't have too many objections to Federal Reserve policy since 1951. At least not nearly as many as before 1951.

Senator PROXMIRE. There is an apparent built-in automatic conflict today between interest rates for domestic and for balance-of-payments purposes.

I do not mean the situation we find ourselves in now. But what we are likely to find in the future indefinitely. Germany is a good example of the contrary situation. They have every reason to have high interest rates for domestic purposes because they have a shortage of labor, terrific pressure on resources, real inflation, but for foreign reasons they want to discourage the inflow of capital, they have too much. For that reason they should lower their interest rates.

Is this likely to persist as an automatic contradiction? If so, perhaps we should make some kind of tentative long-range determination of whether we should be more concerned with our domestic situation vis-a-vis monetary policy or the foreign situation.

Mr. RITTER. I agree completely. Until we get an adequate growth rate and high employment we are going to be faced with this conflict between wanting low interest rates for domestic reasons and high interest rates for international capital flow reasons.

Senator PROXMIRE. When we get that growth and full employment, we will have exactly the opposite situation.

Mr. RITTER. No; then I should think if we do get a high employment economy we can afford high interest rates.

Senator PROXMIRE. Yes; we can. Then there might be reason with regard to flow of capital abroad. Other countries may have adverse balance of payments and losing their capital to us, so we would have reason to lower our interest rates.

Mr. RITTER. I agree. I think we should explore alternative methods of adjustment. That is why I raised the question of flexible exchange rates; to have it automatically move up and down to make dollars more or less expensive to foreigners.

Senator PROXMIRE. I think your suggestion that we need a great deal more research in this area is excellent. I agree. It is very foggy and very indefinite.

Mr. RITTER. It is a shame.

Senator PROXMIRE. I would like to ask one more question of the three members of the panel. When Mr. Martin appeared before the House Banking and Currency Committee earlier he was asked his view on the steps the Federal Reserve would take if the administration and Congress reduce taxes.

The decision will be recommended to us next year. He said this: "In the event the decision is made which widens or further deepens the deficit we are already running, I want to put the Federal Reserve specifically on record this morning, if I have not done it already, that I think we must not finance a deficit by bank created funds and that how the deficit is financed is of vital importance and it should be financed out of bona fide savings and not by writing up assets on one side or the other of the bank ledger." Starting with Mr. Sprinkel, what effect will this have on the expansion?

If we have a tax cut of \$10 billion, and the Fed sells bonds to make sure that this is not financed by bank created funds, what impact is this going to have on the economy?

Mr. SPRINKLE. As I indicated in my testimony if we can believe that the evidence of the past has some relevance for the present, we would have to conclude, I believe, that if there shall be no monetary expansion; namely, no provision of additional reserves to the banking system, a tax cut would probably provide only a modest stimulus.

I would not want to argue no increase in spending would occur. However, there would not be a substantial or lasting stimulus unless we got some additional money into the system.

This is not to say we can't get too much money into the system. We have done so on numerous occasions in our economic history. It is entirely conceivable to me that 2 years from now we could be in that situation and it could very well result in inflation.

That is not the current problem. We have a great deal of slack. Some addition to total spending is highly desirable if we are to get back closer to full employment levels. Consequently, I would hope that at least some provision would be made whether it is through the effect of a deficit or through providing funds to the private sector which would lead to some expansion in monetary growth.

Mr. RITTER. I don't think I could improve upon that.

Mr. CULBERTSON. I also should disagree violently with it. It would be a clear case of riding off in both directions.

Senator PROXMIRE. You would disagree with what Chairman Martin suggests?

Mr. CULBERTSON. Yes, and not with my colleagues. You are reducing taxes specifically because you want economic expansion. But to finance the deficit in the bond market would minimize the economic expansion you get. Indeed, if you finance the deficit entirely through bonds, which doubtless Chairman Martin would not really follow through on, I am not sure but that the whole package would have a depressive effect. You might be dumping a very large amount of Government bonds on the market, much more than it is accustomed to seeing.

Clearly, a policy of financing all Government deficits in the bond market does not make any sense as a part of a coordinated package of Government stabilization policies. You have a deficit often because you want economic expansion. Therefore, you finance the deficit in relatively short-term and liquid Government securities. Monetary policy I should regard as largely independent of the Government deficit. If the Government runs a \$15 billion deficit, this does not mean that you ought to have a \$15 billion increase in money supply. But you should have some increase in money supply, one that is judged appropriate to the circumstances.

Senator PROXMIRE. Then, if he sold bonds to the public to compensate for the increased deficit of \$6 billion that might flow from a \$10 billion tax cut, assuming that the multiplier might increase revenues, you say this might have a temporary negative effect overall.

The two policies together might have a minus effect rather than a plus. In any event, the plus effect would be greatly reduced; is that correct?

Mr. CULBERTSON. The psychological effects of such policy measures is a dimension that none of us knows much about. But opinions on the efficacy and perhaps the morality deficits are divided. Some people oppose them on ideological grounds, and their practical effectiveness may be much less than an analysis on economists' usual assumptions seems to indicate. If at the same time that you run a large deficit you float a very large volume of bonds and thoroughly shake up the bond market, this would further disturb some of the same people as well as directly having an adverse effect upon investment and upon prices of bonds and related investment units.

So, where you would come out with such a package I am not sure.

Senator PROXMIRE. I do not want to delay you gentlemen longer because a live quorum has apparently been called, but the effect of this action would presumably be designed by Chairman Martin to prevent inflation and a rise in the price level.

Do any of you gentlemen feel that, under present circumstances, if we should have a tax cut, if the situation is about the same in January or February or March of next year, if such a policy as Chairman Martin advocates of spring benefits, the public would be warranted to prevent inflation?

Mr. SPRINKEL. You mean have no monetary growth whatsoever? Senator PROXMIRE. That is correct.

Mr. SPRINKEL. I would say such a policy would not be warranted. Inflation is currently not a problem. It may become a problem. The evidence is quite clear, if we look at the price indexes, they have been quite stable.

As the Stigler committee report indicated, there are good reasons for believing the indexes are probably biased upward by a modest amount. We have had little inflation, if any, in recent years.

With all of the slack in both labor and capital resources, at the moment, it is inconceivable to me that we are on the brink of another large inflation in the near term. If we were to suddenly expand the money supply very rapidly and have large deficits and maintain that posture over a period of a couple of years, conditions could change completely.

You asked as of the moment, and I would agree with you.

Mr. RITTER. Yes, we are talking about a deficit that is not an inflationary deficit. Inflation is not our problem today. If we had a very large deficit, we might have an inflation problem. But that is not what we are talking about.

Senator PROXMIRE. I want to interrupt to say that yesterday Mr. Lolli, who is the executive vice president of the biggest bank in Europe, testified that he favored this approach under some circumstances because he said Italy had enormous deficits equivalent to \$40 or \$50 billion dollars in this country without serious inflationary pressures.

They sold bonds to the public to compensate for the deficit. The result was that the inflationary bias of the deficit had been neutralized.

Mr. RITTER. I am not acquainted with economic conditions in Italy. That is what we ourselves tried to do in World War II. With the heavy deficits we ran then, we made tremendous attempts to sell bonds to the public. We tried to get the deficits financed out of savings. But World War II was a situation where this was a high-pressure economy with inflation threatening at every turn.

It was completely different from the situation today.

Mr. SPRINKEL. Even so not all of it was sold through savings. Much of it actually was financed through the banking system during this period.

Mr. CULBERTSON. On that point I think the suggested way of looking at it is fundamentally in error. We either have excessive demands or we don't. Our diagnosis is that we have deficient demands. That is why we have to reduce taxes.

It makes no sense to take action in another area that would tend to prevent this one from being effective. At some other time we may have excessive total demands, but we can't have both problems at the same time.

If we have inflationary problems within the next year or so, they will be of the cost-push kind rather than resulting from excessive

total demands. I think it most important to try to prevent this sort of inflation from developing, but that requires an entirely different set of measures and not restrictive monetary policy.

Senator PROXMIER. I want to thank you gentlemen again.

I want to apologize for keeping you so long. This has been an extraordinarily competent and responsive panel.

We will resume our hearings this afternoon at 2 o'clock at AE-1, in the Capitol.

(Whereupon, at 12:10 p.m., the joint committee recessed, to reconvene at 2 p.m., the same day.)

#### AFTER RECESS

(The Joint Economic Committee reconvened at 2 p.m., Hon. Henry Reuss presiding.)

Representative REUSS. The committee will come to order. The Joint Economic Committee is conducting a series of hearings on the state of our economy and on the question of how the policies of the Federal Government might be revised to stimulate employment and economic growth.

This morning we heard testimony from three expert witnesses on the subject of domestic monetary policy.

This afternoon we are privileged to have a panel of very distinguished experts on the balance of international payments and the flow of funds between the countries. Gold outflow has been a concern to policymakers and we are glad to have you gentlemen here to shed some light on the subject.

We will hear first from Prof. Philip W. Bell, professor of economics, Haverford College.

Would you proceed, Mr. Bell.

#### STATEMENT OF PHILIP W. BELL, PROFESSOR OF ECONOMICS, HAVERFORD COLLEGE

Mr. BELL. In the preliminary press announcement for the current hearings by the Joint Economic Committee, two questions were raised by the committee relating to the balance of payments:

1. How much is the deficit in our balance of payments affected by the flow of bank funds to and from foreign countries?
2. What are the practical alternatives to the policy of raising domestic interest rates to levels of those in Western Europe?

It seems to me that implicit in the posing of the second question is the assumption that the answer to the first question is "a lot," and "it is caused by the differential in interest rates."

The evidence that I have presented casts doubt on the assumption about the role of interest rates. Existing interest rate differentials here and abroad, and most especially short-run changes in these differentials appear to have played a relatively minor role in inducing both the long- and the short-term capital flows out of the United States over the past 5 years.

May I say something that is in the statement that I would like to make clear?

I emphasize that what I say this afternoon must be of a tentative nature. It is based primarily on a careful, but still incomplete, study of the data available. I mistrust this approach by itself just as I mistrust sweeping conclusions based simply on personal experience.

I have not had a chance to test the hypothesis against the judgments of the people in the field and I cannot attach great significance to them until this is done, especially since private international capital movements are a tricky field and I have only been deeply immersed in it for 2 months.

Representative REUSS. We have three gentlemen here at the table who can put their minds on what you say.

Mr. BELL. Consider first the movement of capital on long-term capital account. Table 1 is an abbreviated summary of the balance of payments. Table 2 gives a summary of the net purchases of foreign long-term securities by U.S. residents and of U.S. long-term securities by foreigners.

When this is broken down, if you look at the period from 1957 to 1961, you see that to a large extent there was a heavy new issues outflow and that trade in existing securities which is given on table 3, the next table, was somewhat evenly balanced between the United States and the rest of the world.

What I have done is to take the various types of capital flows broken down as much as I could possibly do it and correlate them with interest rates in Canada, in England, in other European countries, and those in the United States. If we do this, we come up in general with the conclusion that interest rates are not a very significant item in inducing the flow of long-term portfolio investment.

There are two exceptions to that. One is that interest rates seem to be of some significance in the purchase of Canadian bonds by U.S. citizens, and also in the European purchase of U.S. bonds.

I have done two things. One is to take purchases and interest rates and relate them to each other. The other is to establish the trend in purchases over time and try to analyze deviations around the trend correlated with interest rates. Interest rates only become significant in terms of deviations around the trend.

This suggested to me that the timing of new Canadian issues in this country is geared to interest rates, but not the total amount of such new issues. This seems to be similarly true of European purchases of U.S. bonds.

By the way, in passing I will say that in the flow of funds buying foreign stocks and foreigners buying our stocks, which has been approximately evenly balanced in recent years, I cannot really find any great correlation between those flows and anything except possibly the level of economic activity of the United States. It is true that foreign purchases of stocks fall off rather sharply when we have a recession here. They are much more geared to that than to share prices in the United States.

Turning to short-term capital movements, broken into two parts

(1) U.S. short-term capital flow which consists of changes in our short-term claims on foreigners; (2) the foreign short-term capital flow which consists of changes in short-term liabilities to foreigners—I would like to summarize each one of those.

With respect to the flow of our capital abroad, when one breaks it down into its relevant components and analyzes those carefully, as I have tried to do in table 5 for the period 1960-61, the tremendous amount of short-term outflow in those 2 years is summarized by the basic categories of changes and claims.

First, there are bank loans to foreign official, and second, bank credit which consists of collections outstanding and other loans by banks. Then a category which is listed as "Other" in the data reported by U.S. banks. That really consists, I believe, of two parts. (Mr. Klopstock knows more about this and may add to what I say or correct me.) It seems to consist both of trade credit for our export and of dollar deposits which may have nothing to do with trade credit. The latter has been a big item in recent years. The other category consists of reports of dollar claims by nonfinancial corporations. These are the short-term claims which are payable in dollars. In addition, there are short-term claims, both on the part of banks and nonfinancial corporations, which are payable in foreign currency.

If one looks at the general developments for 1960-61, one can see that about 60 percent of the recorded outflow of that 2-year period, which was so large and has caused so much consternation on the part of so many people, actually was related to financing our growing volume of exports. Of the remaining 40 percent, only a very small fraction could be said to be primarily induced by high rates of interest abroad. This tentative conclusion is drawn by relating each of these separate categories of short-term capital movement to different areas of the world, to relevant interest rates and exports and trend factors and so on, to see which variables seem to move together.

It would seem that loans by U.S. banks to foreign banks and official institutions, the trade credit, and the large amount of other bank short-term capital which is payable in dollars to the rest of the world are related closely to exports. Japan comprises a great, big chunk of that large 2-year outflow, given the special Japanese acceptance credits.

Those three add up to 60 percent. Then when you take apart the other items, so to speak, I can find only about 4 percent which seems consistently to be related to short-term interest rates here, in London, and in Canada. So one has to ask oneself, if interest rates are not the dominant factor, what else is involved?

There has been a substantial upward trend throughout the 5-year period, 1957 to 1961. Two trend factors would appear to be important. One, the need for growth and working balances consequent upon convertibility and the general increase in activities between the United States and Common Market countries. Two, the long-run stimulus of artificial tax inducements because of tax-haven operations and the opportunity to invest in securities which yield tax-free or nearly tax-free income because of the building up of excess tax credits on income earned abroad.

I believe that the provisions of section 13 in H.R. 10650, as amended in the Senate, and the other provision added in the Senate with respect to interest income earned abroad by foreign corporations so that it will not be applicable to the excess tax credits, should cut down on the movement of short-term capital which may be related to that factor.

When we turn to the foreign short-term capital in the United States, which is invested in liquid liabilities of this country, we have again tried to see whether there has been any switching of balances over a 5-year period, using quarterly data for the most part, between the United States and other areas of the world on the basis of changes in interest rates.

Our general conclusion is that it has been very, very small indeed. What we did, detailed in the statement here, is to take the ratio of dollar assets to total foreign exchange reserves in toto and for various individual countries and tried to see whether that was geared to interest rates or whether it was geared to the total reserves of that country or simply to a trend factor and so on.

In only one period between 1957 and 1961 did substantial switching occur in the case of the world as a whole. If I can refer you to table 7 at the very back of the statement, one can see that, for example, in the case of official holdings of dollar assets, there has been very little response as one would expect. In the case of commercial banks, if you look at the next to last line, you will see that commercial banks in general remained holding about 60 percent of their foreign exchange assets in dollars and about 40 percent not.

But these percentages both took a very sharp drop in the fourth quarter of 1960 and the first quarter of 1961, the ratio for commercial banks remaining down through June 1961. I have not been able to get data yet to continue that series.

This material indicates that a substantial amount of switching occurred, presumably from here to London, but a switching occurred at only that one stage of the game. That switching would not be directly interest rate induced because the interest rate margin between London and New York was relatively high in the early part of the 1960's. The interest rate differential narrowed during this fourth quarter of 1960 and into the middle of 1961, and then widened. So I think there is good reason to suspect that this was really a speculative switching of funds against the dollar in anticipation that the dollar might devalue, and this switching had relatively little to do with the factor of interest rates.

So I find very little interest effect on short-term liabilities. One very good study by the Federal Reserve Board has come up with generally the same sort of conclusion.

We turn finally to one other factor. I have tried to discuss thus far both long- and short-term recorded capital movements. There is, however, a very substantial error and omissions item in balance-of-payments data. Many people feel that this is probably closely related to short-term capital movements. Again, what I have done is to try to see if I can find any consistent relationship between the errors and omissions item and other short- or long-term capital movements.

Indeed, one does find that the errors and omissions item throughout the 1950's has behaved in a very consistent fashion with short-term capital movements in particular, and it may be that direct investment and/or long-term securities are related as well. If one looks at this relationship closely, one can at least arrive at an estimate of how much of the errors-and-omissions item may actually be short-term capital outflow, but not recorded as such. If the relationships which I tried to establish here are correct, then it would suggest that the short-term

capital outflow of the United States in 1960 and 1961 was actually \$2.5 billion each year rather than the \$1.3 billion which was recorded. Still since the recorded short-term outflow seems to be reduced by factors other than interest-rate differentials, there is no reason to suppose that this is not true of the unrecorded flows as well since the two were closely related one to another.

Mr. Chairman, to summarize, so far as the evidence that we have been able to find in our studies, we can find or they suggest—let me say this—they do not lend support to those who attach great importance to the role of interest rates in inducing short- or long-term capital flows. The data do not suggest that no importance should be attached to interest rates or, more generally, to the degree of looseness or tightness of money markets. They suggest that interest rates play a relatively minor role in and of themselves, although under certain circumstances when interest-rate differentials favorable to the movement of the capital are combined with more influential considerations such as speculation, the role of interest rates may be more significant.

Thank you.

(Mr. Bell's prepared statement follows:)

STATEMENT OF PHILIP W. BELL, PROFESSOR OF ECONOMICS, HAVERFORD COLLEGE

The outflow of private capital from the United States in recent years has become a matter of considerable concern to those formulating national economic policy. In the last 5 years the outward flow of private long-term capital has approximated the total of Government loans and grants (other than military grants, which do not directly affect the balance of payments), which we hear so much about, and there has been a substantial outflow of private short-term capital as well. More important, there has been a substantial increase in private capital moving abroad in the last 5 years as compared with the previous 5 years, as shown in table 1.

I understand that this committee is interested this afternoon primarily in the question of what role interest rates and interest-rate policy has played and might play in the future in influencing these private capital movements. I have been studying this question this summer and hope that some of my preliminary, very tentative findings may be of some use to the Congress and the administration in formulating policy. I emphasize that what I say this afternoon must be of a very tentative nature—it is based primarily on a careful but still incomplete study of the data available. I mistrust this approach by itself just as I mistrust sweeping conclusions based simply on "personal experience." But I have not yet had a chance to test the hypotheses that are posed by study of the data against the judgments of people in the field, and I cannot attach great significance to them until this is done, especially since private international capital movements comprise a complex and tricky field, and while I have studied around it, so to speak, for a number of years, I have been deeply immersed in it for only 2 months.

Be that as it may, the evidence which I have been able to put together thus far does not lend support to those who attach great importance to the role of interest rates in inducing either short- or long-term capital flows, or both, into and out of the United States. The data do not suggest that no importance should be attached to interest rates, or more generally to the degree of looseness or tightness in money markets. They suggest rather that interest rates and interest-rate changes play a relatively minor role in and of themselves, although under certain circumstances, when interest rate differentials favorable to the movement of capital are combined with certain other, in many ways more influential considerations such as speculative fear of devaluation, the role of interest rates may be more significant.

I would like to divide my testimony into four parts, the first concerned with long-term portfolio investment—our purchases of foreign stocks and long-term bonds; the second with changes in our short-term claims on foreigners; i.e., what is reported in balance-of-payments statistics as "U.S. short-term capital (net)"; the third with changes in our short-term liabilities to foreigners; i.e., their

short-term claims on us; and lastly with the "errors and omissions" item in balance-of-payments statistics, an item which has been subject to a sharp adverse shift from a traditional "plus" to a substantial "minus" in the last 2 years, a shift which can, I believe, be shown to be linked to private capital movements. I am excluding consideration of direct investments from my testimony. It is possible that some of the substantial increase in direct investment outlays by American businesses abroad during the last few years has been motivated by high interest rates abroad and low rates in this country. A large proportion of what is "direct investment capital" involves simply changes in intercompany accounts, between the parent company in the United States and subsidiaries abroad. Faced with borrowing short-term capital abroad on the one hand, and borrowing it here or using existing cash here and directing it abroad through intercompany accounts on the other, a corporation may make its decision in part on the basis of interest-rate differentials. But it seems doubtful that the movement of any large magnitude of funds is in fact determined in this way; i.e., solely or even primarily by interest-rate considerations—if for no other reason than that foreign operations of most U.S. companies do not seem to be closely integrated with domestic operations.

#### I. INTEREST RATES AND LONG-TERM PORTFOLIO INVESTMENT

The basic components of recorded movements in long-term portfolio capital into and out of the United States over the last 10 years are shown in condensed form in table 2. Investment by U.S. residents in foreign stocks has been approximately matched throughout the decade 1952-61 by foreign investment in U.S. stocks. The substantial increase in recorded net portfolio outflow has been in bonds, not stocks, and while most of this has been in the form of increased new issues on the New York market, the demand for foreign bonds seems to have outrun the new supply coming to that market so that U.S. residents have been buying outstanding issues, presumably (but not necessarily) going to foreign capital markets to fill their needs.

It is interesting, and necessary if we are to consider interest rate motivation, to get some perspective on the regional distribution of these portfolio investments. Ninety percent of the U.S. outflow over the 5-year period 1957-61 has gone to regions other than Europe (unlike direct-investment outlays, 50 percent of which has been going to Europe). This 90 percent is split about equally between Canada and less-developed countries (counting that moving to such regions through international institutions). Perhaps more informative is the net movement of portfolio capital between the United States and other regions of the world. It is evident from the third part of table 3 that during the last 5 years the United States has supplied Canada with something over \$2 billion, largely through purchases of Canadian bonds, less-developed countries something under \$1 billion, and that one-third of this total \$3 billion outflow has been offset, or financed so to speak, by an inflow of long-term private capital from Europe.

The question arises as to how much of this substantial long-term portfolio investment of the last 5 years, which greatly exceeds that of the previous 5 years, is actually mobile capital—capital which can move in response to changes in interest rates, in share prices, in levels of economic activity, in tax policy, or whatever else may influence it. It would appear from study of the data that around \$1 to \$1.5 billion worth of increased U.S. security holdings by foreigners, and about the same amount of accumulations of foreign securities by U.S. residents, is potentially mobile capital—about half consisting of bonds, half of stocks.

Long-term interest rates in the United States have been consistently below long-term rates in Canada and in Europe during the last 5 years; the Canadian-United States differential has been relatively constant, but the United Kingdom-United States differential has varied from between one-half a percentage point to more than 2½ percentage points in the middle of last year. A high foreign and low U.S. rate, or an increasing differential might be expected to have two types of effects on long-term portfolio capital movements: (1) It might induce a larger amount of new issues of foreign securities here; (2) it might induce foreigners or U.S. residents to sell U.S. bonds and/or buy foreign bonds. I.e., the capital movements would be reflected in transactions in existing securities.

I have tried to investigate these possibilities by comparing bond purchases and relevant interest rates, using quarterly data of the last 5 years. The only rela-

tionships which proved to be statistically significant (and these only barely so) were deviations from trend values of U.S. net purchases of Canadian bonds and European net purchases of U.S. bonds, i.e., the deviations from the upward trend of these two variables did appear to bear some relationship to Canadian and United States long-term interest rates on the one hand, and United Kingdom and United States long-term interest rates on the other.<sup>1</sup> But even these relationships, out of a great many experiments tried, could be established only in terms of deviations from trend values, i.e., the relationship between bond purchases and interest rates independent of the trend was not statistically significant at all for U.S. purchases of Canadian bonds, only of very slight significance in the case of European purchases of U.S. bonds. And this latter relationship is statistically significant probably only because U.S. interest rates were relatively high during the 2 years following the establishment of convertibility in Europe at the end of 1958, when Europeans probably would have increased their holdings of U.S. bonds anyway in order to build up working balances which they had been prevented from doing by exchange restrictions. The fact that long-term interest rates seem to have at least a minor influence on variations around the trend of net purchases of foreign bonds, but little or no influence in determining the trend itself, suggests that perhaps the timing, but not the absolute level, of bond purchases is what is influenced by interest-rate considerations. If the decision of Canadians to issue new Canadian bonds in the U.S. market, or of Europeans to purchase U.S. bonds—say sometime within a given 6-month or year period—is made largely independently of interest-rate considerations, and only the timing of the purchase is influenced by interest rates, then the importance of long-term interest rates to our balance-of-payments position is negligible.

Let me say just a word about recorded foreign purchases of U.S. stocks and our purchases of foreign stocks. As in the case of bonds, the trend factor seems to have been dominant over the last 5 years. I can find no consistent relationship between deviations from trend (on a quarterly basis) and share prices, although various leads and lags were tried as well as coincident series. One thing that can be said, however, is that foreign purchases of U.S. stocks in particular seem to be related much more to the level of economic activity in this country than to share prices; in the 1957-58 recession and again in 1960-61, foreign purchases fell consistently with the index of U.S. production while U.S. purchases of foreign stocks rose during recession. As suggested by the data in tables 2 and 3, this type of capital transaction is an item of growing importance for the viability of our international economic position.

So much for long-term securities. I can summarize by saying that I have hunted high and low for an honest interest rate effect and been unable to find one that is truly significant. That does not mean that long-term interest rates will necessarily continue to be relatively insignificant in influencing foreign portfolio investment, for admittedly the past 3 years have been dominated, at least so far as movements in and out of Europe are concerned, by the establishment of convertibility, while the net outflow to Canada, I believe, has been strongly influenced by tax considerations—a matter to which I shall return later.

## II. INTEREST RATES AND THE OUTFLOW OF U.S. SHORT-TERM CAPITAL

It is not really long-term capital but short-term capital which is supposed, in textbook treatments of the subject, to be dominated by interest rate considerations. It is not surprising, then, that when U.S. short-term capital began to flow

<sup>1</sup> The relationship may be expressed in terms of regression equations as follows (with 21 observations, 1 per quarter, including the first quarter of 1962):

$$\text{U.S. net purchase Canadian bonds} = 101 + 195 \text{ Canadian interest rate} - 161 \text{ U.S. interest rate} - 11 \text{ trend}$$

(75) (77) (8)

$$\text{European net purchase U.S. bonds} = -420 - 11 \text{ United Kingdom interest rate} + 156 \text{ U.S. interest rate} + 8 \text{ trend}$$

(40) (61) (5)

$$R^2 = 0.46.$$

The figures in parentheses are standard errors: if the number above it is more than twice this standard error, the variable associated with that number and the dependent variable (bond purchases) may be said to be significantly related one to another. The first equation shows that from the beginning of 1957 through the first quarter of 1962 more new Canadian bonds were issued in New York or U.S. residents bought more Canadian bonds in Canada the higher the Canadian rate of interest and the lower the U.S. interest rate, as we would expect. The second equation suggests that Europeans tended to purchase more U.S. bonds the higher the U.S. interest rate and the lower the United Kingdom rate, although this latter variable is not statistically significant.

out at an alarming rate in 1960 and this continued in 1961, and further, the statistics showed that European short-term interest rates were substantially above short-term rates in the United States, people quickly put two and two together and concluded that "The emergence of significant differentials in short-term interest rates has resulted in an enormous outflow of U.S. private short-term funds."<sup>2</sup>

Study of the components of the recorded outflow during those 2 years, and of movements in the 3 years previous to that period—what types of capital moved and where they went—as well as of the timing of the various movements in conjunction with the timing of interest rate changes, does not support the hypothesis that U.S. short-term capital has been moving in recent years primarily, or even significantly, in response to changes in short-term interest rates. (I emphasize the term "recorded" capital movements; I shall come to consideration of what I believe to be a very substantial amount of "unrecorded" short-term capital shortly.)

The basic components of movements in the U.S. short-term capital account during the past 5 years are compiled in table 4. There are two main reporting groups providing information on outstanding short-term claims on foreigners: U.S. banks, and some 600 large U.S. nonfinancial corporations with operations abroad. The data in the table have been grouped to show six basic categories of flows, with a regional breakdown for each. The four basic types of recorded U.S. short-term claims are (1) loans by U.S. banks to foreign banks and official institutions; (2) a composite of other bank loans and collections outstanding which I will call "trade credit"—the amounts outstanding tending to move closely with the level of our exports; (3) "other dollar claims" reported by U.S. banks, which contains two quite different types of claim: special arrangements, such as those with Japanese banks and others, that appear to be closely geared to our level of exports, as is the "trade credit" total; and dollar deposits, presumably of U.S. banks and individuals, in Canada and Europe; (4) dollar claims of U.S. nonfinancial corporations. The two other categories of claims shown consist of amounts payable in foreign currency as reported by banks, and by nonfinancial corporations. They consist of deposits in foreign banks (other than dollar deposits) and an "other" category which includes accounts, notes, bills, and drafts receivable, as well as short-term foreign security holdings.

In table 5, the 2-year outflow of 1960-61 is broken down into these six basic categories regionally subdivided. It can be seen right away that almost 60 percent of the nearly \$3 billion total outflow was of a type which would not be expected to be moving primarily in response to changes in interest rates, viz. bank loans to foreign banks and official institutions, bank "trade credit," and the "other" category reported by banks, vis-a-vis the rest of the world, consisting primarily of very large acceptance arrangements made with Japanese banks and corporations. The latter two items are "export finance," and presumably are in part responsible for our \$4 billion increase in merchandise exports between 1959 and 1961. It is doubtful that a change of 1, 2, or even 3 percentage points in our short-term interest rates would have affected these short-term outflows.

But what of the other 40 percent of the short-term capital outflow which amounts to well over \$1 billion over the 2-year period? I have tried to trace the responsiveness of five of the basic categories of short-term capital to various determinants, using quarterly data for the last 5 years. The results are summarized in table 6, with the technical apparatus on which these conclusions rest, tucked away in the appendix. I tried to test, in each case, the general relationship between claims on the one hand, the relevant interest rates and/or level of exports on the other, and deviations from the general trend in claims with interest rates and/or level of exports.

The evidence summarized in table 6 supports the view that bank loans to foreigners other than banks and official institutions and collections outstanding do indeed comprise a short-term capital outflow which is very largely determined by export levels. There is also strong evidence that the "other" category payable in dollars as reported by U.S. banks, vis-a-vis the rest of world (the item which includes the special Japanese acceptance arrangements) is closely related to exports. These two items, with bank loans to foreign banks and officially comprise the 60 percent of total figure referred to previously. Interest rates appear to play no role whatsoever in determining either the level or the timing of these movements of U.S. short-term capital.

<sup>2</sup> Edward M. Bernstein, "Interest Rates and the U.S. Balance of Payments," in Carl J. Friedrich and Seymour E. Harris, *Public Policy, a Yearbook of the Graduate School of Public Administration, Harvard University, 1961*, p. 173.

But the evidence also suggests that interest rates have perhaps played only a minor role in influencing the other 40 percent of the outflow of 1960-61. Interest rates prove to be statistically significant variables for outflow involving only 6 percent of the total, or 15 percent of the 40 percent remainder. Two categories of short-term capital are involved: (1) the "other" category reported by U.S. banks which, in this case, probably comprises dollar deposits in Canada and in the Euro-dollar market; and (2) dollar claims of nonfinancial corporations against regions of the world other than Canada and Europe, claims which may also consist of dollar deposits in the Euro-dollar market. Interest rates appear to have had no significant bearing on the outward flow of U.S. short-term capital which involved increases in claims payable in foreign currency. This flow has been steadily increasing since 1959, and the growth rate seems to be unaffected by interest rates. Nearly 60 percent of the portion of this outflow which was reported by banks went to Canada, approximately 30 percent to Europe; nonfinancial corporations reported a much smaller proportion going to Canada, a much larger proportion going to Europe, and a considerable amount going to other regions, but possibly ending up in some way in the Euro-dollar market.

The fact that the outflow of U.S. short-term capital into foreign currency over the last 2, 3, or 5 years does not appear to have been systematically linked to interest rates, does not, of course, mean that interest rates in fact played no role in the movement. The fact of the matter is that short-term interest rates in the main financial centers abroad were generally higher than in the United States. Even if more was sent abroad when rates were 1 percentage point higher than when rates were  $2\frac{1}{2}$  percentage points higher (which is generally what the evidence indicates), whatever was sent abroad may have been because the return there was higher than it was in this country. What alternative explanation is there for the movement?

There would appear to be two possible alternative explanations: One is that with convertibility coming in Europe toward the end of 1958 and in early 1959 there was need and an opportunity to develop working balances for the extensive interrelated economic activities expected and already developing between the Common Market and the United States. European banks and others invested heavily in both short- and long-term U.S. securities in 1959; U.S. banks and others were slower to respond, but the widening interest-rate differential and the sluggish U.S. economy made 1960 a propitious year to start. The fact that there appears to have been little systematic playing of the interest-rate game implies that funds were not being moved primarily to take advantage of higher yields but rather for other purposes, with the higher yields perhaps serving as an added, but secondary inducement.

The second alternative explanation, which probably has more to do with the capital movement reported by nonfinancial concerns than that reported by banks, involves the various types of tax inducements which exist for companies with oversea operations to send capital abroad and to keep capital abroad. I am thinking particularly of tax-haven operations where they involve investment in liquid assets, through personal holding companies, or corporate subsidiaries in countries which do not tax income earned outside the borders of the country. Section 13 of H.R. 10650, as amended in the Senate, should help to close some of these loopholes. I am thinking also of the inducement established by the provision instituted in 1959 to enable firms to consolidate all of their oversea earnings in measuring the tax credit to be allowed in computing U.S. taxes when those earnings were brought back to this country. It is believed that a number of companies, even before the Canadian Government recently instituted its special 15-percent withholding tax on dividends, thereby sending the statutory corporate tax rate on income distributed by U.S. companies in Canada to  $57\frac{1}{2}$  percent, may have had excess-tax credits on consolidated foreign operations—particularly, perhaps, some petroleum companies. Interest-rate differentials would have to be substantial indeed to outweigh tax considerations if one income was to be taxed 52 percent, the other income at a low rate or not at all because of unused tax credits. The amendment to H.R. 10650 proposed by the Treasury Department in the Senate, which would separate interest income from other income in tax credit computations, should alleviate this situation.

Before considering some further possible ramifications of U.S. short-term capital which are possibly involved in the "errors and omissions" item in balance-of-payments data, let me turn to our short-term liquid liabilities and the possibility that their level at any given time is influenced by short-term interest rates here and abroad.

## III. INTEREST RATES AND U.S. SHORT-TERM LIABILITIES

If there exists a single, dominant, world financial center, a role London fulfilled in the 19th century, short-term interest rates can affect only the amounts of liquid assets which would be kept at home or deposited in London. With two main financial centers today, and a number of smaller subcenters—in Switzerland, Canada, France, etc.—the possibility is opened up for the switching of foreign exchange reserves from low- to high-interest rate countries, or more likely, for simply a building up of balances in one center rather than another as foreign exchange reserves are accumulated, thereby altering the ratio of reserves held in different foreign centers.

In some cases, such movements in reserve holdings would make little or no difference to the financial centers involved; a liquid liability is merely transferred from the name of one country to the name of another in the country losing the balance, while the recipient country experiences both an increase in an asset (in the other financial center) and an increase in a liability. Even when a commercial bank repatriates a foreign asset, it may often mean simply that the liability of the financial center is now to a foreign central bank rather than to a foreign commercial bank.

If, however, a liquid liability of the United States owed to, let us say, a German commercial bank, is moved to London because of a higher yield there, it may mean that the United States loses gold. The British exchange equalization account may prefer to hold gold rather than U.S. securities. And if the German bank moves its asset home, the German authorities may decide to exercise the same option. Thus, while the movement of foreign short-term funds in response to interest-rate differentials is unlikely to affect our overall financial deficit as measured by the Commerce Department presently (this is even true of commercial bank assets as the financial deficit is measured in table 1, but not of nonbank assets), it may affect our gold holdings and thus have an influence on our world economic position.

In table 6, there is presented a summary picture of changes in our liquid liabilities to foreigners for the period from the end of 1956 to the end of 1961. Sixty-five percent of our increased liquid liabilities to other countries from the end of 1956 to the end of 1961 consisted of new liabilities to Europe, and 88 percent of the total increase involved additional liabilities to Canada and Europe combined. Furthermore, 60 percent of the increase in our liquid liabilities to other countries, or about \$3.2 billion, represents new, privately owned dollar assets; only \$2.2 billion of the \$5.4 billion increase has accrued to foreign central banks and governments. Surely the stage has been set for large-scale "switching" operations if foreign banks and private citizens, particularly the former, wish to, or feel compelled to move their liquid assets out of the United States, either in response to interest-rate differentials or to some other stimulus.

In an interesting study of the movement of such funds over the past few years, Robert F. Gemmill of the Federal Reserve System found that the amplitude of the fluctuations about the trend from peak to trough in dollar assets held by foreign commercial banks and other private parties in recent years has been between \$600 million and \$1 billion, suggesting that this is the maximum amount of switching which may take place as a result of interest rate differentials or for other reasons. And he suggests that two other considerations may well have swamped the interest rate factor, in spite of a relatively high correlation between deviations from trend and interest rate differentials, viz: The need to build up working balances consequent upon convertibility, to which I alluded previously, and probably a speculative movement against the dollar in late 1960 and early 1961, which could explain the large absolute decline in privately held liquid dollar assets during this 6-month period.<sup>5</sup>

Using a slightly different approach, I have tried to analyze the degree of switching of foreign exchange reserves which might be occurring in response to interest rate differentials by considering how the composition of foreign assets around the world has varied with movements in short-term interest rates. Table 7 shows first of all that between 1956 and 1958 foreign central banks and other official bodies tended steadily to increase the ratio of both gold and dollars relative to total foreign asset holdings, and that this ratio was relatively constant through 1959, 1960, and 1961 although there was a movement away from dollars into both gold and other foreign currencies—presumably sterling—dur-

<sup>5</sup> Robert F. Gemmill, "Interest Rates and Foreign Dollar Balances," *Journal of Finance* 16 (September 1961), 369-376.

ing the period of substantial speculation against the dollar, evidently sparked by a fear that the United States might devalue, in late 1960 and early 1961.

The behavior of the group holding the second largest portion of liquid dollar assets—foreign commercial banks—follows a somewhat different pattern. It appears that banks steadily lowered the ratio of dollars to total foreign exchange reserves between 1956 and 1958, increased the ratio substantially again following convertibility (the increase comprising mostly increased holdings of European commercial banks), and dropped the ratio even more sharply than did central banks during the last quarter of 1961 and first quarter of 1962. The 10-percentage-point drop during this period implies a loss of around \$500 million in U.S. liquid liabilities; whether this in fact meant a gold loss of that amount depends upon what the recipient central authority, in the bank's own country or elsewhere, did about its increased foreign assets, that is, whether it decided to increase its gold stock, its dollar assets, or its exchange reserves in non-dollar currencies.

An aggregative approach to the switch problem can hide a multitude of sins. Perhaps reserves were simply moving from countries which do not hold the bulk of their reserves in dollars (sterling area countries, for example) to countries which do, and this movement was reversed toward the end of 1960 and in early 1961. In an attempt to scrutinize the switching problem more closely, I have analyzed the behavior of some 23 countries, tracing the relationship between the ratio of dollar assets to total foreign exchange reserves and the short-term interest rate in London and New York, and the relationship between this ratio, short-term interest rates, and total foreign exchange reserves of the country, using quarterly data for the period 1957-61. A few countries—Belgium, the Netherlands, Mexico, and Peru, for example—do seem to be responsive to interest rates here and in London, and build up and draw down exchange reserves in one center or the other accordingly (assuming that the residual foreign exchange not in dollar assets is in pounds sterling, although there is no way to know this for sure). But most countries seem either to maintain a relatively fixed ratio of dollar reserves to total foreign exchange reserves, or to alter this ratio in some regular and systematic fashion in accordance with the level of their total reserves.

There thus appears to have been only a small amount of switching of foreign exchange reserves around from one country to another—presumably primarily between London and New York—in response to movements in interest rates in recent years. As in the case of U.S. short-term claims, the fact that higher short-term rates prevailed abroad may have aided and abetted the speculative movement out of dollars in the fourth quarter of 1960 and first quarter of 1961, but it seems doubtful that interest rates caused the movement, per se. The short-term interest differential between London and New York was large on either side of this period of speculation, but relatively small during the period. Furthermore the spot price of sterling fell steadily from September of 1960 to May of 1961 so that people who switched funds suffered at least short-run losses.

#### IV. THE ERRORS AND OMISSIONS PROBLEM

Everything that I have said so far relates to recorded long- and short-term capital movements. One of the great problems for balance-of-payments analysts has to do not with what is recorded in the official statistics, but rather what is not recorded—with the residual item entered at the bottom of balance-of-payments tables which is termed "unrecorded transactions" or "errors and omissions." Many people suspect that movements in this item represent short-term capital flows. There is a logical reason for this suspicion. The statistics for most balance-of-payments items are collected for flows during a period. But the statistics on which short-term capital movements data are based are stocks at the end of a month, and the flow is measured by the change in the stock outstanding from month to month. Suppose deposits payable in foreign currency, either of banks or of nonfinancial corporations, rise from the end of one quarter to the end of the next, then are lower at the end of the following quarter. The statistics report that there was a short-term capital outflow during the first quarter, an inflow during the second quarter, as if the funds came back to this country. But there would seem to be no real reason to believe this to be the case; the foreign deposits may well have turned into another kind of foreign asset. If the deposit was used to buy out a foreign firm, and the U.S. firm making the purchase was one of those reporting to the Commerce Department on its direct

investment both sides of the movement from one type of foreign asset to another will be recorded in balance-of-payments statistics. (The purchase of English Ford by the parent company was first recorded in the statistics of December 1960 as an outflow of short-term claims payable in foreign currency on the part of nonfinancial corporations, then moved to direct investment.) But if the deposit is used to buy short- or long-term securities through a foreign broker, then it will probably not be recorded since we collect no information from foreign brokers and security dealers. There will be recorded an outflow and then a flow-back of short-term capital, and a negative amount for "errors and omissions" which should in fact be recorded as purchases of either short- or long-term securities.

The "errors and omissions" item in our balance-of-payments statistics was substantially positive throughout the 1950's, but turned sharply negative in 1960 and 1961, leading many people to feel that the outflow of short-term capital during this period was substantially greater than that indicated by the statistics on recorded flows. I share his view and have tried to trace what type or types of capital flows may have been involved. Time does not permit me to go into the details of this work, but there is evidence which points to the movement of capital by U.S. nonfinancial corporations as a likely suspect. Changes in short-term claims on the part of such corporations are very closely correlated with changes in "errors and omissions"—so closely correlated that, regardless of the paucity of data, it seems almost inconceivable that the relationship is due to chance.

If changes in "errors and omissions" are in fact associated primarily with short-term capital movements as the data suggest, the outflow was actually \$2.5 billion in each of the years 1960 and 1961, rather than the \$1.3 billion which was recorded. Some of the unrecorded flow may well have been moving in response to interest rate differentials, but the suggested link to the short-term capital outflow of nonfinancial corporations would point more, perhaps, to the tax factor. I am afraid that I will have to end this section at this point by simply saying that more work needs to be and is being done on this thorny problem.

TABLE 1.—U.S. balance of payments, annual average of 1952-56 and 1957-61

(Millions of dollars)

	Annual average	
	1952-56	1957-61
Balance on current account.....	2,083	3,450
Private remittances.....	-471	-687
U.S. long-term capital:		
Direct investment.....	-1,006	-1,657
Net purchases of foreign securities.....	-100	-778
Other, including trade credits.....	-138	-232
Total.....	-1,244	-2,667
Foreign long-term capital:		
Direct investment.....	189	144
Other, including net purchase of U.S. securities.....	161	265
Total.....	350	409
Government loans and grants (nonmilitary).....	-2,247	-2,744
Basic balance.....	-1,549	-2,139
Short-term capital:		
U.S.....	-254	-672
Foreign.....	217	224
Errors and omissions.....	427	137
Total.....	390	-311
Financial balance.....	-1,159	-2,450
Change in gold holdings (+ denotes foreign purchases).....	163	930
Change in liquid liabilities to banks plus official.....	996	1,620
Total.....	1,159	2,450

TABLE 2.—Annual averages of net purchases of foreign long-term securities by U.S. residents and of U.S. long-term securities by foreigners, 1952-56 and 1957-61

[Millions of dollars]

	Annual average	
	1952-56	1957-61
U.S. net purchases of foreign securities as given in Treasury data:		
Bonds.....	-102	-650
Stocks.....	-124	-210
Total.....	-226	-860
Less adjustment for direct investment transactions.....	-126	-82
Total, for balance-of-payments purposes.....	-100	-778
Of which:		
New issues.....	-289	-660
Redemptions.....	138	111
Net.....	-151	-549
Transactions in existing securities.....	51	-220
Foreign net purchases of U.S. securities as given in Treasury data:		
Government bonds.....	125	261
Corporate bonds.....	19	18
Stocks.....	115	195
Total.....	259	474
Less adjustment for direct investment transactions.....		
Total, for balance-of-payments purposes.....		

Source: Treasury data compiled from tables I-3 and I-4 in the capital movements section of the Treasury Bulletin, May 1962, pp. 81-82. The breakdown of U.S. net purchases into new issues and redemptions is from lines 33 and 34 of the latest Commerce Department revision of balance-of-payments data, as yet unpublished, while the figure for transactions in existing securities was supplied the writer by the Commerce Department. The adjustment factor for direct investment in the residual of Treasury and Commerce data; it is largely the amount of purchases recorded in Treasury data which Commerce has recorded as direct investment.

TABLE 3.—Cumulative net purchases of foreign long-term securities by U.S. residents and of U.S. long-term securities by foreigners, regional breakdown, 1957-61

[Millions of dollars]

	Canada	Europe	Other regions	International institutions	World
Net U.S. purchases of—					
Foreign bonds.....	-1,704	333	-509	-1,200	-3,081
Foreign stocks.....	-226	-696	-111		-1,033
Total.....	-1,930	-363	-620	-1,200	-4,114
Net foreign purchases of—					
U.S. bonds.....	-193	543	244	798	1,391
U.S. stocks.....	-142	837	215	15	974
Total.....	-335	1,430	459	813	2,365
Net portfolio capital flow in—					
Bonds.....	-1,897	876	-265	-402	-1,690
Stocks.....	-368	191	104	15	-59
Total.....	-2,265	1,067	-161	-387	-1,749

Source: Figures are compiled by cumulating the monthly totals given in the Treasury Bulletin over the 5-year period 1957-61. The Treasury Department publishes only preliminary data on net purchases of securities vis-a-vis individual countries; revised data are given only for the world as a whole. There are therefore small discrepancies between the data in this table and the data in table 2.

TABLE 4.—U.S. short-term capital outflow, 1957-61

[Millions of dollars]

	Increase in short-term claims					Claims outstanding December 1961
	1957	1958	1959	1960	1961	
A. Total payable in dollars.....	-350	-175	-99	-877	-1,414	5,427
Banks:						
1. Loans to foreign banks and officials.....	-66	-192	-1	26	-201	1,014
Of which—						
Canada.....	-12	13	8	-1	-3	9
Europe.....	-10	-39	56	-33	57	121
Rest of the world.....	-44	-166	-65	60	-255	864
2. Bank loans to other and collections outstanding.....	8	-110	-135	-91	-251	1,322
Of which—						
Canada.....	8	-81	-56	-14	-5	218
Europe.....	-20	-3	-5	-12	-64	251
Rest of the world.....	20	-26	-74	-65	-182	853
3. Other dollar claims.....	-269	58	74	-610	-597	1,789
Of which—						
Canada.....	3	-7	12	-10	-43	65
Europe.....	-84	54	110	-7	-56	151
Latin America.....	-159	18	23	-195	-28	486
Japan.....	-24	8	-91	-375	-444	999
Rest of the world.....	-5	-15	15	-23	-26	76
Nonfinancial corporations:						
4. Dollar claims.....	-23	69	-37	-202	-365	1,301
Of which—						
Canada.....	-1	19	-6	-25	-359	492
Europe.....	18	-12	-22	-132	5	377
Rest of the world.....	-40	62	-9	-45	-11	432
B. Total payable in foreign currency.....	19	-62	14	-390	-153	893
1. Banks.....	28	-50	-38	-241	-109	585
Of which—						
Canada.....	-4	-17	5	-103	-90	249
Europe.....	6	-31	-20	-105	5	244
Rest of the world.....	26	-2	-23	-33	-24	92
2. Nonfinancial corporations.....	-9	-12	52	-149	-44	308
Of which—						
Canada.....	-2	-9	7	-35	-22	84
Europe.....	-1	-2	37	-111	9	142
Rest of the world.....	-6	-1	8	-3	-31	82
C. Grand total.....	-331	-237	-85	-1,267	-1,587	6,320
D. Broker balances and adjustments.....	55	74	8	-45	184	.....
E. U.S. short-term capital (net) (in balance-of-payments data).....	-276	-311	-77	-1,312	-1,383	.....

Source: Compiled from monthly data reported to the U.S. Treasury Department, most of which is published in the Treasury Bulletin (and/or in the Survey of Current Business). Line 10 is from unpublished revisions of the Department of Commerce's balance-of-payments data.

TABLE 5.—*Change in recorded U.S. short-term claims on foreigners, 1960-61*

(Increase in claims equals capital outflow: In millions of dollars)

	Amounts		Percent of total
Total payable in dollars.....		-2,291	81
Bank loans to foreign banks and official.....	-175		6
Bank "trade credit".....	-342		12
Bank, other:			
Canada.....	-53		2
Europe.....	-56		2
Rest of the world.....	-1,098		39
(Of which Japan).....	(-819)		
Total.....	-1,207		
Nonfinancial corporations:			
Canada.....	-384		14
Europe.....	-127		4
Rest of the world.....	-56		2
Total.....	-543		
Total payable in foreign currency.....		-543	19
Banks.....	-350		12
Nonfinancial corporations.....	-193		7
Grand total.....		-2,834	100

TABLE 6.—*Summary of analysis of relationships between U.S. short-term claims and interest rates and exports*<sup>1</sup>

Line in table 4	Short-term claim	Relationship to interest rates and exports
A1.....	Bank, "trade credit":	
	Canada.....	Dominated by upward trend; level of exports to Canada and Canadian and United States short-term interest rates had no significance, by themselves or together, nor did they have any influence on deviations from trend.
	Europe.....	Strong upward trend, but exports to Europe a significant factor; no significance can be attached to United Kingdom and United States short-term interest rates.
	Rest of world.....	Dominated by exports to other than Europe and Canada; United Kingdom and United States short-term interest rates had no significance by themselves, in terms of deviations from trend, or in terms of influencing the residual not accounted for by exports.
A2.....	Bank, "other":	
	Canada.....	Canadian short-term interest rate of considerable significance, not U.S. rate, nor level of exports; no marked trend.
	Europe.....	Both United Kingdom and United States interest rates significant in measuring deviations from trend, but not in and of themselves; no significant relationship with level of exports to Europe.
	Rest of world.....	Strong relationship with level of exports, both in and of themselves and in terms of deviations from trend; no significant relationship with United Kingdom and United States short-term interest rates.

TABLE 6.—*Summary of analysis of relationships between U.S. short-term claims and interest rates and exports*<sup>1</sup>—Continued

Line in table 4	Short-term claim	Relationship to interest rates and exports
A3.....	Nonfinancial corporation, dollar claims:	
	Canada.....	Dominated by strong upward trend; exports and interest rates had no significance in and of themselves, nor in terms of deviations from trend.
	Europe.....	Strong upward trend, but level of exports to Europe quite significant, both by itself, and in terms of deviations from trend; United Kingdom and United States interest rates of no significance whatsoever.
	Rest of world.....	Unusually strong relationship with United Kingdom short-term interest rate, considerably less significance for relationship with level of exports and with United States short-term interest rate.
B1.....	Bank, claims payable in foreign currency:	
	Canada.....	Dominated by strong upward trend; interest rates had no significance in and of themselves, nor in terms of deviations from trend.
	Europe.....	(Same as Canada.)
	Rest of world.....	Largely the same as Canada and Europe, although United Kingdom short-term interest rate significant in terms of deviations from trend.
B2.....	Nonfinancial corporation, claims payable in foreign currency:	
	Canada.....	Strong upward trend; interest rates not at all significant in and of themselves, nor in terms of deviations from trend.
	Europe.....	(Same as Canada.)
	Rest of world.....	No trend; interest rates not at all significant.

<sup>1</sup> See appendix for detailed evidence which underlies table 6.

TABLE 7.—*Changes in U.S. liquid liabilities owed to foreigners, 1957-61*

[Millions of dollars]

	Increase during year					Out-standing December 1961
	1957	1958	1959	1960	1961	
1. International institutions.....	65	27	1,614	795	-149	3,804
2. Official national bodies.....	-128	748	480	1,226	880	10,902
3. Commercial banks.....	-4	83	1,069	176	458	5,345
4. Official (national) and banks.....	-132	831	1,549	1,402	1,338	16,247
Of which:						
Canada.....	76	363	610	308	314	2,466
Europe.....	159	587	719	735	1,122	9,424
Rest of world.....	-367	-119	670	359	-98	4,357
5. Other.....	266	171	-13	-186	139	2,358
Of which:						
Canada.....	29	22	33	-70	8	279
Europe.....	244	-18	-14	-95	44	763
Rest of world.....	-7	167	-32	-31	87	1,316
6. Total, all countries.....	134	1,002	1,536	1,216	1,477	18,905
Of which:						
Canada.....	105	385	193	238	322	2,745
Europe.....	403	569	705	640	1,166	10,187
Rest of world.....	-374	48	638	338	-11	5,673
7. Grand total.....	199	1,029	3,150	2,011	1,328	22,409

Source: For the breakdown between lines 2 and 3, see source, table 7. Lines 1 and 4-7 are from published information in the appropriate Treasury Bulletin.

TABLE 8.—*Estimated world national holdings of gold, liquid dollar assets, and other foreign exchange, 1956-61*

[Dollars in millions]

End of period	1956	1957	1958	1959	1960				1961				
					I	II	III	IV	I	II	III	IV	
<b>Official:</b>													
Gold.....	\$14,027	\$14,493	\$17,493	\$18,363	\$18,388	\$18,742	\$19,425	\$20,246	\$20,622	\$20,777	\$21,338	\$21,918e	
Foreign exchange.....	\$19,785	\$18,050	\$19,230	\$19,175	\$19,405	\$20,515	\$21,300	\$21,600	\$22,195	\$22,220	\$22,450	\$22,480	
Of which:													
Dollar assets.....	\$7,874	\$7,746	\$8,494	\$8,974	\$8,828	\$9,401	\$9,939	\$10,200	\$10,212	\$9,910	\$10,862	\$10,902	
Other.....	\$11,911	\$11,204	\$10,736	\$10,201	\$10,577	\$11,114	\$11,361	\$11,400	\$11,983	\$12,310	\$11,588e	\$11,578e	
Ratio: Dollars to gold.....	0.561	0.534	0.485	0.489	0.490	0.502	0.512	0.504	0.495	0.477	0.509	0.497	
Ratio: Dollars to foreign exchange.....	0.398	0.409	0.412	0.468	0.455	0.458	0.467	0.472	0.460	0.446	0.434	0.485	
<b>Commercial banks:</b>													
Foreign exchange.....	\$5,705	\$6,303	\$6,852	\$8,118	( <sup>1</sup> )	\$8,700	\$8,764	\$8,930	\$9,514	\$10,319	( <sup>1</sup> )	( <sup>1</sup> )	
Of which:													
Dollar assets.....	\$3,563	\$3,559	\$3,642	\$4,711	\$5,160	\$5,294	\$5,373	\$4,887	\$4,781	\$5,183	\$5,313	\$5,345	
Other.....	\$2,142	\$2,744	\$3,210	\$3,407	( <sup>1</sup> )	\$3,406	\$3,391	\$4,043	\$4,733	\$5,166	( <sup>1</sup> )	( <sup>1</sup> )	
Ratio: Dollars to foreign exchange.....	0.624	0.565	0.532	0.580	( <sup>1</sup> )	0.609	0.613	0.547	0.503	0.501	( <sup>1</sup> )	( <sup>1</sup> )	
Other foreigners: Dollar assets.....	\$1,981	\$2,247	\$2,418	\$2,405	\$2,243	\$2,252	\$2,230	\$2,219	\$2,107	\$2,199	\$2,226	\$2,358	

<sup>1</sup>Not available.

International Monetary Fund, International Financial Statistics. Data on dollar assets are published in the Treasury Bulletin.

Source: Official gold and total foreign exchange reserves, and the total foreign exchange reserves of commercial banks, are the latest estimates for each period published in the

Senator SPARKMAN (presiding). Thank you, sir. Mr. Humphrey.

**STATEMENT OF DON HUMPHREY, PROFESSOR OF INTERNATIONAL ECONOMICS, FLETCHER SCHOOL OF LAW & DIPLOMACY, TUFTS UNIVERSITY**

**MR. HUMPHREY.** The competitive position of the United States in world trade has greatly improved since 1959. According to reports from Europe, the outlook is for continued improvement. The odds now favor relatively greater upward pressure on European wages and prices than on our own. The favorable prospect depends on our keeping enough restraint on wages and prices to avoid inflation, even when unemployment and idle capacity are eliminated.

If the American economy were operating more nearly at capacity, we would import more, so that our large surplus of exports over imports would be somewhat reduced. That is why full recovery may delay the complete elimination of our foreign deficit. In considering magnitudes, we need to distinguish the deficits that we have actually experienced from the still larger deficits that we might have faced with full employment. The deterioration of our competitive position, during the last half of the 1950's, contributed to a slack in the domestic economy because we failed to produce and sell enough exports to balance the international accounts.

The other side of the picture is that the surplus countries have been overexporting, as compared with the requirement for balance-of-payments equilibrium. Thus, while underexporting has meant unemployment in the United States, overexporting contributed to an excess of demand in the surplus countries. This disparity is further exacerbated by the flow of capital. When the surplus countries employ high interest rates to hold down demand and prices, this attracts capital from the United States, where low interest rates prevail in an effort to stimulate domestic output. From this we can see how the overall payments picture may not improve as rapidly as our competitive position.

In the end, full recovery would have a favorable effect on capital movements. Capacity output will raise profits and interest. This will not only keep the extra funds at home which have been moving abroad, it is expected to attract foreign capital. The trouble is that these favorable effects on capital movements come rather late in the recovery, while imports of merchandise may increase temporarily faster than exports with each step of domestic expansion. In fact, business may accumulate inventory in anticipation of higher domestic requirements.

All of this brings us to the prescription of higher interest rates and budget deficits. While there are many possible ways of curbing balance-of-payments deficits, there is only one good method: that is to make price competitive. For the rest, the choice, I'm afraid, is between the undesirable and the unthinkable. We can agree, I assume, that it would be a miscarriage to sacrifice \$30 billions of potential output for the sake of speedier elimination of a foreign deficit, which is so very small by comparison and is already diminishing. We can cut taxes, as may be needed to restore the momentum of domestic recovery, and bear with our foreign deficit a little longer. Sophisticated Eu-

rope is less concerned with domestic budget policy and more concerned that our exports be competitively priced. Moreover, with output more nearly at capacity, unit costs will be lower, so that there is no need for higher prices.

Senator SPARKMAN. Mr. Humphrey, unfortunately there is a rollcall in the House, and there is also one in the Senate at the same time, so I think we are going to have to recess these hearings briefly. I shall go and answer the Senate rollcall and be right back. It is possible that some member of the committee from the House will beat me here, and if so, whoever it may be will resume the hearings.

Mr. HUMPHREY. We understand, Mr. Chairman.

(Brief recess.)

Senator PROXMIRE. Gentlemen, I want to apologize once again for these interruptions. This is going to be a very difficult day because, for the first time in 35 years, the Senate has invoked cloture. There are some 250 amendments pending. Whether they will all be called up, there is a question. I pray for your indulgence, and I apologize once again for this lack of courtesy.

Senator SPARKMAN. Mr. Humphrey, I understand you were on page 2.

Mr. HUMPHREY. That is right, sir, starting with the last paragraph.

Mr. Chairman, those who recommend high interest rates for the United States should prescribe low interest rates for countries with a balance-of-payments surplus, in order to avoid a disturbing flow of capital from the deficit to the surplus countries.

Of course, it will be said that countries with a balance-of-payments surplus need high interest rates to restrict demand and avoid inflation. The answer is that, if the United States is expected to rely on budget deficits to expand demand and restore full employment, then, by the same logic, the surplus countries should increase taxes, and rely on a budget surplus to control inflation.

Both low interest rates and budget deficits are favorable to an expansion of domestic employment and output, but each may have adverse balance-of-payments effects. For the same reason, both high interest rates and budget surpluses have adverse effects on domestic employment, but each helps to improve the balance of payments. Now if the effects are favorable to the achievement of one objective, but adverse to the other, then a nation needs to employ two instruments of policy in a different fashion in order to achieve both objectives. Thus, the conception that fiscal policy should be employed to expand domestic employment, while monetary policy is used to protect the balance of payments, has a certain logic.

The trouble, Mr. Chairman, is that European countries, with a balance-of-payments surplus, have failed to take the same medicine that they prescribe for us. It is not written in the heavens that the United States (or any country with a payments deficit) should bear the whole responsibility for curbing these disturbing international flows of capital. If the prescription is that monetary policy should serve balance-of-payments objectives, then the surplus countries should dose with their own medicine by lowering their interest rates.

The risk of a flight from the dollar, of which there are no signs, remains a source of possible trouble. If the uneasy climate deterio-

rated, the toll could be critical. We should be prepared to pay something, if necessary, to avoid this. If raising the short-term interest rate by half a point would help significantly, this does not seem too high a price, in the light of the alternatives. But, on the other hand, I should resist choking off a couple of billion dollars of building construction with higher, long-term rates.

Because of the great fundamental strength of the American economy, we would not need to match foreign interest rates in order to stem the outflow capital. A second point is that the nominal high interest rates of Europe are already impaired by the development of Euro-dollars.

The least offensive direct control would be a Capital Issues Committee to screen flotations of new foreign securities in the United States. But here we should recognize that these issues are partly taken up by nationals of the borrowing country which may already own liquid dollar assets. To curb the purchase of foreign securities by Americans is a more serious step, while regulation of ordinary bank loans is still more drastic.

The trouble with a little regulation is that it risks touching off fears, however unfounded, of still more extensive controls. Thus, it is argued that even the most modest curb on the outflow of capital might tip off the shipment of capital to Europe by those preparing for future investments and travel. But against this view is the opposite possibility that a little firmness in screening outside borrowers and foreign portfolio investment might be regarded as a sign of strength. It can be argued that if we do not care enough to protect ourselves in this respect, we may not hold the full confidence of others.

Extreme controls would involve licensing of foreign transactions and registration of foreign assets, such as were used during the war. The technical problems are onerous and the loopholes are many. Anything less than comprehensive and effective regulation in this direction might threaten, rather than strengthen, the improved position of the dollar as a reserve currency for the immediate period ahead.

A quiet different bargaining weapon, which I sometimes feel we may have neglected, is the taxing of tourist travel and expenditure in continental Europe, though it would hardly be popular politically to deny school teachers their trip to Europe while allowing the free outflow of capital in search of profits.

Another measure, which is rarely mentioned, would be to allow a tax rebate on exports, in order to encourage exports during this cyclical period of domestic expansion when imports normally increase faster than exports. Many European countries normally remit excise taxes, which amounts to an export subsidy. Since we use the corporate income tax, rather than relying as heavily on excises as they do, such a step could be justified. A tax rebate equal to, say, 10 to 15 percent of certain exports might be preferable, all around, to the type of import restrictions which Europe employed, and we accepted, when Europe was wearing the deficit shoe. Compared with import restriction, export expansion has the advantage of moving in the direction we want to go. And the loss of tax receipts need be

no more serious than the cost of some of the other measures proposed. The loss of tax revenue remitted for export expansion may be preferable to the same amount of extra budgetary deficit that is implied by the prescription of higher interest rates.

I want to make it clear that I am not mentioning these possibilities as something that is attractive, but as possibilities among unattractive alternatives. In short, each prescription should be judged by the magnitude, so far as possible, rather than by an oversimplified doctrine.

Once we get out of this dilemma, our experience points to the need for overhauling the key currency system of the postwar era. That it is too fragile a system has been demonstrated.

Quite apart from the current gold problem of the United States, some people believe (or hope) that, eventually, the free world will be forced to double the price of gold. Their argument is that the monetary stock of gold has not kept pace with the growth of world trade. From this fact, the mistaken conclusion is drawn that the future expansion of world trade will be hampered, unless the supply of gold increases roughly in proportion to trade.

While it is true that an increase in the price of gold would expand reserves both by raising the value of existing stocks and by stimulating future production, there is no firm basis for the assumption that gold reserves need to increase in proportion to trade. For one thing, no one supposes that the proportion was "just right" to start with. Secondly, we all see how the banking system has developed domestic clearing systems which economize the use of cash by requiring only the payment of clearing balances. For similar reasons, there is no firm basis for assuming that the need for international gold reserves increases in proportion to the expansion of trade.

In addition to gold, the world now holds monetary reserves in two key currencies—the dollar and the pound sterling. The Common Market may develop a third key currency and, from the point of view of economizing on gold, three key currencies are better than two. I shall mention only briefly still other ways in which the demand for gold may be reduced.

Nations may decide to economize on the use of gold for settling international payments by pooling their gold and reserve currencies with the International Monetary Fund in exchange for gold certificates. A development in this direction may begin in Europe. The Common Market, which may decide to eliminate the use of gold and dollars for settling debts between members, just as we do not use gold to settle accounts between States or regions of the United States. In this event, the Common Market would need gold or dollars only when the combined balance of payments of all member countries was in deficit with the outside world.

By pooling their reserves to economize on the need for holding large reserves, Common Market countries as a bloc could prudently hold less gold than they may need individually. (Moreover, if Britain joins the Common Market, the sterling area may, also, be tied into this arrangement.) By reducing the demand for gold in such an important trading region as Western Europe, the supply available to other nations would be increased.

With the emergence of free trade and capital movements in Western Europe, the Treaty of Rome makes it very difficult for a member country to protect its balance of payments by direct control of trade or payments. But, so long as individual nations retain primary responsibility for wage policy and full employment, it is predictable that payments deficits will recur from time to time. The fact that resort to direct control of trade or payments will become more difficult supports a policy of more frequent changes in the exchange rate between national currencies.

If we stopped pegging exchange rates, transactions between residents of different countries would be held in balance by a free-market price of currency. This means that there would be no balance-of-payments deficits and, hence, no need to hold gold for international payments. Thus, with free-market exchange rates, the demand for gold would fall drastically, and the price of gold could be allowed to fall, too.

But the world would not need to adopt completely free-market exchange rates, in order to reduce the size of monetary reserves which the present system of pegged rates makes it prudent to hold. An accepted policy of more frequent adjustment of exchange rates would eliminate balance-of-payments deficits more readily and, hence, would reduce the size of gold stocks which nations now wish to hold as a precaution.

To those who are saying—and betting—that the price of gold will have to be doubled, eventually, I would point out that a reform of the IMF, which accepted more frequent adjustment of the exchange rates between national currencies, would eliminate the need for holding large gold reserves. I believe that such a system might allow both national governments and the IMF to support currencies which were temporarily weak and to sell those which were temporarily strong. Such a system would be more serviceable, for it would avoid both the unemployment that the present system often imposes on deficit countries and the disturbing capital flows which make a bad situation worse. And by reducing the need for large gold reserves, the price of gold could be allowed to fall at times, which would be an effective answer to speculators.

Thank you, Mr. Chairman.

Senator SPARKMAN. Thank you, Mr. Humphrey.

Mr. Klopstock.

Mr. KLOPSTOCK. I believe Mr. Pizer has been asked to present his statement at this point.

Senator SPARKMAN. Very well.

**STATEMENT OF SAMUEL PIZER, ASSISTANT CHIEF, BALANCE OF PAYMENTS DIVISION, OFFICE OF BUSINESS ECONOMICS, U.S. DEPARTMENT OF COMMERCE**

Mr. PIZER. I won't read the statement that you have before you. I will summarize what it says.

Senator SPARKMAN. Your statement will be printed in the record in full, so you proceed as you wish.

(The statement follows:)

## STATEMENT OF SAMUEL PIZER

## DATA ON U.S. PRIVATE CAPITAL OUTFLOWS

This statement has been prepared to describe for the committee the nature and sources of the data being collected on U.S. private investments abroad, and entering into our balance-of-payments accounts, and to indicate some of the chief characteristics of these outflows in recent years.

## DESCRIPTION OF DATA AND SOURCES

In order to compile data on and analyze the flows of private capital entering the balance-of-payments accounts a wide variety of sources are drawn upon. Data on short-term capital flows, defined as those involving assets or claims payable on demand or with an original maturity of 1 year or less, are collected monthly from banking institutions by the Treasury, through the agency of the Federal Reserve banks.

Figures on these short-term banking claims are supplied for an extensive list of countries, and are subdivided into the following broad types: amounts payable in dollars, comprised of loans to banks and official institutions, loans to others, collections outstanding, and "other," and amounts payable in foreign currencies, divided into deposits and "other." These data are grouped and summarized in the upper panel of the appended table 1. Banks also report on their longer term bank loans, with a distribution by country, but not by type.

Data are collected quarterly, also by the Treasury and the Federal Reserve banks, on short-term claims and assets held by nonfinancial concerns. These also are reported by country and board types, and are summarized in the central panel of table 1.

These data on short-term assets are incorporated into the balance-of-payments accounts with only minor adjustments. In general, the change in the amount of assets reported to be outstanding from one period to the next is used as a measure of the capital outflow or inflow. Comparable data are collected on U.S. liabilities to nonresidents.

The principal types of long-term capital flows on which data are regularly collected are (1) transactions in foreign securities, (2) loans by banking institutions and nonfinancial concerns, and (3) direct investments in foreign branches or affiliated companies.

Data on transactions in foreign securities are reported monthly by banks, dealers in securities, and others, to the Treasury Department via the Federal Reserve banks. Information is obtained on the country from which foreign orders to buy or sell originated, or in which domestic orders are carried out, and the securities are differentiated as between stocks and bonds. These data are further subdivided in the balance-of-payments accounts, using information obtained from underwriters and others, so as to show new issues of foreign securities, amortizations, and transactions in outstanding securities. The monthly reported data do not identify the foreign securities being traded.

Data on long-term loans by banking and nonfinancial concerns are collected monthly as an adjunct to the forms used for collecting the short-terms data described above.

Data on capital and other transactions of U.S. companies with their foreign branches, subsidiaries, or associated companies, are collected directly from the companies by the Office of Business Economics of the Commerce Department. These data are collected quarterly, for the major items, and annually for certain additional items. Formerly collected from a sample of companies on a voluntary basis, these reports were made compulsory beginning with the first quarter of 1962, and now cover all sizable investments.

Direct-investment data are classified into country and industry groups, and the data obtained are regularly published in detail in the Survey of Current Business and in special reports such as U.S. Business Investments in Foreign Countries, as well as in summary form as part of the balance-of-payment statements.

In addition to compiling data on capital flows and income and other transactions related to these various types of investments, annual statements are prepared and issued showing their accumulated value. These amounts outstanding are shown in the appended table 2, together with a summarization of capital

flows by principal types and areas, and other factors affecting the values of the investments, since 1950.

#### SHORT-TERM CAPITAL OUTFLOWS

Information on short-term foreign assets reported by banks and nonfinancial institutions shows that capital outflows of this type averaged a little over \$200 million annually in the 1951-59 period, then rose abruptly to \$1.3 billion in 1960 and \$1.4 billion in 1961. In the first half of 1962, the partial data now available indicate that the outflow has been greatly reduced.

Many types of assets and possible motivations come under the category of "short-term assets," and the grouping in table 1 is intended to separate out, as far as it can be done with the basic data available, the main types and patterns of these flows.

The first important distinction is between acquisitions of assets in the principal monetary centers and assets or claims in other countries. The former group is considered for this purpose to consist of the United Kingdom, the Common Market countries, Switzerland, and Canada. It will be seen from table 1 that U.S. banks have directed comparatively little capital to these countries, although the flow in 1960-61 was above the very small amounts of the 1951-59 period.

Since the end of 1961 short-term claims of U.S. banks in the European countries have been reduced, and in the case of Canada, the reductions began late in 1961.

A further subdivision is made in table 1 as between claims and assets payable in dollars and those payable in foreign currencies. Acquisitions of the latter in part reflect attempts to protect against any losses in value of the dollar, as well as the existence of liquid instruments with a higher interest yield. Banks reported moderate increases in both of these categories on the financial centers in 1960-61, and reductions in the first half of 1962. Such flows include funds of the banks' customers, as well as of the banks themselves.

Almost all of the activity in European foreign currency assets was with the United Kingdom, and the 1960 flow to the United Kingdom coincided with an enlarged interest differential, after covering the exchange risk. However, the maximum amount of sterling assets reported by banks was about \$200 million. In the case of Canada, the flow into foreign currency holdings reported by banks reached a peak late in 1960, when the interest differential was large, and the amount outstanding reached a peak of about \$275 million during 1961. These holdings were much reduced by June 1962.

Holdings reported by banks of foreign currency assets in countries other than the United Kingdom and Canada have been relatively inconsequential.

By far the largest outflow of funds reported by banks has been to countries other than the main financial centers. Sizable amounts of financing have been provided to Latin American countries over a long period, and in 1960-61 a greatly enlarged flow of credit to Japan was the principal factor in the overall rise of bank lending to foreigners. Loans to this group of countries are almost entirely repayable in dollars, and probably largely represent commercial financing of trade and other transactions.

This lending by banks has also diminished greatly in 1962, with the large outflows to Japan largely representing the completion of credit arrangements made in 1961.

Beginning in 1960, the capital outflow was augmented considerably by acquisitions of short-term assets abroad, principally in the financial centers by non-financial concerns. It 1960 the flow was largely directed to the United Kingdom and in 1961 to Canada.

An important feature of the short-term capital outflow in 1961 was an increase of well over 300 million in U.S.-dollar-denominated assets in Canada. These presumably included deposits attracted to banks in Canada, but the basic data do not permit a distinction between deposits and other assets payable in dollars.

The foregoing has described the situation for short-term capital outflows as recorded in the available data. Although capital flows connected with assets or types of investments that are nominally long term are discussed in a following section, it should be noted here that in fact there is no such sharp distinction. Many of the flows included in the direct investments relate to intercompany current trading accounts or may actually involve the indirect acquisition of money market instruments abroad. Also, trading in foreign securities may be highly volatile, and in some cases the securities may be close to maturity.

TABLE 1.—Foreign assets and loans of U.S. banks, and short-term foreign assets of nonfinancial concerns, by type, 1950–June 1962

[Millions of dollars]

	Amount outstanding, end of period					Increases or decreases (–) 1			
	1950	1959	1960	1961	June 1962	Annual average, 1951–59	1960	1961	January–June 1962
<b>Short-term assets and claims, total</b> .....	1,340	3,304	4,724	6,131	(?)	218	1,341	1,435	(?)
<b>Reported by U.S. banks 2</b> .....	896	2,599	3,594	4,656	4,714	189	990	1,063	58
<b>Major financial centers, total</b> .....	343	666	971	1,140	928	36	305	169	–212
United Kingdom.....	106	121	245	181	151	2	124	–64	–30
EEC and Switzerland.....	111	273	305	422	362	18	32	117	–60
Canada.....	126	272	421	537	415	16	149	116	–122
<b>By type:</b>									
Commercial and financial claims payable in dollars.....	174	488	566	667	574	35	78	101	–93
Foreign currency deposits and claims.....	169	178	405	473	354	1	227	68	–119
<b>Other countries, total</b> .....	555	1,933	2,623	3,516	3,786	153	685	894	270
Japan.....	12	324	806	1,445	1,680	35	482	639	235
Latin American Republics.....	378	1,147	1,328	1,447	1,477	85	176	120	30
Other.....	165	462	489	624	629	33	27	135	5
<b>By type:</b>									
Commercial and financial claims payable in dollars.....	483	1,919	2,569	3,447	3,721	160	650	878	274
Foreign currency deposits and claims.....	72	14	54	69	65	–7	35	16	–4
<b>Reported by nonfinancial concerns</b> .....	442	705	1,130	1,475	(?)	29	351	372	(?)
<b>Major financial centers</b> .....	194	271	612	863	(?)	9	298	342	(?)
United Kingdom.....	60	50	272	170	(?)	–1	219	–73	(?)
EEC and Switzerland.....	66	120	153	203	(?)	6	20	78	(?)
Canada.....	68	101	187	490	(?)	4	59	337	(?)

Claims payable in dollars.....	88	217	397	602	( <sup>2</sup> )	14	154	364	( <sup>2</sup> )
Foreign currency deposits and claims.....	106	54	215	261	( <sup>2</sup> )	- 5	144	- 22	( <sup>2</sup> )
Other countries, total.....	248	434	518	612	( <sup>2</sup> )	20	53	30	( <sup>2</sup> )
Claims payable in dollars.....	241	388	461	531	( <sup>2</sup> )	16	49	6	( <sup>2</sup> )
Foreign currency deposits and claims.....	7	46	57	81	( <sup>2</sup> )	4	4	24	( <sup>2</sup> )
Longer term bank loans, total.....	390	1,545	1,698	1,820	1,975	128	153	122	155
Europe.....	290	366	367	493	531	8	1	126	38
Major financial centers.....	222	149	146	213	198	- 8	- 3	67	- 15
Other.....	68	217	221	280	333	16	4	59	53
Canada.....	10	104	76	74	91	10	- 28	- 2	17
Latin America.....	73	789	914	917	947	80	125	3	30
Asia.....	12	116	134	170	239	12	18	36	69
All other countries.....	5	170	207	166	167	18	37	- 41	1

<sup>1</sup> Changes adjusted for variations in coverage and may therefore not correspond exactly to changes in amounts outstanding.

<sup>2</sup> Not available.

<sup>3</sup> Excludes exchange stabilization fund holdings.

<sup>4</sup> Excludes \$370 million held pending direct investment.

<sup>5</sup> Excludes amounts netted against direct investments.

Source: U.S. Department of Commerce, Office of Business Economics, based on data collected by the Treasury Department.

Mention should also be made of the unrecorded transactions, or errors and omissions item, in the balance-of-payments accounts. As its name implies, the composition of this item is not known. However, when this item swings over from a long period of indication of unrecorded receipts, on balance, to an indication that payments are now being unrecorded, on balance, there is a presumption that such a swing reflects to a considerable extent capital flows. Thus, the emergence of a large unrecorded payments item in our balance of payments in most quarters since 1959 suggests that there have been unrecorded capital outflows of some magnitude. This may be either U.S. capital going abroad, withdrawals of foreign capital which previously entered the United States without having been recorded, or shifts in the direction of unrecorded capital flows which formerly went to the United States but now are directed elsewhere. It would be unwarranted, however, to imply that all unrecorded capital movements are of a volatile and short-term character, or that all errors and omissions represent unrecorded capital movements. There are many other foreign transactions for which data are not available.

#### LONG-TERM CAPITAL OUTFLOWS

Outflows of long-term private capital from the United States have been a large and relatively consistent feature of our balance of payments since 1950. In 1960 and 1961 the flow reached a rate of \$2½ billion annually, which was higher than the average for 1951-59, but less than the rate in 1956-58 when investments by the petroleum industry and sales of foreign bonds here were extraordinarily large. In the first half of 1962, the available data indicate some slowing down of the rate of foreign investment.

Further additions to investments are derived from undistributed foreign profits of subsidiaries, now at an annual rate of over \$1 billion. By the end of 1961 the aggregate value of private foreign investments was nearly \$49 billion, compared with \$17½ billion in 1950 (table 2).

Direct investments abroad by U.S. companies are by far the most important class of long-term investments in terms of their accumulated value, capital outflows, earnings (\$3.7 billion in 1961) and overall economic impact.

A rising share of the direct-investment activity has gone to Europe in the past few years; over 45 percent of direct-investment capital flows went to Europe in 1961 compared to an average of 16 percent in 1951-59. Direct investments in Canada have tended downward with the completion of major projects to develop raw materials. In other areas, there has been a considerable dropping off of capital flows to Latin America since the high points of 1956-57, while there was an upturn in 1961 in flows to north Africa and the Middle East.

Sales of foreign bonds in the United States denominated in dollars (net of amortizations and retirements) have not shown any definite uptrend for several years. Such issues reached a peak of nearly \$1 billion in 1958, when interest rates here were relatively low. The principal issues have been those of Canadian borrowers, Israel, and the International Bank for Reconstruction and Development.

Beginning in 1961, however, the volume of European issues has grown rapidly, and issues of Japan and others not active here since the war have also become more common. In the first half of 1962 European issues in the U.S. market amounted to roughly \$200 million, of which about half was purchased by U.S. investors and the remainder by Europeans and others.

U.S. purchases of foreign equity securities also reached substantial amounts beginning in 1958. In 1961 such purchases amounted to about \$325 million of which three-quarters went to Europe. This flow fell off quickly in the first half of 1962 as stock prices dropped in all principal markets.

Loans by banks and nonfinancial concerns with an original maturity of over 1 year make up nearly all of the "other" long-term capital outflows shown in table 2. The largest and most consistent flow has been to Latin America, although this has been sharply reduced since 1960. There have also been sizable flows to Europe, including financing of Norway's shipping fleet.

To summarize the data available for the first half of 1962, the rate of capital outflow from the United States was sharply reduced in nearly all categories. The first quarter rate was still quite high, but by the second quarter the flow was at an annual rate of about \$2 billion, compared with over \$3 billion in the like quarter of 1961. The drop was especially steep in short-term capital outflows reported by banks.

TABLE 2.—U.S. private long-term <sup>1</sup> investments, by type and area, 1950-61

[Millions of dollars]

Types of investments and areas	Amounts outstanding, year ends—				Annual increases or decreases (—)					
	1950	1959	1960	1961	Annual average, 1951-59		1960		1961	
					Capital outflows from United States	Other factors <sup>2</sup>	Capital outflows from United States	Other factors <sup>2</sup>	Capital outflows from United States	Other factors <sup>2</sup>
<b>Total</b> .....	17,488	41,244	45,410	48,927	1,710	930	2,544	1,622	2,481	1,036
<b>Europe</b> .....	3,104	8,229	9,958	11,340	243	327	1,099	630	1,058	324
<b>Canada</b> .....	6,993	15,472	16,600	18,040	649	293	633	495	512	928
<b>Other areas</b> .....	7,391	17,543	18,852	19,547	818	310	812	497	911	-216
<b>Direct investments, total</b> .....	11,788	29,827	32,778	34,684	1,170	834	1,694	1,257	1,475	431
<b>Europe</b> .....	1,733	5,323	6,681	7,655	192	207	962	396	686	288
<b>Canada</b> .....	3,579	10,310	11,198	11,804	439	309	471	417	272	334
<b>Other areas</b> .....	6,476	14,194	14,899	15,225	539	318	261	444	517	-191
<b>Foreign dollar bonds, total</b> .....	1,692	4,314	4,891	5,300	320	-28	473	104	387	22
<b>Europe</b> .....	85	327	357	406	17	10	13	17	46	3
<b>Canada</b> .....	1,106	2,310	2,523	2,704	176	-42	180	33	151	30
<b>Other areas</b> .....	501	1,677	2,011	2,190	127	4	290	54	190	-11
<b>Other securities, total</b> .....	2,641	4,229	4,667	5,615	53	123	177	261	366	582
<b>Europe</b> .....	409	1,473	1,798	2,040	19	99	108	217	209	33
<b>Canada</b> .....	2,132	2,508	2,567	3,230	16	26	14	45	100	563
<b>Other areas</b> .....	100	248	302	345	18	-2	55	-1	57	-14
<b>Other long-term assets, total</b> .....	1,367	2,874	3,074	3,328	167	1	200		253	1
<b>Europe</b> .....	877	1,106	1,122	1,239	15	11	16		117	
<b>Canada</b> .....	176	344	312	302	18	1	-32		-11	1
<b>Other areas</b> .....	314	1,424	1,640	1,787	134	-11	216		147	

<sup>1</sup> "Long-term" investments cover all assets, securities, or other claims with an original maturity of more than 1 year.

<sup>2</sup> Includes for direct investments undistributed profits of foreign affiliates as follows: average, 1951-59, \$971,000,000; 1960, \$1,266,000,000; 1961, \$1,046,000,000. Other factors affecting the book values of direct investments are changes in dollar equivalents of foreign currencies, writeoffs, losses or gains on liquidation, and revaluations of fixed assets. For securities the principal adjustment is for changes in market values.

NOTE.—Direct investments at book values; securities at market values; other assets at face or stated values.

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

Mr. PIZER. My objective is the limited one of describing where our figures come from and saying something about what these capital flows have been doing in the last few years.

The data we have on short-term capital movements are collected by the Treasury from the banking system on a monthly basis and from nonfinancial concerns on a quarterly basis. The Treasury Department, through the Federal Reserve banks, also collects information on securities transactions between this country and foreign countries. The other important class of capital flows is that between American companies and their subsidiaries and branches abroad, and that information is collected directly by the Commerce Department from the companies who have the investments, both with respect to capital flows, and earnings, and income remittances.

Our job at the Balance of Payments Division is to correlate the different kinds of capital flow information that exist with information on all the other kinds of international transactions into a coherent picture of our international transactions.

I can best describe what has been happening to our short-term capital outflows by referring to table 1 of the statement. That shows in the right-hand group of columns that our short-term capital outflow, which averaged only about \$200 million a year in the period 1951-59, reached \$1,300 million or more in 1960 and over \$1,400 million in 1961.

In that table we have broken the capital flow down into its principal components because this tells us something about the kinds of flow that are taking place and possibly about the motivations. There are many different kinds of flows included under the overall title of short-term capital.

In the first place, we have a flow by American banks which increased very sharply in 1960 and 1961 to a rate of about a billion dollars a year. The table shows that not very much of that flow went to the major financial centers, which would be principally European countries and Canada. There was a rise in 1960 to a rate of about \$300 million, of which a considerable part went to the United Kingdom, and this perhaps could be identified with the interest rate differential that developed at that time and that is shown on this chart which is displayed here in the bottom panel.

At the middle of 1960 the interest rate differential after covering exchange risks reached about 2 percent. This is one of the few episodes perhaps where one can find a good relationship between the differential interest rates and the money markets. One can see from the figures in the table that this capital flow was not a major part of the capital in 1960. By far the largest capital flow from banks went to countries other than the major financial centers.

As Professor Bell has already mentioned, a very large part of that flow went to Japan. Another large part of the short-term capital flow, which also became larger in 1960 and 1961 than it had been before, was the flow by nonfinancial concerns. This in 1960 was directed mainly to the United Kingdom and some of that possibly was also connected with the interest rate differential. In 1961 it was mainly directed to Canada.

The information supplied by nonfinancial concerns does not show the types of assets that they are acquiring, but it is assumed that in

1961 at least some of this outflow represented deposits being placed in Canadian banks.

This table also shows that so far as we have information for the first half of 1962, there has been a very sharp drop in the amount of capital outflow reported by American banks. The only large flow was reported for Japan, and we know that was largely in the early months of the year and has since also fallen off.

In addition to the short-term capital flows, we have shown in table 2 the principal components of the long-term investments held by Americans in foreign countries, showing both estimates of the value of those investments and of the annual increases growing out of capital outflows or other factors.

I should say here there is no clear-cut distinction between so-called long-term capital outflows and short-term capital outflows. These are largely nominal differences, short-term being merely applied to investments in assets whose original maturity is 1 year or less. But a great deal of the investment in direct investments can also be short-term in character, and also purchases of securities.

Table 2 shows that the capital outflow of the long-term variety was also high in 1960 and 1961 at a rate of about \$2½ billion a year. But this is not drastically different from the experience we have had for a good many years in the balance of payments. As has generally been true, the direct investments have been the largest component, and the principal changes in recent years in the outflow of capital of this kind has been an increase in the proportion going to Europe, and some falling off in the amounts going to Canada and Latin America.

Sales of foreign bonds in this country have been relatively stable. They reached a peak in 1958 when our interest rate structure was particularly low. The borrowers have been principally Canadian borrowers, the International Bank for Reconstruction and Development, and the steady sale of the bonds of the State of Israel. More recently there have been heavy offerings from Europe and from Japan.

With respect to the European and also the Japanese bonds, a considerable part of what is offered in this market is taken by investors in other countries. As Professor Bell has said, Americans buy considerable quantities of equity securities of European countries, and Europeans buy considerable amounts of American equity securities. At the moment equity markets throughout the world have been declining, so that European purchases of American stocks have become quite low, and the same thing has happened to American purchases of European equity securities.

I believe that summarizes the principal facts that we have at hand on the kinds of capital outflows that have been occurring in the last 10 years or so.

Senator PROXMIER (presiding). Thank you very much, Mr. Pizer. Mr. Klopstock, you may proceed in any way you wish.

**STATEMENT OF FREDERICK H. KLOPSTOCK, MANAGER, RESEARCH DEPARTMENT, FEDERAL RESERVE BANK OF NEW YORK**

Mr. KLOPSTOCK. I do not have a statement, sir. But I would like to comment briefly, if I may, on the statement of Professor Bell.

We at the Federal Reserve Bank of New York are also engaged in studies on the interest rate sensitivity of capital movements. Our

research has not yet been completed. But from preliminary analysis of the statistics, we have reached the conclusion that interest rate differentials while perhaps not the dominant factor, are very important for capital movements out of the United States and into the United States.

The strong upsurge of short-term and long-term outflows in 1961, we believe, is significantly related to interest rate differentials. Short-term bank loans increased very substantially to \$335 million in 1961. While a sizable part of these loans is related to trade credit, nevertheless, the pull of interest rate differentials was important because many of the foreign importers that employed credit lines in the United States could have gone to their own banks or to banks in third countries had interest rates been more attractive elsewhere.

Similarly with respect to long-term loans. On these loans we had more than a doubling of the outflow in 1961. American banks have been relatively liquid and, therefore, interested in seeking profitable employment of their funds abroad. There is a substantial demand abroad for these term loans at present interest rates.

The tremendous expansion of our acceptance credits has also to do with interest rate differentials. Japanese banks found interest rates in London unattractive relative to interest rates available in this country. That is one reason why they made use of acceptance facilities here.

There are many other types of short-term and long-term outflows that are related to interest rate differentials. For instance, money market investments abroad including placements of American corporate funds in Canadian time deposits, purchases of Canadian Treasury bills or British Treasury bills, which at various times amounted to very large aggregates, all are related to interest rate differentials.

We know that in the last few weeks a very substantial outflow has occurred into Canadian Treasury bills and Canadian commercial paper, because even on a covered basis there is an interest rate incentive to move funds to Canada.

Whenever there is a squeeze in foreign money markets, U.S. exporters immediately feel the repercussions of that squeeze, because foreign importers ask for more liberal credit terms from them. We also believe that low interest rates in our capital market induce outflows of long-term funds. Whenever interest rates are low here in the long-term capital market, there is a tendency for foreigners to come to our capital market and employ its resources and take advantage of bond placements at relatively low interest rates.

Similarly, foreigners make decisions on whether or not to invest in our money market on the basis of interest rate differentials. That became particularly clear in 1959 when the money market investments of foreign commercial banks and other foreigners increased from approximately \$900 million to more than \$2 billion early in 1960. Later that year, when interest rates in this country nosedived, foreign commercial banks and other foreign private investors liquidated their investments in our money market. The total money market investments of foreign commercial banks and other private foreigners dropped to less than \$900 million at the end of 1960 from as much as \$2 billion at the end of January 1960.

In the light of these facts we feel that with respect to many categories or components of our capital outflow and inflow, interest rates are of substantial importance.

This completes my comment on the interest rates sensitivity of short-term and long-term capital flows.

Representative GRIFFITHS (presiding). Thank you very much.

Mr. Widnall, do you have any questions you wish to ask?

Representative WIDNALL. No, I don't think so.

Representative GRIFFITHS. I have a question I would like to ask.

The Secretary of the Treasury, Mr. Dillon, at the monetary conference in Rome recently remarked that actually the borrowing in the United States by foreigners was not because of the low interest rates but because of the poor money markets available in Europe. Do you not agree with this?

Mr. KLOPSTOCK. I believe to some extent the placement of foreign bonds in our capital market is related to the inadequacy of capital markets in Europe. I would agree that to a considerable extent the motive for placing bonds in our capital market is that the absorptive power and the organization of the European capital market are inadequate to take care of these placements.

Representative GRIFFITHS. Then you would say that to some extent the lack of restrictions on borrowing in the United States and the availability of capital plays as great a part as the low interest rates?

Mr. KLOPSTOCK. I would say the availability of capital in the United States is also a very important factor. But so is the cost.

Representative GRIFFITHS. I believe he further stated that you are in reality borrowing your own money. You are making investments here and you are borrowing your own money. To what extent do you think that is true?

Mr. KLOPSTOCK. The Secretary is correct. Some of the capital issues, or some proportion of each and every capital issue, by a foreign country in the United States is taken up by foreigners. But certainly not the total amount. A substantial proportion of these capital issues are picked up by Americans rather than by foreigners. There is always some participation on the part of foreigners in the purchase of new issues in our capital market.

I believe Mr. Pizer may have some figures on the changing proportion of foreign participations in foreign bond issues in our capital market.

Representative GRIFFITHS. Would you care to comment, sir?

Mr. PIZER. We know that in rough terms for the European issues which have been sold here in 1961 and probably also in 1962 about half of the total amount offered is probably taken by Americans and the rest by others, again primarily Europeans. Of course, when an issuer can offer a bond to the public in the United States, the instrument becomes a much more highly marketable liquid instrument than if we had bought it out in a smaller capital market. There is that inducement of structure of the market here, even though perhaps the issuer expects only half of it to be taken in the U.S. market.

Representative GRIFFITHS. To what extent do you think we would be justified in placing some restriction on borrowing by Europeans? In place of increasing the interest rate, just restricting the amounts or looking the loans over a little more sharply?

Mr. KLOPSTOCK. Personally I believe in freedom of capital markets.

Representative GRIFFITHS. And yet Switzerland does do this, does it not? I believe we had a Swiss economist testify yesterday who pointed out that they do that. It is not necessarily that you can't borrow it today. They delay it a little longer.

Mr. KLOPSTOCK. Yes, I understand there is some measure of restriction on capital issues in Switzerland and some other European countries.

Mr. BELL. May I just comment on that?

Representative GRIFFITHS. Yes.

Mr. BELL. I think we don't want to exaggerate the degree to which European countries have, in fact, floated bonds in this country. The net figures for 1961, it would seem it was only a net purchase of \$13 or \$14 or \$15 million during that year. Over a 5-year period, 1957 to 1961, actually the net flow was from Europe to the United States on foreign bonds. In other words, they paid off more than they borrowed during this period. I gather it has increased in 1962. I don't know the latest figures. The first quarter it was \$17 million for the quarter. When you take that, compared to the Canadian borrowing, the Canadian borrowing in this country is tremendous and has been throughout this period; isn't that correct?

Mr. PIZER. There is some difficulty in statistics in this area. What happens is this: In the first half of this year, for instance, the total amount of bonds offered here by European issuers is probably close to \$200 million, of which perhaps \$100 million is taken back immediately by Europeans or others so that the net figure taken by Americans is perhaps \$100 million.

At the same time Europeans and others are buying in our market foreign bonds of other issuers. If they are buying foreign bonds in our market, on balance, in the figures you are putting together, you are also netting that against the gross amount of new issues. It is true that the net capital flow on European accounts would be much smaller than the gross amount of money that European borrowers actually come into the U.S. market and borrow.

Mr. BELL. In balance-of-payments terms, I would think that would be the important element.

Mr. PIZER. The net result would be small but the gross figures are considerably larger.

Representative GRIFFITHS. Maybe you have already given this figure, but what is the net for Canada and what is the net for Japan?

Mr. BELL. The net for Canada in 1961 was roughly \$210 million for the year compared with Europe of \$13 or \$14.

Representative GRIFFITHS. And Japan, what is it for Japan, do you know?

Mr. BELL. I don't have the separate figure for Japan on long-term capital.

Representative GRIFFITHS. Thank you very much.

Representative WIDNALL. Would not the Common Market eventually provide greater ability to finance within the Common Market so there would be no necessity to come to the United States?

Mr. HUMPHREY. The British are very much hoping. If they join they hope London will become the capital center, and they will earn something from handling this business.

Mr. BELL. May I just say, I think somehow or other we are exaggerating this long-term capital flow from the United States to Europe. I have summarized on table 3 the actual net purchase of both foreign bonds and foreign stocks from Europe and of European purchases of U.S. bonds and U.S. stocks over the 5-year period. It is a net inflow. If you take this 5-year period as a whole, one could point this way. There has been approximately a \$2 billion outflow, in both stocks and bonds to Canada. Another billion to the rest of the world, including that going through international agencies to less developed countries, and a net inflow of a billion, which, in effect offset that \$3 billion outflow from Europe. So, on balance, the European capital flow has been to the United States, and the outflow has been heavily to Canada and less heavily to the less developed countries.

Mr. HUMPHREY. It is true, as you say, that this has been the balance-of-payments effect. But if we did restrict new flotations here, I don't see that it follows that foreigners would buy less of other issues here. So isn't there a possibility, if this were decided on—I am not discussing the desirability of the policy—if we restricted, that this would not necessarily restrict European buying here. We might still have the inflow and restrict the outflow.

Mr. BELL. I don't know how acceptable they would find that.

Mr. HUMPHREY. They are complaining that we are unduly complacent.

Mr. BELL. I just don't think if you restrict it from Europe, I don't think you will restrict much capital even on the gross side relative to what you are doing.

Representative WIDNALL. Yes, sir. The three European economists recommended that the United States provide gold guarantees to the foreign dollar holders and in that way protect against the effects of any future devaluation. What is your opinion of such a measure? Have you formed any opinion as to whether or not that would help reduce the export of our gold?

Mr. BELL. I personally would not think that it was terribly imperative. Foreign governments have not been shifting heavily from dollars into gold. The statistics again show, I think I have taken a ratio in table 7, of dollars to gold by foreign governments, out of their total—what is the ratio of dollars to gold holdings, aggregating all of them together, it has stayed right around approximately 50 percent. There has been no marked shift from dollar reserves into gold reserves. I don't think a gold guarantee would have any great effect one way or another at the present time. It obviously would, if there exists the possibility of devaluation.

Representative WIDNALL. If my figures are correct, the gold lost from January, 1, 1962, to July 1962, was \$420 million as against \$200 million in the comparable period in 1961.

Mr. BELL. We are losing gold, but that is because of our overall balance-of-payments deficit. They are not holding less short-term Treasury bills or less dollar deposits in this country. Their overall balances have been building up, and they will take a share of that in gold and a share in increased dollar claims. That ratio has been roughly constant.

Representative WIDNALL. So you feel if we went into this gold guarantee proposal and implemented it by action, that it actually would not have any material effect?

Mr. BELL. It might very well, sir. I don't mean to be hogging the floor, but in the case of the speculative outflow at the end of 1960 and early 1961, Mr. Klopstock and I disagree as to whether this was interest-rate motivated or speculative. I think it was speculative. There was some fear of devaluation. It is true, when the Democratic President went into power in 1933, the United States devalued, and the situation was different. I detect that was more speculative in nature than interest-rate motivated.

A gold guarantee should certainly eliminate that type of speculative outflow.

Representative WIDNALL. Mr. Humphrey or Mr. Klopstock, would you comment on it?

Mr. HUMPHREY. I would resort to such a measure only in an extremity where the climate was a great deal worse than it is now and a real flight from the dollar seemed imminent.

I think it is well to recognize that we have this tool in the arsenal that can be used, but I don't detect the need for using it.

After all, remember that a country holding dollars loses nothing directly, except a windfall profit, from devaluation of the dollar. So long as the United States avoids inflation, the dollars which foreign countries hold will buy just as much in the United States after the adjustment of exchange rates, as before. In asking for a guarantee, they are asking to be cut in 100 percent on any windfall profits, without ever having to carry any of the burden of holding a no-interest asset in the form of gold reserves for years and years.

What would keep every nation in the world from shipping its gold here and exchanging it for an interest-bearing dollar asset, if we guaranteed them 100 percent of any windfall profits from any future change in the price of gold? We sometimes forget that the United States has benefited from losing gold to the extent that the gold is exchanged for an income-producing asset.

There is also a possibility that the price of gold might be allowed to fall some day. In my earlier testimony, I outlined a number of developments which would reduce the demand for gold to hold as a monetary reserve. I don't imagine that countries who leave gold here in exchange for income-producing dollar assets would want to take the loss from any future reduction of gold prices.

I can imagine circumstances, however, in which there might be some question as to whether the United States should take 100 percent of the profits or loss from future changes in the price of gold. In particular, there is some question as to just how much a windfall profit should be used. As I remember it, the United States sterilized the gold profits of 1934. Much later, the largest part of the free gold—not needed to cover the certificates issued to the banks—was used by the U.S. Treasury to pay its initial subscription to the IMF.

Representative WIDNALL. How do you feel, Mr. Klopstock?

Mr. KLOPSTOCK. I have not studied this problem in any detail, but I recall that Mr. Sproul, formerly president of the Federal Reserve Bank of New York, wrote a letter to the New York Times expressing the view that a gold guarantee would be highly undesirable. I respect the views of Mr. Sproul who is an authority in this area.

Representative WIDNALL. Mr. Pizer, do you have any comment on that?

Mr. PIZER. No, sir.

Representative WIDNALL. That is all.

Senator PROXMIRE. Mr. Bell, I am delighted to see this study. I see in addition to your summary you have a detailed statement which I presume has been put in the record, which is most impressive.

I have been pleading with the Federal Reserve to make a study to show the effect of interest rate differentials on international capital flows without much success. I feel so strongly if we are going to adopt a monetary policy based to any extent on its effect on the balance of payments, we should have some studies to back it up. I see you have made a study, and I think quite an impressive study, right here which I hold in my hand. On the basis of that, you summarize, and then I want to ask Mr. Klopstock to comment :

Existing interest rate differentials here and abroad, most especially short-run changes in the differentials, appeared to play a relatively minor role in industry short- and long-term capital outflows from the United States.

You say there is no strong relationship between the European bond purchases and no relationship between U.S. purchases of European bonds and the level of interest rates.

Then you say in your excellent analysis :

Study of the components of the recorded outflow during those 2 years and movements in the 3 years previous to that period, what types of capital moved and where they went, as well as the timing of the various movements, does not support the hypothesis that U.S. short-term capital has been moving in recent years primarily or even significantly in response to changes in short-term interest rates.

Then, you refer to a very interesting study put in the record by the Federal Reserve Board, who found that the—

amplitude of the fluctuations about the trend from peak to trough in dollar assets held by foreign commercial banks and other private parties in recent years has been between \$600 million and \$1 billion, suggesting that this is the maximum amount of switching which may take place as a result of interest rate differentials or for other reasons. And he suggests that two other considerations may well have swamped the interest rate factor, in spite of a relatively high correlation between deviations from trend and interest rate differentials.

These were the need to build up working balances and a speculative raid on the dollar in 1960 and 1961.

I want to thank you very much, because, while we have had some very excellent papers and fine analyses, it is good to have a study which is based on careful observation.

Mr. HUMPHREY. In case Mr. Bell is too modest, I would like to note that he is making a full and longer study which will be available for publication by the committee within a month.

Senator PROXMIRE. Very good. I will be looking forward to that.

Mr. KLOPSTOCK. First, I would like to state that we do, at the Federal Reserve Bank in New York, study the question of interest rate sensitivity of capital movements in great detail. Our studies have not yet been completed. We are engaged in such a study. Several papers are being prepared on the subject matter at the bank.

Only recently our Monthly Review carried an article on short-term capital movements which I would like to put in the record if it is not already in the record.

Senator PROXMIER. I put it in the record on the floor. It would be very useful here.

(The following was later received for the record :)

#### SHORT-TERM CAPITAL MOVEMENTS AND THE U.S. BALANCE OF PAYMENTS<sup>1</sup>

Since the principal European currencies became externally convertible at the end of 1958, short-term capital flows have come to exert a major impact on the U.S. balance of payments. In 1960 and 1961, the recorded outflows of short-term U.S. funds soared to unprecedentedly high totals and contributed, respectively, from one-third to over one-half of our large balance-of-payments deficits of those 2 years. In addition, unrecorded short-term capital outflows are believed to have been exceptionally large in both years.

Short-term capital transactions are among the least understood items in our balance-of-payments accounts. A common misconception, for example, is to think of short-term capital as merely a stock of footloose money, hopping from country to country only because relative interest rates vary or in search of gains from exchange rate speculation. Some short-term capital transactions clearly conform to that description, but most of the U.S. short-term capital outflow in our balance of payments is related to the financing of international trade and to the need of foreign banks, businesses, and even foreign governments for funds to meet their immediate payments requirements. And while interest rates and, at times, uncertainty over exchange rates are important in influencing the volume and direction of such short-term capital flows, many other factors also play a role.

As recorded in U.S. balance-of-payments statements, short-term capital movements are shown as net flows of U.S. capital to or from foreign countries and net flows of foreign-owned capital to or from this country. Movements of U.S.-owned capital are measured by changes in short-term claims of U.S. residents on foreigners, while movements of foreign-owned short-term capital are measured by changes in foreign-owned deposits and short-term securities held in U.S. banks and by changes in other types of U.S. short-term liabilities to foreigners. Net outflows of U.S. capital tends to add to the aggregate liquid dollar holdings of nonresidents in U.S. banks. Changes in these holdings are considered "settlement" items in the U.S. balance of payments and, hence, any rise in these holdings contributes to an increase in our payments deficit. (The deficit or surplus as a whole is commonly measured by changes in foreign holdings of liquid balances in the United States, together with changes in the gold and convertible currency holdings of our monetary authorities.) The additional claims on foreigners that arise as U.S. short-term capital flows out, on the other hand, are not treated as an offset to this country's balance-of-payments deficit but are regarded as one of its causes.

This article describes in broad terms the various types of private short-term capital flows between the United States and other countries, investigates the factors influencing these flows, and reviews their recent behavior. Although the article's main emphasis is on the movement of U.S. capital, much of the discussion is also relevant to shifts of private foreign-owned funds to and from this country. It is worth noting, however, that such shifts do not affect our balance-of-payments deficit directly, inasmuch as ordinarily they are offset by opposite changes in holdings of foreign monetary authorities. The factors influencing these official holdings are not discussed here. Since these holdings are part of the monetary reserves of other countries, they are in a different category from privately owned short-term capital and therefore respond to different forces. Official institutions may, for example, use their dollar holdings to purchase gold from the United States, a choice that is not available to other dollar holders.

#### REPORTING OF SHORT-TERM CAPITAL MOVEMENTS

Because of the need for a practical criterion of measurement, short-term capital is defined in the balance-of-payments statistics as that capital which is held in the form of assets (including bank deposits) with an original maturity of not more than 1 year. Neither the owner's intention nor the actual duration of the holdings affect this definition. Consequently, a number of capital trans-

<sup>1</sup> George H. Bossy and Haskell P. Wald had primary responsibility for the preparation of this article.

actions that are classified as short term may actually be akin to long-term transactions because they are regularly renewed at maturity. It is not infrequent, for instance, for maturing short-term bank loans to be extended or replaced by new loans. On the other hand, marketable securities maturing in more than a year may serve as a medium for short-term investments. Similarly, a portion of the capital flows between parent companies and their foreign subsidiaries may in fact be no more than short-term financing, but in the existing statistics such flows are all counted as direct investment, a form of long-term capital movements. For these and other reasons, the accepted definition of short-term capital is not ideal from a conceptual point of view. Its adoption was determined by the need for a criterion that is statistically manageable. Even so, the task of gathering the necessary data is difficult, and the burdens on the reporting banks and businesses are large.

The statistics on private short-term capital movements are derived from monthly and quarterly reports filed by U.S. banking institutions and other businesses with the Federal Reserve banks of their districts under regulations established by the Treasury Department. The reporting firms provide a breakdown of their outstanding claims on, and liabilities to, foreigners by major categories and by more than 50 foreign countries and geographical areas. The reports for banking institutions also include the foreign claims and liabilities held by them on behalf of their domestic customers. The data that are collected are published in consolidated form in the Federal Reserve Bulletin and the Treasury Bulletin. The quarter-to-quarter changes in the reported claims on, and liabilities to, foreigners—adjusted for certain other transactions—constitute the short-term capital movements incorporated by the Department of Commerce in its balance-of-payments statistics. The table on page 96 presents a summary of the changes in the outstanding amounts of U.S. short-term claims on foreigners in recent years.

This reporting system, although comprehensive in conception, does not catch all short-term capital movements. It is widely believed, for example, that the substantial shift of "errors and omissions" in the balance-of-payments accounts from net receipts in the period prior to 1960 to net payments in 1960 and 1961 reflects an increase in unrecorded short-term capital outflows. This would not be surprising, in view of the freer convertibility recently achieved by the principal foreign currencies. Various factors may be responsible for the incompleteness of the reporting. One conspicuous source of omission is that no reports are collected from individuals. Moreover, firms with foreign claims or liabilities below prescribed levels are exempted from filing.<sup>2</sup> It is also possible that some institutions fail to file because of ignorance of the requirements, although the extensive publicity given to the reports in recent years has broadened the coverage of the reporting system substantially.

In contrast to the U.S. long-term and overall international investment position, in which this country is a substantial net creditor, its recorded short-term capital position is that of a net debtor; this country's short-term liabilities to foreigners exceeded its short-term claims on them by \$17 billion at the end of 1961. This short-term debtor position results from the combination of the wide use of the dollar as an international currency and the U.S. payments deficits of recent years. Foreign central banks and governments hold substantial portions of their official reserves in the form of dollar assets which, because of the need for liquidity, are almost entirely composed of deposits, U.S. Government securities, and bankers' acceptances. In addition, foreign commercial banks and corporations hold sizable working balances in the United States, since they settle in dollars not only their transactions with this country but frequently also transactions with third countries.

#### TYPES OF SHORT-TERM CAPITAL MOVEMENTS

The short-term capital movements reflected in the U.S. balance of payments are the net result of many individual transactions made for different purposes and responding in varying degrees to economic forces. When analyzing such a complex aggregate, it is useful to attempt to classify the transactions according to the major purposes and motives for which they are undertaken.

<sup>2</sup> Banking institutions are exempted from filing a report for a particular month if their month-end claims on (or liabilities to) foreigners average less than \$500,000 in the 6-month period ending with the reporting date. Nonfinancial institutions are exempted from filing for a particular quarter if their claims on (or liabilities to) foreigners at the end of that quarter and of the preceding one average less than \$100,000.

In very broad terms, two classes of private short-term capital movements can be distinguished. First, there are those initiated primarily by the recipients of the funds and related to their specific current needs—such as, for instance, the financing of their import needs. The major portion of the outstanding short-term claims of the United States on foreigners arose out of such needs, particularly out of needs for financing international trade. To the extent that new credit extensions exceed or fall short of repayments, the differences are recorded as capital flows in our balance-of-payments statistics. Secondly, there are those short-term capital movements that are mainly initiated by investors, in order to obtain a higher interest rate or tax savings or perhaps to gain from an anticipated change in exchange rates.

Some financing of international trade by U.S. banks and businesses covers trade among third countries, but most of it covers U.S. exports and is related to borrowers' needs. Trade financing is mainly undertaken through bankers' acceptances, bank loans to foreigners, sight and time drafts, and open-book credits. Such financing is reflected in various items in the accompanying table: in bank-reported loans to foreigners, collections outstanding (i.e., bills on foreigners held by banks for collection), and "other" bank-reported dollar claims (largely acceptance financing). The short-term claims reported by nonfinancial concerns also reflect export credit as well as short-term balances held abroad for business or other reasons.

The available statistics do not distinguish between foreign borrowing in this country that is directly tied to trade financing and foreign borrowing for more general purposes. The latter category, however, is probably large and would include many conventional bank loans as well as dollar exchange acceptances—i.e., acceptances that are drawn for the express purpose of creating dollar exchange and which do not arise from any specific trade transaction. Such borrowing will often be for temporary foreign exchange needs in countries that are subject to wide swings in export earnings.

*Movements of U.S. short-term capital, 1957 to 1st quarter 1962*

[In millions of dollars; (–) denotes outflow, (+) denotes inflow]

Type of movement	1957	1958	1959	1960	1961	1962: 1st quarter
Reported by banks, total.....	-253	-343	-81	-991	-1,086	-172
Dollar claims, total.....	-256	-293	-61	-729	-980	-289
Loans to banks and official institutions.....	-45	-213	-8	+33	-199	-194
Loans to others.....	+27	-125	-32	-22	-136	-32
Collections outstanding.....	+17	+2	-95	-89	-89	38
Other <sup>1</sup> .....	-255	+43	+74	-651	-556	-25
Foreign currency claims, total.....	+3	-50	-20	-262	-106	+117
Deposits.....	-1	-49	-22	-39	-143	+83
Other.....	+4	-1	+1	-223	+38	+34
Reported by nonfinancial concerns, total.....	-31	+57	+15	<sup>2</sup> -425	-476	( <sup>3</sup> )
Dollar claims.....	-23	+69	-37	-253	-443	( <sup>3</sup> )
Foreign currency claims.....	-8	-12	+52	<sup>2</sup> -172	-32	( <sup>3</sup> )
Total U.S. short-term capital <sup>4</sup> .....	-284	-286	-66	<sup>2</sup> -1,416	-1,562	( <sup>3</sup> )

<sup>1</sup> Represents principally bankers' acceptances.

<sup>2</sup> Excludes \$370,000,000 held pending direct investment.

<sup>3</sup> Not available.

<sup>4</sup> Does not include Department of Commerce adjustments to a balance-of-payments basis.

NOTE.—Because of rounding, figures do not necessarily add to totals.

Source: U.S. Department of the Treasury.

Finally, there are the various other types of capital movements which fall in the second broad category identified above—that of transactions, largely initiated by the investors. These arise mainly, but not exclusively, out of transactions induced by international interest rate differentials or exchange rate speculation. The opportunities for such transactions were greatly expanded with the reestablishment of external convertibility of the major European currencies at the

end of 1958. Since then, interest arbitrage transactions—between the United States and foreign countries as well as among foreign countries—have occasionally reached substantial amounts. These consist of the investment abroad of liquid balances to take advantage of higher interest rates than those prevailing in the home market. The interest arbitrage, unless he is confident of being able to avoid an exchange loss when he decides to repatriate his capital, ordinarily will cover the exchange risk associated with his transaction by buying back his own currency in the forward exchange market. The forward "hedge" in this so-called covered interest arbitrage normally involves a cost that reduces, and could eliminate, the uncovered interest arbitrage incentive. On the other hand, the forward hedge might actually offer an additional incentive to engage in arbitrage operations. Indeed, if the forward exchange rate premium on the currency of a low-interest-rate country is large enough, this could even induce a flow of covered capital from a high-interest-rate to the low-interest-rate country, because the interest loss would then be more than offset by the exchange rate profit.

The specific interest rate relationships that induce investors to move short-term funds abroad are not readily identifiable, but they obviously are not restricted to the interest rates on Treasury bills alone. A few countries now have money markets of significant size, where numerous short-term instruments—Treasury bills, time deposit facilities, various types of commercial paper, and in some cases local government obligations—are available for investment. In addition, the Euro-dollar market, in which European as well as Canadian banks take an active part, is widely used for interest arbitrage operations.<sup>2</sup> There is thus a broad international constellation of interest rates and forward exchange discounts and premiums which influence the potential arbitrage.

Interest arbitrage operations of U.S. corporations have become more common in recent years, though the number of companies engaged in these transactions has remained relatively small. Partly because the availability and liquidity of foreign short-term securities are generally less than in this country, most U.S. corporations have been reluctant to engage in interest arbitrage.

Speculative capital flows occur when a change in the exchange rate of one or another currency is anticipated. These flows may include outright purchases of the currency that is expected to appreciate or sales of the currency that is expected to depreciate, but they also take the form of so-called leads and lags, which involve the acceleration or deferment of payments or receipts. When a currency is under speculative attack, commercial interests will try to postpone payments in that currency because, in the event of a devaluation, the cost in terms of their own currency would be reduced. Furthermore, the residents of the country with the weak currency will attempt to pay more rapidly or even to prepay debts in foreign currencies, while trying to prolong the maturity of their claims in foreign currencies by renewing loans or letting credits accumulate. The net result will be a reduction in the country's receipts from abroad and an increase in the net outflow of short-term capital. If, on the other hand, the speculation is motivated by the expectation of an exchange rate appreciation, the leads and lags will of course shift in favor of the strong currency.

#### INFLUENCE OF DEMAND, SUPPLY, AND COST FACTORS

The determinants of short-term capital movements may be analyzed from the standpoint of the borrowers or the lenders, in terms of demand or supply factors. In some cases, demand factors are predominant and the borrowers are much more the active agents, in the sense that they actually initiate the transactions. In other cases the initiative may largely rest with the suppliers of funds, and the lenders may actively seek to lend or invest abroad, with or without active participation by the borrowers or the sellers of credit instruments. Similarly, interest rates, which are a cost to the borrower and income to the lender, may exert a determining influence on some transactions and hardly any influence on others.

For most types of capital transfers that are in the nature of "accommodating" finance, the impetus for the transactions is more likely to come from the borrowers than from the lenders. Each borrower must weigh his financial needs

<sup>2</sup> See Alan R. Holmes and Fred H. Klopstock, "The Market for Dollar Deposits in Europe," *Monthly Review*, November 1960, pp. 197-202.

against the cost of the loan, while each lender must decide whether making the loan would be more advantageous than alternative uses of his funds. If the borrower's needs are compelling and if he does not have access to other sources of funds, he will be inclined to pay whatever interest rates the market requires. The lender will meet the loan demand if he is in a relatively liquid position and rates the borrower as a good credit risk. But, if the lender is short of funds, he will tighten his lending terms and perhaps scale down the amount he will be willing to provide. In all these respects, international lending is essentially the same as domestic lending.

Nevertheless, there are also some important differences between international and domestic short-term lending, apart from the obvious intrusion of foreign exchange considerations in the former. In the first place, the needs of foreign borrowers for capital are determined by developments in their respective countries and are largely unrelated to internal developments in the supplying country. This means that the total loan demand from abroad is unlikely to follow definite cyclical patterns of the sort that characterize domestic financing. Some countries will experience balance-of-payments strains, while others are in a comfortable payments position; internal growth rates or the behavior of prices will often vary markedly from country to country. For these reasons, foreign borrowers' demands tend to be sporadic and difficult to anticipate in advance.

Secondly, foreigners' decisions as to where and how much to borrow are influenced by international differences in interest rates as well as by the relative availability of loanable funds in different centers. These differences are determined by the prevailing monetary policies in the respective countries. Generally speaking, a country where monetary conditions are easy will attract foreign borrowers away from countries where monetary conditions are tight. It is true, however that many foreign borrowers have close and long-established business relationships with lenders in only one country and, therefore, prefer not to shop around to find the country where interest rates are lowest. Furthermore, the position of the United States as an international financial center is in many ways unique. Not only do U.S. financial markets permit borrowing on a scale not possible elsewhere, but foreigners also have complete freedom of access, which is not always the case in financial centers abroad.

Thirdly, some forms of international capital movements are independent of the borrowers' needs. Covered interest arbitrage transactions, described above, are one example; the initiative for such investments rests almost entirely with the supplier of capital. Their volume will depend, not only on the interest rate spreads and the price of foreign exchange cover, but also on the availability of liquid funds in the lending country. Speculative capital transactions are an example of capital movements which may be initiated by lenders as well as by borrowers.

The strength of the various causal influences bearing on short-term capital movements fluctuates widely over time. The 1955-57 spurt of our exports, for example, was paralleled by marked increases in acceptance financing and in bank lending, as well as by some growth in collection items and commercial credits to foreigners. The extension of new export financing in that period exceeded the repayment of maturing claims. The subsequent decline of exports was accompanied by reductions in several types of claims, but not in bank lending which experienced another large rise in 1958 because of easy monetary conditions here and strong credit demands from abroad.

The resumption of export gains after mid-1959 carried all types of short-term lending to foreigners to new high levels. However, the 1960-62 increases in claims, particularly in bankers' acceptances, were more than in proportion to the export rise, partly because of the huge borrowing by Japan as a consequence of that country's balance-of-payments difficulties and its decision to liberalize the restrictions on external borrowing by its residents. Furthermore, sizable interest arbitrage outflows occurred in the second half of 1960, when the business downturn in the United States led to relatively low interest rates compared with rates in other industrial countries that were still experiencing boom conditions. As these outflows contributed to a substantial worsening of our payments position, the continued stability of the dollar itself came to be questioned in some quarters; the weakened confidence in the dollar in late 1960 led to speculative outflows in addition to the transfers that were motivated by higher rates of return abroad. Early in 1961, on the other hand, speculation against the dollar ceased, as the speculators became aware of the determination and ability of the U.S. monetary authorities to defend the dollar. Meanwhile, however, for-

eign requirements for short-term financing—especially by Japan and several Latin American countries—rose sharply. While the outflow of short-term U.S. capital was slightly larger in 1961 than in 1960, the rate of outflow thus far this year seems to be running somewhat lower than in the comparable year-earlier period.

#### BALANCE-OF-PAYMENTS EFFECTS

Viewed as isolated transactions, movements of U.S. short-term capital worsen the country's balance-of-payments position when the funds flow out and improve it when they return. But when short-term capital movements are considered in their relationship to other transactions in the balance of payments, the problem of their net effects becomes more complicated. The availability of credit is as much a factor in the competitiveness of our exports as prices or design. Credits extended to foreign purchasers of U.S. exports yield a net gain to our balance of payments, not only when they produce interest income, but also when they finance exports that would not have otherwise been made. The balance-of-payments gains, however, are not realized until the credits are repaid, whereas if the exports had been sold for cash the gains would have been immediate. Furthermore, the benefits to this country's balance of payments may be offset by a rapid growth of new credit extensions.

Short-term capital movements, however, should not be judged by their balance-of-payments effects alone. While they have at times been a vehicle for speculation, they normally serve constructive purposes. The credit facilities provided by U.S. banks and exporters to countries short of capital have helped to sustain the flow of international trade and therefore have been of great benefit to the growth of the world economy. Consequently, the United States, as the world's leading financial center, must make every effort to maintain an appropriate position as a supplier of short-term funds. The measures taken to reduce our balance-of-payments deficit promise to assist in achieving this objective.

The reestablishment of external convertibility by major European countries, by facilitating the international flow of funds, has contributed to the increased efficiency of the international financial mechanism. At the same time, however, convertibility has given rise to sudden and occasionally disruptive shifts of international reserves and thus has added to the tasks of international monetary management. In the face of these new problems, major steps have been taken over the past 2 years to strengthen the international monetary system through the expanded resources made available to the International Monetary Fund, through closer cooperation among central banks and governments, through expanded operations to stabilize the exchange markets, and through the new Organization for Economic Cooperation and Development. At the individual country level, efforts are being made to design policy measures which will more effectively serve both internal and external requirements. Among the latter requirements is the clear need to encourage active participation in the provision of international capital, including short-term funds, by more countries with ample monetary reserves and fundamentally strong currencies. The hallmark of an efficiently functioning international financial system is its ability to channel short-term and long-term capital to those countries where it will contribute most effectively to promoting international monetary stability and accelerating economic growth.

**Mr. KLOPSTOCK.** It is called "Short-Term Capital Movements in the United States." This is one of several studies that are going on at the Federal Reserve bank in New York.

As I explained during your absence, our studies tentatively do show a substantial, though perhaps not dominant, influence of interest rate movements on both short-term and long-term capital outflows from the United States.

**Senator PROXMIRE.** Let us start with Mr. Gemmill's paper. He is a Federal Reserve economist in Washington?

**Mr. KLOPSTOCK.** Yes, sir. I believe the study was made some time ago.

**Mr. BELL.** It covered through the middle or late quarter of 1961.

Senator PROXMIRE. He indicated, to try to put this in quantitative terms, some \$600 million to \$1 billion maximum, and he claimed it was swamped by other factors.

Mr. KLOPSTOCK. It is now some time since I studied the paper of Mr. Gemmill. Meanwhile we have seen what happened in 1961. We witnessed very sizable outflows from the United States, both on short-term and long-term accounts. Many of these outflows are difficult to study purely on the basis of statistics because many important components are not identified in our statistics on capital outflows.

Let me mention, for instance, one important type of outflow which makes quite a bit of difference and which is not identified in our capital movements statistics. That is the short-term financing by American corporations of working capital needs of their affiliates abroad. Movements on that account are not identified. At least until recently they have not been identified. They are mingled with other figures in the direct investment account in our balance of payments.

Whenever Treasury bill rates in this country are very low or show a tendency to decline, many corporations that have substantial operations abroad find it profitable to back out, so to speak, loans to their affiliates from European banks made at relatively high interest rates. It then becomes profitable to them to use their own liquid funds to finance their affiliates on short-term account.

I believe substantial movements of that type have taken place, though the statistics do not permit us to identify them.

Senator PROXMIRE. What amount is involved?

Mr. KLOPSTOCK. It can amount to very substantial aggregates. I can't offer any figures because we really don't know.

Senator PROXMIRE. On the order of a billion dollars?

Mr. KLOPSTOCK. Several hundred million dollars, I would say off-hand. The short-term indebtedness and the working capital needs of some of these affiliates of American corporations are very sizable. It is expensive for them to borrow abroad, and often cheaper for these affiliates to employ funds of their parent companies. The parent companies are much more willing to transfer funds to their European affiliates in periods of low interest rates.

Another component which I mentioned previously is the purchase of money market paper abroad. Currently in the last few weeks we know that substantial investments have been made in Canadian Treasury bills and other Canadian money market paper. In 1961 there was a very sizable movement of capital into the British Treasury bill market. Large movements of short-term funds have been going during 1961 into the Canadian banks. American corporations have put time deposits into Canadian banks because interest rates offered by these banks to U.S. corporations were more attractive than interest rates in this country.

Senator PROXMIRE. In the first half of 1962, on the basis of the Survey of Current Business, U.S. Department of Commerce, there was a very sharp improvement in private short-term capital flow. Whereas the adverse position was \$500 million in 1958-60 on the average, in 1961 it was \$2.1 billion. In the second half, on an annual seasonally adjusted basis, \$1.6 billion. It was only \$300 million adverse in the first half of 1962, a very substantial improvement.

**Mr. KLOPSTOCK.** This substantial improvement has to do with the deterioration of the Canadian position. A lot of U.S. capital left Canada and came to the U.S. because of the difficulties the Canadians got into. They have resolved these difficulties and there is again an outflow of American capital to Canada since the beginning of July.

Similarly, acceptance credits to Japan have eased off somewhat.

**Senator PROXMIRE.** Nevertheless, the fact is that with interest rates generally lower here than abroad, not only Canada but Europe and elsewhere, the fact is that we greatly improved our short-term position vis-a-vis capital flows despite the interest rate situation. I recognize that short-term interest rates of some kinds are even lower still in Switzerland and Germany and the Netherlands. When we raise this argument, they say that this pertains to only some official securities and is broadly not typical, particularly in Germany.

So it would seem to me that this is a pretty persuasive indication that differentials in interest rates are overbalanced now by other factors.

**Mr. KLOPSTOCK.** That is correct, but there are also long-term outflows that have to be taken into account. For instance, our long-term loans have been quite sizable even in the first half of 1962. Long-term loans have been amounting to \$150 million in the first two quarters of 1962.

Also, I believe as to the statistics on the short-term outflows that you quoted—I would have to study them more carefully—they may have something to do with the fact that one Canadian corporation floated an issue here and used the proceeds of that issue to repay short-term loans. Mr. Pizer, I believe, can confirm this.

**Mr. PIZER.** Yes, about \$100 million was a refunding.

**Senator PROXMIRE.** This is on the order of being one-fifth of what it was in the second half of 1962, seasonally adjusted; \$300 million as compared to \$1.6 billion.

**Mr. BELL.** I would like to say a couple of things. The Gemmill study relates to our short-term liabilities to foreigners. It doesn't have anything to do with U.S. short-term capital going overseas. It is foreign holdings of liquid liabilities in this country.

The other thing I wanted to comment on was that I don't understand the London-New York interest rate differential expanding sharply from the early part of 1961 on. Mr. Klopstock says that our holdings of British Treasury bills increased substantially. But banks reported each quarter in 1961 that they fell steadily. I must stress that doesn't necessarily mean that our short-term claims in British pounds, which were 97 million at the end of 1960 and steadily dropped to 60, to 30, to 26, throughout the year, it doesn't necessarily mean they came back to this country.

Unfortunately we get a figure at the end of the month. For all we know, that drop may mean that they went out into some other securities purchased through a foreign security dealer, which never enters into our statistics but will crawl into the errors and omissions column in the balance of payments. You get an increase and a decline, and the decline in the stock at the end of each month may simply mean you put a deposit abroad and you bought a British long- or short-term security as an individual, and there is no way to get it into

the statistics. The statistics show a decline rather than an increase. Is that correct?

Mr. KLOPSTOCK. It is not entirely correct. We have to look at investments not only by banks but also corporations. We have to put the figures together. If we do, we find in early 1961 the investments by both U.S. banks and corporations in British money market assets increased to \$208 million from \$44 million in March of the preceding year.

Later on during 1961 a substantial part of these investments were liquidated because the covered interest incentive to move funds to the United Kingdom declined. It was no longer profitable to any considerable extent to move funds on a covered basis to the United Kingdom.

In the case of Canada, there was also a decline during the second, third, and fourth quarters of 1961. But during the first quarter of 1961 there was a very substantial movement of American money into the Canadian money market. That is now taking place again.

We have to look not only at the interest rate differential, but also at the forward discount of sterling or the Canadian dollar in terms of U.S. dollars. Corporations only invest abroad if the covered interest rate incentive makes it profitable for them to go into foreign money markets.

Senator PROXMIRE. Let me ask you, Mr. Klopstock, because you are one of the few economists who appeared before us who argues, or has been able to document to any extent the argument, that interest rate differentials are important in international outflow. Many support the notion that you have, I don't know that you have it or not, that we should have higher interest rates at the present time. Do you advocate higher interest rates now, or I should say, a little tighter money policy, an increase in the money supply?

Mr. KLOPSTOCK. I do not wish to take a position on interest rate policies. I am merely analyzing the impact of rates on capital flows.

Senator PROXMIRE. Would you agree or disagree that a policy of monetary tightness, that is, not increasing the money supply as the gross national product increases, would tend to discourage borrowing for home purchasing, borrowing for consumption purchases? It would tend to slow down the economy in this particular area?

Mr. Humphrey, in his very excellent paper, says that it would be a miscarriage "to sacrifice \$30 billion of potential output for the sake of speedier elimination of a foreign deficit, which is so very small by comparison and is already diminishing."

A little further on he says, "I should resist choking off a couple of billion dollars of building construction with higher long-term rates."

I don't want to be unfair, but I think if the discussion of policies should have any practical meaning, we should bring it down to the tough decision we have to make in considering the argument for higher interest rates for international payments purposes, but it obviously doesn't mean that the economy can move ahead on the same drive on the domestic basis.

Would you concede that this is a balancing problem or do you think that interest rates are not very important domestically?

Mr. KLOPSTOCK. I do believe that interest rates exert an important influence on home construction. I believe there is general agreement they do.

Senator PROXMIRE. Home construction is very vital to employment?

Mr. KLOPSTOCK. Certainly.

Senator PROXMIRE. I understand for every man working at the homesite there are two in factories, and so forth, providing materials. The dilemma that we are in now was brought out for the first time this morning. I would be very interested to have your comment. And that is on this: Now that we have some slack in the economy, you can make a strong argument for some monetary ease domestically, but some monetary tightness in terms of our balance of payments. Germany has exactly the opposite situation. They have an embarrassment of capital inflow which they want to discourage, but they also have a tight labor market, a full utilization of resources, inflationary pressures, and therefore a strong argument for high interest rates domestically.

Are we going to be faced with this problem of pretty much permanently having to decide between our domestic needs and our international interests? It seems to me that in this country, as compared with others, because the domestic market is still so much more important than foreign trade usually, a logical decision would be on the side of meeting our domestic requirements. High interest rates when inflation threatens and monetary ease when the economy is slack.

Mr. BELL. I don't think we should neglect the fact that the level of activity in this country also has a substantial effect on capital flows. I don't deny that we might lose what I feel from my study is a small amount of capital with a rather low interest rate policy at the present time, but if, in fact, we could stimulate the level of economic activity, we could entice some capital to come back to purchase stocks and other things that might well offset the interest rate effect.

I feel on the side at the present time we need to do everything we can to stimulate the economy and we should not exaggerate the seriousness with which this will affect the balance of payments.

Senator PROXMIRE. It is possible that monetary ease may be consistent with the international balance-of-payments position.

Mr. BELL. I think in part it would be. It would gain and lose. I would think, for example, that if a tax cut came, the sensible thing to do would be not immediately to raise interest rates and in effect choke off a lot of the effects of the tax reduction, and not hold interest rates down permanently at a low level either, but it would be to gain an immediate monetary fiscal mix to pump some money into the system to keep the rates from going up too sharply, but to let the interest rates rise slowly as the economic activity rose slowly, and I hope not too slowly.

I think that would be the best type of monetary fiscal mix.

Mr. HUMPHREY. I don't think I have anything to add to that, except to stress Mr. Bell's last point, that this time phasing makes a big difference. I would quite agree with him that once we have recovery, the high level of activity will be favorable even as to the balance of payments. I would fear that in the initial stage an all-out policy of low interest rates would have initially a negative balance-of-payments effect.

The question is, Just how much are we willing to pay to avoid any extra fears in this delicate matter of climate? As I have said, I would not pay in terms of choking off building construction, but if a little higher on the short-term rate would help, it doesn't seem to me it is

too high a price. But, by the same logic, the surplus countries should lower their interest rates.

Senator PROXMIRE. Mr. Klopstock?

Mr. KLOPSTOCK. I don't think I have any comment on this subject matter.

Senator PROXMIRE. Mr. Pizer?

Mr. PIZER. I think I would be skeptical of any generalizations here. In the first place, I think the more familiar you become with the figures, the less likely you are to draw conclusions from them very quickly. It is true that we have not had a very sizable outflow of banking funds this year. We still don't know what nonbanking funds are doing. I am interested to hear from Mr. Klopstock that there has been some outflow of that kind since the Canadian situation reversed itself.

I am not sure how good a guide to the potentialities in the system is given to us by the events we have been able to measure for the last couple of years. We simply don't know what corporations would do, corporations which are tremendously liquid, if there were a sharp divergence once again between interest rate structures.

It is very difficult to measure differences in the interest rates partly because of needing to take account of the foreign exchange risk, but also because there is such a variety of instruments available, both in the United States and in foreign countries, that one scarcely knows which two kinds of instruments ought to be compared to see what the differential is. So I would really be afraid to generalize on that situation.

Representative GRIFFITHS. I was especially pleased to hear Dr. Bell point out that it was not absolutely necessary that you have an interest rate rise accompany a tax cut. I have heard the reverse for 3 weeks.

Representative WIDNALL. I would like to throw this question out for the panel. We have recently had devaluation of the Canadian money. How did their situation at the time they devalued differ from ours?

Mr. BELL. I am not familiar enough with that. I just have not studied Canada in any way. I believe they would know more about it.

Representative WIDNALL. I had understood that Canada was quite prosperous and everybody was pointing to the great gains they were making in production. There was a lot of investment going into the United States from Canada.

Mr. BELL. That slumped off.

Representative WIDNALL. I know that. I want to know how they differed in their situation from ours, because they prided themselves on getting a premium on their dollar. For example, it was \$1.05 to the dollar at one time.

Mr. BELL. It would seem roughly to me that one thing one can say is that it was not because of short-term capital outflow. Isn't that true? There was no substantial short-term capital outflow prior to that.

Mr. PIZER. We think there was a substantial outflow of capital funds out of Canada, perhaps some American. We think that may have contributed to the strength of our own balance of payments in the first half of the year.

Representative WIDNALL. What do you feel led to that outflow of funds or led to the lack of confidence in the Canadian money?

Mr. PIZER. I also don't qualify as an expert on Canada. They had suffered greatly from the falloff of the capital flow to Canada. Apparently they were having difficulty selling abroad, also. To some extent, changing their exchange rate would help both of those situations.

Representative WIDNALL. Have they been adversely affected by the Common Market?

Mr. PIZER. I would just be assuming, I really don't know.

Mr. HUMPHREY. No, sir; up to now I do not believe they have as yet been adversely affected by the Common Market.

Canada does not have the large, strong, and diversified manufacturing industry that the United States has. We have been able to improve our competitive position, and we are still making progress in this respect.

The difference between the United States and Canada is that, except for the temporary flight of capital associated with the Canadian devaluation, there is normally a heavy inflow of capital from the United States. Both direct venture investment and borrowing by Canadian municipalities support extra exports of goods from the United States to Canada.

Now, when Canada developed substantial unemployment, these extra imports of goods from the United States make the Canadian unemployment situation worse. Unemployment and a balance of payments problem are bad enough for the United States, and for a country that normally borrows capital it may be worse. I suppose that it was Canadian unemployment which led to adjusting the exchange rate in order to expand exports and restrict imports of goods. We have to recognize that this makes the American export drive more difficult and is certain to have adverse effects on our favorable balance of trade with Canada.

Representative WIDNALL. We are going to have to reevaluate a lot of our figures. I noticed an article about the oxygenizing of steel and what that will do to the productive capacity of our plants.

You just shoot oxygen into the steel without building plants and it materially increases the uses of the steel. I don't know how you can compare a set of figures today with tomorrow, when the basic matter you use for evaluation keeps changing so much. There is quite a hazard in prophesying today.

Mr. BELL. In any change like that where you have a basic technical change, that is certainly true. If you are implying that one can't draw on past experience, so far as short-term capital flows are concerned, and so on, I think I would tend to disagree. I think you can draw on it and then consider in what way the situation is different. It is important to use statistical evidence on which to draw conclusions.

One of my teachers once told me that the only statistics that were good in this world was that mass being collected down in Washington, that no one knew why it was collected.

I think we ought to use these statistics as much as we possibly can. I agree with Mr. Pizer we have to be cautious about drawing general sweeping conclusions on the basis of them.

Representative WIDNALL. All of the members of the foreign panel were of the opinion that employment would be stimulated here by deficit spending. Do you care to make any comments on that as to whether deficit spending will stimulate the economy?

Mr. KLOPSTOCK. I would first like to say, on the question of Canada, that they had a substantial deficit in the balance of payments that they financed by capital imports. During 1961 these capital imports or capital investments in Canada began to diminish. In 1962 there was a withdrawal of foreign capital from Canada and the Bank of Canada began to lose very substantial amounts of foreign exchange reserves, which forced the Canadians to stabilize their exchange rate at a relatively low level.

Mr. HUMPHREY. Yes; I agree that a tax cut will stimulate the domestic economy. The evidence on consumer spending with relation to disposable income is pretty consistent for a long period of time; I think a tax cut is also favorable to business expansion.

Representative WIDNALL. The question goes further than just the tax cut. It is a question of whether deliberately incurring deficit spending at this time is going to be healthy for the economy when we already have a deficit.

Mr. HUMPHREY. I think a larger deficit at this time would be stimulating.

Mr. BELL. I would have to agree.

Representative WIDNALL. Mr. Klopstock?

Mr. KLOPSTOCK. Budget deficits tend to have a stimulative effect on the economy, that is true.

Representative WIDNALL. Would it have this in the long run or would it just be a shot in the arm?

Mr. KLOPSTOCK. I would say it depends on the circumstances.

Mr. BELL. May I comment on one thing that disturbs us at times in talking about a larger deficit? It is really the total of Government spending and the total of taxes taken away from people so that they cannot spend which are the significant items so far as the effect on the economy is concerned. You could have a deficit and a level of Government spending of \$40 billion, and it will be less stimulating than if you have a balanced budget at \$80 or \$90 billion.

The reason is that you are taking tax money from people that they would have spent only nine-tenths of anyway, and you give it to the Government which automatically spends it. The difference between the \$40 billion budget and \$90 billion budget.

Representative WIDNALL. When you comment on that, do you take into consideration the potential debt of the Government in connection with all the guarantees we have out?

Mr. BELL. You mean to the rest of the world?

Representative WIDNALL. Guarantees that we as a government have made in a number of programs. They are not included as deficits or anything like that. But they are hanging over our head all the time and they are greater than the actual debt as a potential. Is that something that should be considered at the time we are talking about incurring more and more direct debt?

Mr. BELL. I am not sure. I wouldn't think it would have an effect on the efficacy of the fiscal policy on the economy. That is what we really are asking here. Anyway that is out of all of our provinces.

Representative WIDNALL. Thank you very much.

Senator PROXMIRE. I would like to ask the panel to comment on this because this is extremely important. The statement was made before this committee a short time ago by Mr. Martin in response to a question by our chairman, Mr. Patman. The question related to financing the deficit, and Mr. Martin said that—

In the event a decision is made which further widens or deepens the deficit we are already running, I want to put the Federal Reserve specifically on record that I think we must not finance the deficit by bank-created funds. It should be financed out of bona fide savings and not by writing up assets on one side or the other of the bank ledger.

Mr. Bell, I want to know whether or not, if Mr. Martin does this, if the Federal Reserve Board does sell bonds to the public under these circumstances to this extent, what would be the effect on the economy? Will it reduce the expansionary impact of the increased deficit one for one? Would it cut it in half? Would it reduce it only a little?

Mr. BELL. It does seem to me, Senator Proxmire, that if you do not finance the deficit in part by new money, you would have to have a larger deficit to get the same economic results. In other words, what I suggested a little while earlier is that the medium position of partly financing it by new money and partly financing out of savings so that the interest rate rise is gradual and does not choke off the expansion would seem to me to be wise and not put us in a very difficult position.

Senator PROXMIRE. What was that again? If you what?

Mr. BELL. If you finance any increased deficit partly out of new money and partly out of existing savings, you can do three things. You can pump enough money in so there is no rise in the interest rate and not call on the existing loan market. You can say, "I will not pump in any money," in which case all of the funds for additional spending must come out of the loan market, bidding the rate of interest up rather sharply. Or you can take a middle monetary fiscal mix and say, "Let us let the interest rate rise with the level of the rise in economic activity." That implies pumping some money in but not enough to keep the interest rate low while the level of activity is rising.

Senator PROXMIRE. As long as you have 5½ percent of the work force out of work, which we have had for 7 months, as long as you have indicators of capacity suggesting that we are operating at about 85 percent with the optimum 90 percent of our plant capacity, why in the world would there be any merit in any restrictive activity until we come closer to fuller utilization of our resources?

The whole point of the tax cut at the time of an unbalanced budget is to stimulate the economy. Why should we undo any part of it with monetary policy?

Mr. BELL. One reason is that you do not want to announce—I have not said that my studies showed that interest rates have no effect; I have said they have a small effect on foreign capital movements—they might have a significantly larger effect if you say you are permanently going to hold your interest rates down for 6 or 9 months or a year.

Senator PROXMIRE. I am not asking for a peg. I say, suppose you decided you would follow a policy of relative ease and sell most of these bonds to the banks until you found you had some inflationary pressures to be concerned about.

Mr. BELL. I think we are very close together. I would try to hold them low and let them rise very gently. I think that flexibility in interest rates is good.

Senator PROXMIRE. Certainly, the lower you hold them, the lesser the tax cut required and the lesser the deficit required and the lesser the debt burden that you would require to get an equal amount of stimulation for the economy.

Mr. BELL. I would agree. I think different economists might feel differently. I agree definitely because I think the interest rate is of considerable significance in the level of investment undertaken. Others would say it is negligible.

Senator PROXMIRE. Before I move on to the other gentlemen, I want to say that Mr. Lolli, yesterday, who is a very experienced European banker and vice president of the biggest bank in Europe, pointed out in Italy they had enormous deficits, comparable to a \$40 or \$50 billion deficit to us, but didn't have the inflation that you might expect.

They did what we did in World War II. They sold their bonds to the public. They did it pretty much on a one-for-one basis. Of course, they have no excess labor to speak of as compared with us, and excess plant capacity.

Under these circumstances, do you think that the experience that Italy had would be useful for us?

Mr. BELL. And a number of European countries. If you are at or near full employment, it is certainly not the time to create full money. In that case, if they sold the bonds to individuals, they were not creating new money.

Senator PROXMIRE. If you sell all the bonds to the public then, this is something you can do if you want a very big national Federal effort, whether it is a war effort or a big rebuilding of the economy, a big Federal housing operation, something really enormous, then you can prevent inflation by selling the bonds to the public.

If the purpose is to stimulate the economy and keep it as free enterprise as possible, it would minimize the amount you would want to finance by sales to the public.

Mr. BELL. I would agree.

Mr. HUMPHREY. I feel Mr. Martin's statement, which is what you asked about, may have overstated his position somewhat there, perhaps intentionally. I think we do have to watch prices very carefully. As long as we can hold prices stable, particularly in the export sector, I would not be so apprehensive about using new money.

I think Senator Proxmire that, as you imply, we should adopt our policy to serve the objectives we want to attain. With substantial unemployment and excess plant capacity, a larger Government deficit need not involve the inflation of prices. Regulation of the money supply should be guided by the requirement for avoiding inflation, rather than by what is done about reducing taxes.

The double problem of domestic unemployment and a balance-of-payments deficit calls for some readjustment of our thinking. High interest rates and tight money usually go together when we want to restrict an excess of demand. But that is not our problem today. To the contrary, we need to expand. Thus, even if we should be forced, for balance-of-payments reasons, to keep short-term interest rates higher than we would like, this should still be associated so far

as possible with a supply of money which is ample for the expansion that the economy needs.

Senator PROXMIRE. So you can concentrate on restraint in the wage-price front?

Mr. HUMPHREY. Yes, sir.

Senator PROXMIRE. And also the administered price front. You feel we might be able to sell some to the banks and create some additional money to finance the deficit?

Mr. HUMPHREY. Yes.

Senator PROXMIRE. Do you share Mr. Bell's viewpoint that it ought to be split, or do you think it should be concentration on sales to the banks?

Mr. HUMPHREY. Since it is very hard to make a complete shift abruptly, some split may be prudent with new money initially and more out of savings toward the end, as we go along.

Senator PROXMIRE. Mr. Klopstock?

Mr. KLOPSTOCK. I have not reached any definite conclusions on this issue.

Senator PROXMIRE. Mr. Pizer?

Mr. PIZER. I don't think I can add on this subject.

Senator PROXMIRE. Mr. Klopstock, I understand you are prepared to explain the Euro-dollar market. We welcome that. We have had this term tossed to us by you professional economists. We are very interested in this. One of the questions that particularly interested us is whether or not the Euro-dollar market represents a flight of American capital, or can, and how it relates to claims that the central bank may make against us.

Mr. KLOPSTOCK. I have made a study of the Euro-dollar market together with an associate of mine. The study was published in the Monthly Review of the Federal Reserve Bank of New York, and if I may, I would like to submit the study to the committee.

Senator PROXMIRE. Very good.

Mr. KLOPSTOCK. As to capital outflows.

Senator PROXMIRE. How long a study is that?

Mr. KLOPSTOCK. It is several pages published in our Monthly Review.

Senator PROXMIRE. That will be printed in the record of the committee's proceedings at this point.

(The study follows:)

#### THE MARKET FOR DOLLAR DEPOSITS IN EUROPE

(By Alan R. Holmes and Fred H. Klopstock<sup>1</sup>)

In recent years a broad and active market for dollar deposits has emerged in Europe. In this market, generally referred to as the continental or Euro-dollar market, European and other foreign banks place and accept for varying time periods deposits held at banks in the United States. The banks accepting such deposits employ them for various types of loans and investments either in the form of dollars or other currencies. The attractiveness of this market for dollar deposits partly derives from the fact that interest rates paid by foreign banks have generally been higher than those paid by U.S. banks on time deposits, or obtainable on money market instruments of similar maturity in New York. In addition, European banks offer interest on call and very short-dated deposits, a

<sup>1</sup> Alan R. Holmes is manager, securities department, and Fred H. Klopstock is manager, research department, Federal Reserve Bank of New York. Their analysis is based in part upon a survey which they jointly conducted in Europe during June 1960.

practice that is forbidden by law in the United States. Any estimate of the volume of dollar deposits placed in the market rests on tenuous grounds, but the total is believed to exceed \$1 billion. Since many European banks that obtain dollar deposits in this market redeposit these funds with other banks (i.e., act as intermediaries), the overall volume of dollar interbank deposit claims outstanding abroad may well be a multiple of the amount cited above. Variations in the volume of trading are, however, sizable, since the market is highly fluid, being directly influenced by shifts in national monetary policies, by changes in bank liquidity, and by changes in international interest and exchange rate differentials. A market of this size and scope clearly warrants examination, particularly because of its implications for the position of New York City as an international financial center, for the dollar as a world currency, and for the European banking and money market structure.

#### HISTORY OF THE MARKET

The original impetus for the postwar development of the continental dollar market is believed to have arisen from the desire of several banks in Eastern Europe to leave their dollar balances with their correspondents in France and England rather than carrying them in their own name in the United States. In making use of these and other dollar balances, the correspondent banks found a number of outlets, often involving the offer of these funds to foreign banks in need of dollar finance, at rates somewhat lower than would be paid for credits from U.S. banks. Before long other holders of dollar balances took advantage of the growing demand for this relatively inexpensive dollar accommodation, and soon an active market for dollar deposits began to develop, notably in Paris and London.

Further stimulus was given to the market in the fall of 1957 when sterling came under pressure. At that time, the British authorities put restrictions on the use of sterling for the refinancing of foreign trade credits to nonresidents; they also banned sterling acceptance credits covering trade between countries outside the sterling area. British banks then offered their customers and correspondents dollar facilities to take the place of the prohibited sterling credits, obtaining the requisite balances in the continental dollar market. Toward the end of 1957, and particularly in the spring of 1958, the new demand met with a rapidly increasing supply, as sizable European acquisition of dollars, and easier credit conditions internally, brought many European banks into the market in search of attractive outlets for their surplus funds.

By mid-1958, the market was well established, but it did not assume really impressive proportions until the end of that year when rates paid abroad for dollar deposits rose well above the maximum interest rates that banks in the United States were permitted to pay for time deposits under Regulation Q of the Board of Governors of the Federal Reserve System. Many European banks that had been reluctant to enter the market on a large scale then became active participants on the supply side.

The introduction of nonresident convertibility throughout Western Europe at the end of 1958, as well as the further relaxation of exchange controls in some countries, also contributed to the broadening of the continental dollar market. The emergence at that time of a fully integrated and active foreign exchange market enabled banks to take in deposits denominated in foreign currencies, "swap" them into dollars, and use the dollars for investment in the continental dollar market. (In such a swap transaction the foreign currency deposit is used to purchase dollars "spot"—i.e., for immediate delivery; and simultaneously, so as to hedge against adverse exchange fluctuations, dollars are sold "forward" for delivery and payment at about the time the foreign currency deposit must be repaid.) In several countries, moreover, banks were permitted freely to swap their own currencies into dollars.

By 1959, the Dutch, Swiss, Scandinavian, and for a limited period the German banks had become the source of substantial funds offered in the market. During the course of the year several central banks in Europe and southern Asia, as well as some banks and other holders in the oil-producing areas of the Near East and even private corporations including foreign subsidiaries of U.S. companies, joined the ranks of the suppliers. On the demand side, in particular Italian, French, British, and Canadian banks, as well as branches of U.S. banks abroad, and more recently German and Japanese banks became important participants. The market had thus become less and less a strictly European affair and had assumed worldwide proportions and ramifications.

## THE MECHANICS OF THE MARKET

For a full understanding of how the market operates, it is important to note that it is only a part of the international market for short-term funds that has emerged in Europe since convertibility. Many European banks stand ready to accept deposits in a number of foreign currencies—pounds sterling, Swiss francs, German marks, Dutch guilders, as well as dollars. The dollar deposit market is by far the most important, however, for a number of reasons. First of all, the dollar is the leading international currency. Second, it has been readily available in large amounts in the foreign exchange markets, a reflection of our balance-of-payments deficit during the past decade. Third, the dollar is virtually the only currency used by European central banks as a reserve currency. Their operations in the exchange market to stabilize the value of their own currencies are conducted, under the European Monetary Agreement, exclusively in dollars. Consequently, central banks are always residual buyers or sellers of dollars in the exchange market.

As already pointed out, suppliers of dollar deposits sometimes acquire them by converting other foreign currency deposits into dollars. Similarly, an acceptor of a dollar deposit may not necessarily use it for lending or investing in the form of dollars. If the constellation of interest and forward exchange rates among various centers makes it profitable to switch the dollars into another currency for lending or investment, many European banks will be quick to do so. The continental dollar market is thus closely integrated through an intricate maze of operations with the full complex of European money and exchange markets.

The continental dollar market is a true market in the sense that there are a large number of banks who stand ready either to accept or to supply dollar deposits at any given time with only a small spread in the rates involved. In many cases, banks will accept dollar deposits from a correspondent bank, not because they have a need for dollars, but to further customer relationships or for some other reason. In some cases, they are willing to redeposit the dollars with another bank with no spread over the interest rate which they themselves are paying. Intermediaries, too, may at times make redeposits at no spread in rates in order to keep their names in the market.

There is a regularly quoted rate for dollar deposits within Europe. At the end of October, for example, deposits on 24-hour notice were quoted in London at 3½ percent, 1-month deposits at 3¾ percent, and 3-month deposits at 3¾ percent. As would be expected, the dollar deposit market is an interbank market with transactions handled by a bank's exchange traders, although activity is closely linked with the bank's money position. In many European banks the manager of the bank's money position is also the chief foreign exchange trader, a practice which is virtually unheard of in the United States and which indicates the close link in Europe between money and foreign exchange markets. Transactions are carried out largely by telephone, but also by teletype or cable. Some banks regularly solicit deposits by mail. While, as in all markets, the amount that can be readily transacted at quoted rates may vary from time to time, it is normally possible for a prime name to place or receive deposits in blocks of \$1 million or substantially more in a few minutes' time. Rates may, however, vary quite considerably according to the names and countries involved (as discussed in the next section of this article).

A sizable part of the activity appears to take place in short-dated deposits—on 24-hour or 7-day notice. Often, however, deposits may be made at short-term with an understanding that they will not be withdrawn for longer periods save for exceptional developments. In other cases 1- or 3-month deposits may be subject to prior withdrawal in unusual circumstances.

It should be made clear that these transfers of dollar deposits among European and other banks and their subsequent use do not usually result in the extinguishing of dollar deposits in American banks. Such transfers are usually effected by means of a cable from foreign bank holding a dollar account in a U.S. bank instructing the latter to transfer funds to the account of the foreign bank accepting the deposit, either in the same or another U.S. bank. What happens subsequently depends on the uses to which the bank accepting the deposit puts the money. Ownership may pass from foreigner to foreigner, or from a foreign account to a U.S. account if the dollars are eventually loaned to an importer abroad who makes payment to a U.S. exporter. Ownership may change, but the deposits ordinarily do not "disappear." Exceptions to this general rule occur

if the acceptor of the deposit swaps it into a local currency, and the dollars are acquired by a European central bank that employs them for the purchase of gold, or if the dollars are used ultimately to pay off a loan at a U.S. bank.

#### THE SUPPLY STRUCTURE

Suppliers of dollar deposits to the market include commercial banks, a few central banks, Eastern European banks, and, through their banks, some non-banking institutions and individuals. Banks of certain countries or areas—Switzerland and the Netherlands, for example—are normally suppliers in the market, reflecting high domestic liquidity and relatively low interest rates (after allowing for the spot-forward exchange rate differential) at home compared with abroad. For these banks, the New York money market and, to a somewhat lesser extent, the London money market have been "safety valves" for any surplus funds that could not be employed at home. The continental dollar market now serves exactly the same function. Even banks in countries where money market rates exceed those obtainable in the continental dollar market may enter the market on a large scale if the unfavorable interest rate differential is more than offset by a premium on forward dollars.

Individual suppliers of dollars, as well as entire national banking groups, may at times withdraw suddenly and almost completely from the market and even appear on the demand side—for instance, because domestic money market conditions tighten or because of shifts in forward exchange rates. Such withdrawals from the supply side can affect the deposit market considerably, much more than similar withdrawals from regular money markets. For instance, liquidation of United States or United Kingdom Treasury bills by commercial banks of a particular country may scarcely make a ripple in these broad and highly liquid markets. The effect is potentially of an entirely different order in a market such as the dollar deposit market where certain national banking groups occupy a key role. While most banks accepting dollar or other foreign exchange deposits take care to offset their liabilities with similar foreign exchange assets, it is not always possible (or profitable) to have exactly corresponding maturities. They may consequently be vulnerable to sudden and unexpected withdrawals of deposits.

Another noteworthy characteristic of the market is the premium put by some suppliers, notably the more conservative banks, on first-class names among depositories of their funds and their consequent willingness to make rate concessions, if they can place their balances with such names. Branches of American banks abroad, for example, can normally obtain deposits at rates somewhat under the going "market" rate. Lesser known names, on the other hand, may have to pay rates above the quoted market.

Actually, the market is somewhat compartmentalized in that bank managements, aiming at risk diversification, ordinarily establish lines for each country in which they place funds and for individual banks in these countries. The market is thus permeated with quotas which in turn may be reflected in the average rate level at which various national groups of banks and individual institutions can actually obtain funds.

These various deposit policies and procedures also reflect the fact that many major operators in the market instinctively dislike placing large amounts of funds with a bank in a currency other than that of the bank's country and would prefer to place their deposits in the United States, or at least with foreign branches of U.S. banks, if the rate differential is not too great. Since they often have insufficient information on what their placements are employed for, and do not know the quality of the ultimate borrowers, some banks feel uneasy over the possibility that bankers in different countries, without each knowing what the other is doing, may place excessive funds with one and the same bank in a third country. While some central banks are well posted on how much and with whom the banks in their country place dollar balances, they are of necessity ill-informed on commitments of bankers in other countries to the same acceptors.

#### INTERMEDIARIES

As already noted, several European banks have made it their business to operate on a large scale on both sides of the market, and to be ready at any time to quote interest rates at which they will accept and offer funds, mainly in dollars, but also in several other major currencies. There is room for a relatively large number of intermediaries in the market because of the services

they perform in bringing suppliers and seekers of dollar deposits together. Most banks serve as principals in this capacity—i.e., they accept deposits in their own name and then redeposit with other banks, earning a small spread (up to one-eighth of 1 percent) on such operations, although as mentioned earlier they may sometimes operate on a "flat" basis. They may also deposit with banks with lesser known names—or with banks with urgent needs—at a somewhat greater spread, reflecting the somewhat greater risk involved. Intermediary banks thus serve as a channel between the more conservative banks and a very large number of banks that are users of dollar deposits.

Because of their closeness to the foreign exchange market and the volume of transactions that they handle, the intermediary banks are quick to take advantage of any opportunities to engage profitably in swap transactions. They may, for example, accept Swiss franc deposits, swap the Swiss francs for dollars, and then deposit the dollars somewhere else; in turn, these dollars may be swapped into sterling or some other currency. An extremely large volume of foreign exchange transactions, both spot and forward, has resulted from these operations.

In addition to intermediary banks, who act as principals in the market, other banks may act on a brokerage basis as a service to correspondent banks. Foreign exchange brokers in both London and Paris also handle dollar deposit transactions in some volume on a brokerage basis.

The leading center for the continental dollar market is London, where a considerable number of banks—merchant banks, foreign banks, and British overseas banks—serve as intermediaries in accepting and putting out foreign exchange deposits quite apart from using the deposits acquired for their own trade financing needs and for other ordinary banking transactions. Banks in other centers—Paris and Milan, for example—have been doing a fairly substantial business in "jobbing" dollar and other deposits.

#### DEMAND PATTERNS

A feature of the market is the very diverse use to which the ultimate receivers put the deposits. Many acceptors of deposits employ them as loans to customers for the financing of imports from the dollar area or elsewhere. Substantial balances are also employed for loans to securities dealers and brokers in New York, and branches abroad of New York banks are in the market to obtain time deposits for use by their head office. Some banks convert dollar deposits into their own currencies and employ them for loans and investments in their own credit and money markets, and still others acquire dollar and other deposits in order to place them in other money markets at a profit.

International trade financing appears to absorb a substantial part of the total of dollars offered in the continental dollar market. Banks in Italy until last summer entered the market heavily for this purpose, but in recent months have become primarily intermediaries. French, Japanese, British, German, and some governmental banks in Eastern Europe have also taken advantage of the market in order to put their foreign traders into funds at rates substantially below the cost of acceptance financing or direct loans in New York. Even trade in the Middle East and southeast Asia has been financed with continental dollars, often through Beirut.

Italian banks resorted to dollar (and other foreign currency) financing of foreign trade on a large scale because they could thereby compete more effectively for new customers. Interbank competition in Italy has long been stifled by rate agreements with respect to lira credits. Until 1959, rates for foreign currency loans, not a factor of any consequence during the period when dollars and other hard currencies were in short supply, were not so regulated. Thus, lending in dollars permitted a wide breach in the highly regulated Italian loan rate and commission structure. (More recently, however, there has apparently been some moderation of this intense interbank competition, but rates on dollar loans remain substantially below those for lira loans.)

In order to offer present or potential customers the lowest possible rates, Italian banks have taken full advantage of interest rate-forward exchange rate constellations. For instance, an Italian bank might have a customer who wished to borrow sterling to finance an import from the United Kingdom. The bank might then take advantage of the facilities of the continental dollar market to arrange to receive a deposit, say, from a British bank, of a corresponding amount of dollars. It would then seek out an opportunity to reduce its borrowing costs by making a profitable swap—i.e., if the forward dollar were at a discount

against the guilder, it would sell spot dollars, say, to a Swiss bank, and buy them back (at a lesser cost in guilders) forward. It would then lend guilders to the customer and in turn, for the customer's account and risk, convert the guilders into sterling. The bank's customer benefits by receiving a loan at substantially lower interest cost than would have been the case if he had borrowed lire, and then used the lire to purchase sterling. He has assumed a foreign exchange risk, however, but so great is the confidence in the stability of European exchange rates that this is often of little concern to international traders. In fact, the willingness of firms in Italy and to a growing extent in France, to take uncovered exchange risks in dollars is of great significance in current foreign exchange market developments.

Banks in several other countries have been important on the demand side of the continental dollar market. In recent months, Japanese banks have taken in very sizable amounts. In Germany, the acceptance of continental dollars or other foreign currencies and their use for foreign trade financing was furthered until recently by regulations under which the resulting bank liabilities, if offset by a foreign currency asset, were free of reserve requirements. However, since July 1, 1960, this special exemption from reserve requirements no longer applies.

Canadian banks have been large borrowers in the continental dollar market, primarily for the purpose of relending to securities dealers and brokers in the New York money market. Among foreign banks, the Canadian banks have been in a particularly favorable position to extend such loans since through their agencies in New York they can supervise such operations.

Overseas branches of U.S. banks have become depositories of very sizable amounts of continental dollars, running into several hundreds of millions of dollars. They have used the market as a means to recapture some of the time deposits that had escaped, or were about to escape their head offices, because of the interest rate ceiling on such deposits under regulation Q and the attractiveness of money market investments either in the United States or elsewhere. These branches have little trouble in attracting dollar deposits, suppliers of dollars being ready to place their deposits with them even at rates substantially below the prevailing market level.

Considerable amounts of continental dollars have at times been swapped by British banks into sterling and then employed at considerably higher rates for loans to hire-purchase finance companies or to local authorities. The spread between rates paid on dollar deposits and the far higher rates received on domestic loans does not, however, represent a net return to the British banks, since covering the exchange risk by the purchase of forward dollars has usually involved paying a substantial premium for such dollars and this represents an additional cost. Japanese banks also have been reported to have converted substantial amounts of dollar deposits into their own currency.

Many other banks also make use of the continental dollar market to engage in covered interest arbitrage in various forms. The existence of an active market for dollar and other currency deposits greatly facilitates interest arbitrage operations. Arbitrators may take in dollars, swap them into another currency, and then employ them for short-term investments, say, in Treasury bills, if and when the interest rate differential after adjustment for the swap costs makes such a transaction worthwhile. Quite a number of European banks, notably among the so-called intermediaries, employ dollar and other foreign currency deposits for such operations, occasionally combining two or more swaps to maximize their profits. The total amount of dollars employed in interest arbitrage is not known, but is believed to be smaller than the aforementioned uses of dollar deposits.

#### IMPLICATIONS OF THE MARKET

With the development of the continental dollar market, European banks now have easy access to a large pool of funds that can be used to cover their dollar financing needs. Since European banks have been willing, moreover, to accept a relatively small spread between the rates they pay on foreign currency deposits and their lending rates, they have been able to offer their customers rates well below either the commercial bank prime loan rate or the cost of acceptance financing in the United States. One consequence has been some relative decline in the position of New York as an international lending center—a development which is confirmed by statistical evidence showing that in recent years acceptance and other credits extended by U.S. banks to British, German, and Italian banks have declined significantly.

The continental dollar market also has had the effect of sharply increasing the volatility of some foreign dollar balances. As noted above, substantial amounts of dollar deposits offered in the market represent balances that previously had been held in the form of time deposits with U.S. banks. True enough, the balances underlying the continental dollar market ordinarily remain in U.S. banks as demand deposits. But there is a great difference for a New York bank between a firmly lodged foreign time deposit, with its relatively low reserve requirement, which may be invested in relatively high-yielding loans or investments, and demand deposits that foreign banks manage and employ actively. As such balances are drawn upon by their foreign owners and transferred to other banks abroad who in turn redeposit them or otherwise make use of them, the volatility of these deposits tends to be high—a definite disadvantage to the U.S. depositories in the management of their own money position.

Although the continental dollar market has somewhat reduced the importance of New York as an international lending center, it has added to the importance of the dollar as an international currency. Perhaps the greatest attraction of the continental dollar market to lenders derives from the fact that it offers opportunities for very short-term investments at rates substantially in excess of those available elsewhere. In fact, it permits dollar depositors to earn interest on demand deposits—which is, of course, not possible in the United States. The covariation of interest rates in the continental dollar market and the New York money market appears to be quite close, except in periods of very easy conditions in the New York money market. Rates for continental dollar deposits for 3 months, as quoted by London merchant banks, are usually considerably above those for U.S. Treasury bills and bankers' acceptances, while 1-month deposit rates are always substantially above U.S. Treasury bills with 1 month to maturity. The prevailing rate differentials in part reflect, of course, investment quality differences, but the fact remains that the continental dollar market has given birth to a new relatively high-yielding and now firmly entrenched and widely used outlet for the short-term investment of dollar funds. In this sense the dollar has become more useful, and banks operating in this market will probably tend to hold on to dollar assets for more extended periods than they would in the absence of the market.

In conclusion, a few words about the repercussions of the market in the European banking and money market structure. Lending of dollars and other deposits to importers has importantly contributed to interbank competition in Italy and France. Another significant effect of the market is the relatively easy access to foreign exchange resources that it has afforded to smaller European banks. At a price, they can within broad limits secure additional dollar and other currency deposits and thereby free themselves of the limitations of their domestic resources. This has further contributed to interbank competition in the countries concerned.

On a broader plane, the easy access of banks to deposit balances abroad has given an additional spur to the intermeshing of money markets throughout Europe. Even without the development of the continental dollar market, the increased freedom with which funds have been permitted to move from one market to another in recent years has been a major force contributing to the interlinkage of national money markets. But the ability of banks to enter an established market for dollar deposits, and thus to obtain on their own initiative funds that they may swap into other currencies, has made for even closer integration. By the same token, the succession of interdependent short-term claims imposes risks of vulnerability, since the liquidity of each participant in the market becomes in part dependent upon the ability of the ultimate borrowers to meet their obligations.

**Mr. KLOPSTOCK.** The Euro-dollar market had various effects on the U.S. balance of payments. On balance, I believe the market has been beneficial to our international financial position. The interest of foreigners in holding on to dollars or purchase dollars has increased because the market offers a profitable investment outlet to foreigners for dollars. They can earn attractive interest rates by placing dollar deposits in this market.

**Senator PROXMIER.** What is the Euro-dollar? Isn't it just a dollar that the Europeans hold?

Mr. KLOPSTOCK. Exactly.

Senator PROXMIRE. To trade in Europe. How does this result in interest yield?

Mr. KLOPSTOCK. The instruments traded in the Euro-dollar market are actually dollar balances in American banks. These are held by foreign banks and corporations. Other foreign banks are interested in accepting these balances and are willing to pay interest for these balances if they are put at their disposal. These acceptors of these dollar balances in American banks then employ them for various purposes. They may, for instance, extend dollar credits to their customers. The fact that a substantial amount of the demand for dollar credit has been satisfied by foreign banks that have obtained the requisite balances in the Euro-dollar market is of importance to our balance of payments. In the absence of this facility or the absence of the ability of the European banks to finance these credit demands, their customers may well have come to American banks for dollar credit. The total outflow on short-term loan account from the United States would have been larger than it actually has been.

So, from that viewpoint, the Euro-dollar market has been beneficial to our balance of payments.

Again, to explain or to clarify the workings of this market, the Euro-dollar market deals in balances that are held in American banks. These balances are transferred from the depositor in the market to the acceptor in the market. The acceptor may use these balances either in the form of dollars to extend loans to his customers or he may employ these dollars to purchase foreign currencies and invest these foreign currencies in foreign money markets, which also has occurred on a large scale.

The market has added to the usefulness of the dollar as an international currency, and for that reason to the foreign demand for dollars. This undoubtedly has helped to reduce the demand for gold because dollars supply pressures in foreign exchange markets, and therefore, accruals of dollars to the accounts of foreign central banks have tended to be less. Some of this favorable effect has been lost however, as a growing proportion of these deposits has been used for transactions involving swaps into sterling, lira, yen, and other currencies.

The market has its negative aspects. There has been a sizable outflow of dollars owned by U.S. residents, into this market, notably via time deposits in Canadian banks. The market constitutes a large pool of liquid funds readily available for speculative attacks against the dollar and other currencies. Speculative purchases in the London gold market have been financed with Euro-dollars. Also, banks and other borrowers in several countries have used the market to escape monetary restraints imposed by their central banks. And the succession of interdependent short-term claims, characteristic of the market, has introduced risks of vulnerability into international financial relations.

Senator PROXMIRE. I regret to do this, but I just have about 2 minutes to get to the floor to vote. I think this was my last question. I think this is a very excellent and lucid explanation and very helpful.

I take it you can put this in the record. It will be very helpful to the committee, I am sure, and I want to thank the gentlemen of the

panel. This has been very interesting and helpful testimony this afternoon.

This is the crux of the problem that we have run into over and over again, that monetary policy stops at international payments, and the frustrating answer has too often been that we have to have high interest rates. You gentlemen have cast some light rather than a roadblock under these circumstances and given us very balanced testimony. We appreciate your appearance.

The committee will reconvene tomorrow morning at 10 o'clock in this room.

(Whereupon, at 4 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, August 15, 1962.)



# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

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WEDNESDAY, AUGUST 15, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, and Thomas B. Curtis; Senators Proxmire and Javits.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will be in order.

The committee continues hearings on the state of the economy and on policies to achieve maximum employment, production, and purchasing power.

This morning we are most interested in monetary policies, and we are happy to welcome back again, as our first witness, Mr. Marriner S. Eccles, chairman of the board, First Security Corp., Salt Lake City; chairman of the board, Utah Construction Co., and former Chairman of the Board of Governors, Federal Reserve System.

In fact, Mr. Eccles served as Chairman of the Federal Reserve Board longer than any other person has ever served. Mr. Eccles, will you come forward, please, sir.

You may proceed in your own way and after you have completed your opening remarks, members of the committee may wish to ask questions under the 10-minute rule.

We certainly appreciate the fact that you were willing to take time out from your busy schedule to come here and give us the benefit of your long experience and knowledge. We highly regard you and appreciate the fine public service you have rendered in the past, Mr. Eccles.

## **STATEMENT OF MARRINER S. ECCLES, FORMER CHAIRMAN OF THE BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM AND CHAIR- MAN OF THE BOARD, FIRST SECURITY CORP., SALT LAKE CITY**

Mr. ECCLES. Thank you, Mr. Patman.

Mr. Chairman and members of the committee, I am complimented to be invited again by this important committee. It is just 1 year and 4 days since I was last here. I should like to feel that I was making a contribution, but I am more inclined to think that my presence here is due to the indulgence of my friends on the committee.

Since I accepted this invitation only a week ago I have had little time and no assistance to prepare the comprehensive statement that this hearing deserves. I have, however, undertaken to write a very short résumé of some of the pressing current problems that face the country today as I see them and what might be done about them.

I hope this will serve as a helpful basis for your interrogation.

Our basic problem seems to be the inability of our economy to generate sufficient growth to utilize our available resources of labor, material, and productive facilities which are our real wealth.

At present the results of this are unemployment of more than 5½ percent of our labor force, extensive idle facilities, an increasing Federal deficit, and tendency toward a recession in the economy, with an increasing international balance-of-payments problem.

These situations tend to bring about a weakening of the dollar, an unstable stock market (due to expected reductions in corporate earnings) and a sagging real estate market, evidenced by increasing foreclosures and a slowing up of housing construction.

The dilemma in which we now find ourselves is not of sudden origin, but is the result of an accumulation of past failures to face up to and to deal with the basic economic problems that have confronted us.

Our failure to recognize our economic limitations is the principal reason for the deficiency in our international balance-of-payments—our most serious problem. During the past 15 years we have disbursed over \$100 billion in economic and military aid, not including our own extensive military expenditures abroad.

This, together with large private foreign investments and expanding foreign travel by Americans, has drastically changed the position of Western Europe from one of a dollar shortage to a dollar surplus.

During this same period excessive increases of wages and fringe benefits of organized labor in this country have tended to price American goods and services out of the world markets and the domestic markets as well.

This has, in effect, deprived us of much of the economic freedom which we formerly enjoyed since we now find ourselves locked into a world situation which we can no longer control.

I do not believe there are any pat or ready solutions to these complex economic and social problems that have built up over the years, but I do feel the present situation, which could easily lead into a serious recession, calls for temporary action now, with permanent tax reduction next year.

While I cannot say we face an emergency, I can see no reason to wait until next year to reduce taxes.

This was written before the President's statement. So I didn't change it because it doesn't change my views any.

Why not act now before there is an emergency and in this way prevent a recession from developing?

There is every indication that this economy has reached a stalemate and may be heading downward. As I see it, the immediate situation calls for a reduction in individual income taxes as well as consumer taxes.

I would recommend that individual income taxes be reduced 5 percentage points across the board. This would be from 20 to 15 percent

and from 90 percent to 85. It is 5 percentage points. In my opinion this action is overdue. In making this recommendation I believe permanent adjustments and reductions should be made in individual as well as corporate taxes immediately after the first of the year.

Although corporate profits after taxes are today virtually the same as they were 10 years ago, the funds available for capital expenditure have increased about 75 percent during the decade. This provided increases of 400 percent in research and development, 80 percent in new plant and equipment, and 50 percent in dividends. The broad increase in depreciation and depletion has largely made this possible. Therefore, although I would favor a reduction in corporation income taxes next year, this would do little at this time to encourage capital expenditures that would otherwise not be made.

Business, generally, has ample funds for expansion, or available unused credit. Capital expenditures by corporations largely depend upon an increase in demand for their products, or competition which induces them to make capital expenditures to reduce their costs. Such expenditures are seldom made just because of confidence. Confidence is an effect and not a cause.

Consumer spending is the propulsion that generates the demand for goods and services which is the justification for capital expenditures and growth. Therefore, a reduction in individual taxes, I believe, is called for at this time. Such a reduction would be much more effective than an increase in public expenditures. An increase in public expenditures and corporate capital expenditures are slow to get underway. It is desirable for the individual to spend his income himself, rather than have the Government spend it for him. Further, it is more likely to get immediately into the spending stream. This does not mean that I do not recognize the necessity for a continuing and expanding Government program of expenditures to meet the economic and social needs that private capital cannot provide.

I recognize that any tax reduction program at this time will increase the Federal deficit. However, with the excess supply of goods and services and foreign competition I do not believe this will be inflationary. On the contrary, it should prevent a recession and stimulate growth.

The Federal deficit, under present conditions, should be financed, as far as possible, outside of the commercial banking system. This would help maintain confidence in the dollar. The long-term interest rate paid by the Government must be high enough to compete in the capital market with mortgages and corporate financing. Short-term rates should be high enough to keep the large amount of short-term foreign funds in the U.S. market.

I know that in a recession or in an economy that is not growing, an easy money policy is the desirable type of policy to pursue. I recognize that to have funds pressing on the market does not necessarily mean they are going to be used, but it does mean they are creating a favorable climate for their use. But under the present circumstances, it seems to me that we can't ignore the international situation when considering monetary and credit policy.

I strongly feel that Federal expenditures are unjustifiably increasing in many categories. The public is not getting value received. This I believe is especially true of the rapidly expanding military

program and the continuing foreign military and economic aid program.

In this connection, it is time that we faced the international situation as other countries do. We spend far more of our national product on the military than any of our allies do. We have been carrying the load for many years almost entirely alone.

In the foreign aid field we have done likewise. With the position occupied by Western Europe, it is past time that they carried much more of their load. We have to look more to our own interests and insist that the countries that have the surplus dollars, that we have made possible for them to acquire, undertake to carry more of the burden than they are carrying and that we carry substantially less of that burden.

Now I would like to further consider the monopolistic powers of organized labor which are largely responsible for the slowing of the growth in our economy, as well as the continuing deficiency in our international balance-of-payments. These, our two basic problems, are inseparably connected and our failure to face them is responsible for our present dilemma.

This country is finding it increasingly difficult to sell goods in the world market. With wages two to five times less in Western Europe and Japan, this should be expected, since productivity in these countries is rapidly increasing and approaching that of the United States. In the light of this situation, the dollar is overpriced in relation to other currencies. If this condition persists the United States cannot maintain its position as the reserve currency country and world banker. This responsibility will have to be taken over by an international monetary organization where currency values can be adjusted upward or downward over the longer period as the need is determined.

In the meantime, further increases in wages and fringe benefits, as well as salaries, must be curbed. The benefits of increased productivity should be reflected in lower prices or superior products. Foreign economic and military aid must be sharply reduced. Our overseas military expenditures should also be reduced. Foreign travel and expenditures by U.S. citizens must be restricted. Foreign investments by U.S. corporations should be controlled. Borrowing in this country by foreign companies and foreign governments should be regulated. The law requiring gold reserve backing for Federal Reserve notes should be repealed. The alternatives are quotas, embargos, exchange controls, with an ultimate devaluation of the dollar.

Organized labor represents about 25 percent of the labor force. There is a wide discrepancy between the income of the organized group getting between \$3 and \$6 per hour, including fringe benefits, and most of the 75 percent of unorganized workers earning between \$1 and \$2 an hour. The disparity in the incomes of these groups makes it increasingly difficult to exchange goods and services, resulting in unnecessary unemployment.

How can workers earning from \$1 to \$2 an hour buy or rent houses or apartments built by unions with common labor getting, in wages and fringe benefits, \$3.52 per hour now and \$4.02 in 2 years? Plumbers get \$5.78 per hour now and will get \$7.55 per hour in 2 years, and other union wages in proportion. These are recent strike winning settlements in the building industry in northern California.

Nor can we hope for any relief if it is left up to the decision of the union leaders. As an example of the attitude of some of them, I quote from Mr. Hoffa's statement made in San Francisco August 4 to the telephone workers, on his philosophy of unionism :

It takes a big rich union to wring money out of a big rich company. Little strikes are a waste of time against an employer whose business spans the Nation.

There is no thought given to the public interest. Much has been said of the monopolistic power of business, but the real monopoly today that is creating our problems is the monopoly of organized labor.

In the public interest, laws should be passed to deal with this menacing situation. Strikes, as well as lockouts, should be outlawed. Where there are conflicts, compulsory arbitration should be provided, with the right of appeal by either party to labor courts to be established.

We should not tolerate private groups dominating our Government and our economy by means of organized monopolies. A few men at the top exercising such power constitute a private dictatorship of public policy and must, in the interest of our country, as well as labor itself, be courageously dealt with by both political parties. This can no longer be considered a party issue. It is a most important national issue, almost as important as national defense.

I feel that it is necessary to face up to the basic issues which I have discussed, whether popular or unpopular, and that this is neither the time nor the place for timidity.

In closing, I wish to thank the committee for the opportunity of appearing here today.

Chairman PATMAN. Thank you, Mr. Eccles.

I want to take advantage of this opportunity to question a witness who, I believe, knows more about the Federal Reserve System than any man in the United States, about some of the practices and procedures and requirements of law concerning the Federal Reserve System, and particularly the Open Market Committee.

Do you consider the Open Market Committee more important, in that it has so much power, than even the Federal Reserve Board, Mr. Eccles?

Mr. ECCLES. You cannot separate them. The Board constitutes 7 members out of a 12-member committee, and the Chairman of the Board has always been the Chairman of the Open Market Committee.

The secretary of the Board during my period as Chairman was the secretary of the Committee, and the Director of Research was the economist for the Committee. Therefore, the Committee cannot be considered separate from the Board.

I feel that the Open Market Committee—let me put it this way—the open market function is possibly the most important function of the Federal Reserve System. The Banking Act of 1935, which I had the responsibility of sponsoring, title II of that act, in 1935—I was the Governor at that time and the new bill brought about a change in the organization and I became the first Chairman who had not been Secretary of the Treasury—this bill which I helped to write and sponsor through the Congress, provided that the Open Market Committee be composed of only the Board.

Chairman PATMAN. That is, as it passed the House.

Mr. ECCLES. That is as it was in the bill and it passed the House in that manner. It got bogged down in the Senate and it came out of the conference committee in its present form.

Chairman PATMAN. I remember that.

What I meant, Mr. Eccles, considering the fact that the Open Market Committee has complete charge of the portfolio, and the power to buy bonds and acquire \$25 or \$30 billion worth of assets, and that the Federal Reserve Board does not have such power, acting alone, it has more power than the Congress and the President, in a way.

It is true that the Federal Reserve Board has the power to change discount rates and change reserve requirements, but don't you think the greatest economic power of any body on earth is the power of the Open Market Committee today? So much depends upon monetary policies. Laws that we pass can be strengthened or their usefulness impaired by the actions of monetary authorities. That is true as to the actions of the President of the United States as well.

For that reason, don't you think that the Open Market Committee is really the most powerful group in the United States today?

Mr. ECCLES. In the field of money and credit, yes. That is the limit of their powerful authority. Now, I realize that certainly in the economic field that power over the supply of money influences the entire economy and is, of course, a very, very great power. You can restrict the growth of the supply of money. As a matter of fact, you could effectively stop the growth of the supply of money through a sufficiently tight monetary policy.

You can provide a very, very easy money policy. You can make bank credit available in an unlimited amount. But it doesn't necessarily mean that it will be used. During the 1930's there was a period when the large flow of gold came into the country, and the excess reserves or free reserves ran into the billions, and the Federal Reserve had used all of the power it had to increase reserve requirements, and there were still these huge reserves. It didn't get us out of the depression. The credit was not used.

At that time the interest rate went almost to zero. The Treasury stepped in and helped the Federal Reserve by sterilizing some of the gold that was being brought into the country. Instead of putting it in the system and adding further to the excess reserves, they sterilized it. That was an example that easy money, by itself, does not assure the economy is going to get out of a recession. I think it was Judge Goldsboro who at that time was not Chairman—

Chairman PATMAN. He was next to the Chairman.

Mr. ECCLES. He was next to the Chairman. He said to me at that time, "You mean you can't push on a string?" I said, "I think that is a very apt description of the effect of easy money under certain conditions."

Chairman PATMAN. May I clarify this just a little bit?

It is unfortunate that your views did not prevail to make the Federal Reserve Board the Open Market Committee. Then you wouldn't have people making monetary policy who are in a position to be persuaded to help the private bankers.

I feel it is unfortunate that we have members on the Open Market Committee who have been selected by the directors of the 12 Federal Reserve banks, two-thirds of which directors are selected by the bankers themselves.

I think you were right in your position on this, and I am so sorry it was not accepted. But in this agreement that finally came out of

conference and became law; seven members of the Board and five Presidents of Federal Reserve banks were to constitute the Open Market Committee.

Now, as you realize, the decisions made by this important group should not be divulged as they are made currently. That would help the speculators, who would want to use it. It would be of great benefit to them.

When you were Chairman of the Board, did you permit any person to come into that room where the Open Market Committee was in session, except the authorized people and certain staff people which you had to have?

Mr. ECCLES. I think the other presidents were present upon occasion when general policies were discussed. I think we had at that time a presidents' conference.

Chairman PATMAN. Was that the official Open Market Committee in session, Mr. Eccles?

Mr. ECCLES. I don't remember. I couldn't say whether it was or not. I think so long as you have five presidents members of the Open Market Committee, and all but the president of the New York bank rotate, that there may be some justification for others being present so as to be prepared and be informed currently.

I wouldn't have concern about the nonmember presidents being present. They don't have the voting power. I don't think they expressed their opinions with reference to policy matters unless invited to do so.

The fact that the position rotates from one president to another tends to, I think, keep them all in touch with the situation. I must say that I don't remember, at least while I was there, of any bad results coming from the meetings of all the Reserve bank presidents with the committee.

I have felt that it was inappropriate to have people on the committee, other than the Reserve Board, irrespective of their ability, and I must say that most of the presidents of the Reserve banks are outstanding. At the present time there are many who are trained economists, who have been the director of research of their bank, and they are very able.

The Board did get, in the Banking Act of 1935, a provision which gives them considerable influence, and that is, they have the veto power over the election of presidents and their salaries. However, I have felt that the Open Market Committee should be composed of those people who were appointed by the President and who were confirmed by the Senate, and whose salary is fixed by the Senate. They have a direct responsibility to the Congress.

The presidents of the Reserve banks are, as you say, elected by the nine directors of the bank. Six out of the nine are elected by the member banks. Their salaries are in the first instance fixed by those boards. It is true that the Board in Washington can veto their election and salaries. I think that it has worked pretty well considering the type of organization that came out of the Banking Act of 1935.

Chairman PATMAN. My time is up, Mr. Eccles, but I do want to make this suggestion: that you give further consideration to your thoughts as expressed. The Open Market Committee, by law, is set up and composed of 12 members--7 members of the Board and 5

presidents of the banks. That is the law. That is the Open Market Committee.

They have to take an oath to faithfully execute the laws, and go according to the Constitution, as members of the Open Market Committee. When you carry the seven members of the Federal Reserve Board into this Open Market Committeeroom, and you permit the five presidents to come in who are part of that organization and who have taken an oath as a part of that organization, it occurs to me that you should exclude everybody else, because anybody else coming in, those other seven presidents, they have not taken an oath at that time as other members have to take.

They are not qualified at that particular time. They alternate different years, as we know, but at that particular time they are not official members of the Open Market Committee.

I deplore the fact that these Open Market Committee meetings are almost like a townhall meeting, it could mean so much to people who have this valuable information, if they cared to use it.

I think I was informed when you were Chairman of the Board that the people who have this information are not obligated not to purchase Government bonds or to sell Government bonds, benefiting from the knowledge that they have at these meetings.

They are only urged not to buy bonds on margin; but it is considered perfectly all right for them to buy bonds outright. I personally think it is in violation of the law to have what is, in effect, a 19-man Open Market Committee instead of a 12-man Open Market Committee. That I shall pursue when I get back to you. My time has expired.

Now, I shall yield to Mr. Curtis of Missouri.

Representative CURTIS. Thank you, Mr. Chairman.

Mr. ECCLES. I have had a chance to read your statement. First, I would like to determine, in your recommendation of a tax cut, which philosophy you are following: whether the philosophy of the quickie tax cut, as some people refer to it, or the philosophy of basic and permanent tax reform, or a mix?

Mr. ECCLES. Both. I am thinking of the quickie now which I think is overdue. I think when the economy leveled out that the quickie tax cut should have been passed. I was in favor of the recommendation of the Commission on Money and Credit, of which I was a member. We recommended to give the President the standby power to reduce temporarily certain individual taxes if certain economic conditions developed.

That is the tax I am talking about. I am also in favor of the proposal that the President has made for an overhaul of the tax system. I think taxes generally are too high. We are taking too much out of the economy. There should be some basic adjustments and reform in the tax system. That could wait until after the first of the year. I am in favor of that.

Representative CURTIS. I am personally very strongly in favor of basic tax reform, and tax rates. I point out that should occur regardless of what the economic picture is and that is permanent.

Mr. ECCLES. In general I agree with that. But I think if we are in an inflationary situation we could certainly wait. I do not feel that taxes should be cut if we are fully utilizing our manpower and our productive capacity and inflationary pressures are developing.

Then certainly it would be no time for tax cuts of either corporations or individuals.

Representative CURTIS. I happen to think it would be if it is real reform. In other words, if the error lies in the fact that our taxes are impeding economic growth, and I certainly think I can point to many areas where it is.

I want to get back to the thesis with which I am in disagreement, to try to develop your reasoning. You point out that you would have this tax cut even though we didn't cut expenditures and state this would recognize that we would have a larger deficit.

But then you state that this deficit would be financed, as far as possible, outside the commercial banking system.

The first point is that I think those who advocate this—and I must apply this to your paper, too—beg the question. The thing we are trying to find out is, would a tax cut stimulate the economy? That is the issue. Most people who have argued for it just presume that it would.

When you say that you would finance this additional debt outside the commercial banking system, let me say this: Why do you figure that cutting \$5 billion out of the tax revenues and turning it over to the private sector and then coming to the private sector and taking back \$5 billion in bonds would be a stimulus?

Mr. ECCLES. The stimulus would be largely in the payroll tax cut. I mean the tax reduction would increase the payroll immediately.

Representative CURTIS. Who will buy these bonds?

Mr. ECCLES. There is a great difference between the financial status of the people in the American economy. There is a large amount in various types of savings funds today. You also have a large number of your lower income groups heavily in debt. I believe the tax saving would be spent either directly or indirectly.

Representative CURTIS. This is not the lowest income group we are talking about. We are talking about Federal taxpayers. That is not the lowest income group.

Mr. ECCLES. If you cut taxes of persons in a high income bracket, they may not spend that money. They may invest it. But it would go back somewhere into the spending stream. In any case that is a small part of the tax savings.

The large amount of funds would come in the first bracket from 20 to 15 percent. That is where the great bulk is.

Representative CURTIS. Let me suppose this, now.

The Ways and Means Committee, on which I serve, has the problem of how to market the debt. Suppose we decide to do it in E-bonds and sell E-bonds through payroll deduction, and suppose that is where you were marketing. Where is your economic income?

Then you get back to the aggregates. You take out \$5 billion in tax cut and you turn it over to the private sector and then you withdraw \$5 billion. As I understand your suggestion, because of the mix, it would be a different group.

Mr. ECCLES. Your long-term investment bonds, if they were at a higher rate, would be competing in the market for the investment funds of institutions. There is a huge amount of funds in the insurance companies and savings banks and various trust funds that may not be used to the extent they should.

I think there is not any large growth in the money supply, demand deposits and currency. The growth has been in time funds that have gone into savings because of the high savings interest rates.

I believe that the Government deficit could be largely financed by putting into use some of these trust and savings funds now with institutions.

Representative CURTIS. Here is what I am getting to, Mr. Eccles. This is a theory that has never been tried anywhere. The witnesses, including yourself, who come forward here with prepared papers, don't go into the things that we are now trying to discuss. In fact, all they do is just pass this problem over into the debt management field and say, "This will create debt management problems."

But that is the issue. That is what we need to know. What are the economic impacts of these added debt management problems, particularly as we know they impinge on our monetary policy? In fact, that is why you say outside the commercial banks, so that it won't impinge on monetary policy.

All I am doing is pleading with the people who agree with you, including your Commission on Money and Credit, who in my judgment did not do an adequate job of dealing with these problems. I am trying to bring out, How do we meet these problems of debt management?

We have a \$90 billion rollover of this big debt now. We have people who are withdrawing their E-bonds. The balance is going the other way.

Mr. ECCLES. That is because of interest rates.

Representative CURTIS. I don't care what it is because of. I am saying that you are dumping on the backs of those of us who have to concern ourselves with debt management problems added burdens and just dismiss the economic impact because you think that cutting taxes with a quickie might stimulate the economy. That is all I am saying.

You have given us the problem and then have not discussed in your paper, at any rate, the problems that you have created.

Mr. ECCLES. Your real economic impact is created by a recession, by not having the national product higher, if it can be higher. Debt is related to the gross national product. Debt is large or small in relation to the size of the economy.

If you permit a recession, you have great difficulty supporting a debt. The philosophy during the 1930's was that we should balance the budget because the income is low. The Government can't afford to carry the debt.

In my opinion, the debt is large or small in relation to the gross national product. Our debt is not a large debt in relation to the size of our gross national product. It is about—

Representative CURTIS. Sixty percent of what it was in 1945.

Mr. ECCLES. But the gross national product has grown more than 60 percent.

Representative CURTIS. I am talking about the GNP. It is about 60 percent less relating debt to GNP.

Mr. ECCLES. Yes, that is right. The thing that concerns me is the failure to utilize your manpower and your productive facilities. That is your real wealth. The Government is the only one that is big enough to act and to counter the failures in the private economy.

It may be very cheap to have a tax cut, even if it creates a deficit. You can't cut expenses immediately, I realize, but I do think you should certainly tend in that direction. I feel, but I can't prove it, if the millions and millions of workers get more in their payroll check every 2 weeks, that is likely to be spent, even if they have savings accounts.

They may be budgeted. They may budget their savings. They may budget their insurance. They may be hard pressed. If they get more in their paycheck, I am sure that it would go into the spending stream and it would go in very quickly.

Representative CURTIS. My time has run out. I will come back to this when I get a chance, because I think you are begging the question and I do want to explore this very question of economic growth.

Representative REUSS. Mr. Eccles, you made a number of recommendations. There is one that I would particularly like to explore, the one where you recommend that strikes be outlawed and that compulsory arbitration be provided.

You arrive at this recommendation which is, in my opinion, an extremely drastic one, because of our balance-of-payments situation, I gather. The key sentence in your written paper seems to be on page 5, which says:

This country is finding it increasingly difficult to sell goods in the world market.

Mr. ECCLES. That is only part of it. I think that happens to be the dilemma that we are confronted with at the present time. Certainly I feel that we should avoid the inflationary impact of wage increases and price increases. I am not one of those that believe in a continued inflation.

I would like to see stability in our economy. I would like to see the insurance and savings of the public protected. I would like our dollar to be a strong currency. It is a strong currency if you have price stability, adequate growth, and employment. It seems to me that we have, as you know possibly better than I, pretty much failed to deal with this monopoly of organized labor.

The demands that have been made by some of the leaders are unreasonable, certainly in relationship to the state of the economy. Their wages and fringe benefits have far exceeded productivity, and productivity, in my opinion, should not go entirely to organized labor. Productivity comes as the result of new investment and not due to the increased efficiency necessarily of organized labor.

There are many features of the situation, your featherbedding, which the President and Mr. Goldberg are trying to get at now. I think they have a formula. I think they recognize the problem. If there is some other way of working it out, fine, but it seems to me we do need some kind of legislation that is going to put a restraint upon the powers of organized labor.

Representative REUSS. Let me say I thoroughly agree with you, Mr. Eccles, in being opposed to inflation. I recognize there is a wage-price problem. Others in the Congress and I have advocated for some years that there should be a mechanism within the Federal Government for at least focusing the spotlight of an informed public opinion upon wage or price increases which would endanger the national stability.

While I think under the President and Mr. Heller we have made some progress in this direction, we need to do more.

Mr. ECCLES. I think we have made a start for the first time.

Representative REUSS. Yes. However, I am concerned at your recommendation which goes so far beyond that. It would take us in the direction of the kind of corporate state which once existed in Italy. Management and labor would lose their present rights to make a bargain, and, instead, rights would be vested in the state.

I want to explore with you the justification you put forth in your paper for so radical a remedy, namely, that this country is finding it increasingly difficult to sell goods in the world market.

I call your attention to our export figures in the current U.S. Department of Commerce Survey of Current Business, which shows for the last 5 years we have been increasing our exports. For example, they went from \$16,263 million in 1958 to \$16,282 million in 1959, to \$19,459 million in 1960, to \$19,915 million in 1961.

So far as one can project this year's figures, it looks as if we will top the 1961 record this year. Thus, we have a situation where every year for the last 5 years we have increased our exports. Doesn't this record show that we have been able to hold our own in the world market?

Mr. ECCLES. I realize that we have increased exports, but also, imports have increased as the recovery has taken place in Japan and in Europe. We are finding it increasingly difficult to export. True, we are getting some increase. The increases are in certain categories. The question is, how long?

Food is a big item. Machine tools and so forth. There are certain things that are produced here that are not produced elsewhere that we have been able to sell in large quantities. We, however, have provided a lot of the credit for those purchases. The large amount of credit that this country has provided, both private credit and Government credit, has been the big factor in supporting these exports.

In spite of the exports that we have made, we are in a very difficult situation with reference to our international balance-of-payments, I feel that the trend is running against us.

We must do something to eliminate the deficiency in our international balance-of-payments. We have gone just about as far as we can go in that direction. Our exports are not sufficient to offset our lending and aid programs, together with our imports, foreign financing that is being done in this country, American capital that has gone abroad.

We have come into a situation where this year, it is true—and this may be temporary—where our deficiency in balance-of-payments has been less than in periods of the past.

Representative REUSS. I think export expansion is the most important single avenue for overcoming our balance-of-payments situation. In view of the fact that, far from falling off, our exports have increased in the last 5 years, is it necessary, in your opinion, to go immediately to a radical remedy for the wage-price spiral like making strikes illegal and substituting compulsory arbitration throughout the country?

Wouldn't it be better to experiment a little more with what the administration is now attempting to do, that is, setting standards which

will guide responsible unions and employers, inform public opinion, and have an effect on what goes on at the bargaining table?

Mr. ECCLES. If it can be successful, that would naturally be the preferable thing to do, but when you have a situation such as just existed in northern California—a 60-day strike in the whole northern end of the State by common labor demanding and getting \$4 an hour, including fringe benefits, in 2 years and now the carpenters are threatening to strike after being out of work 60 days—then compulsory arbitration may be necessary.

Mr. Goldberg wanted the carpenter leaders to come back to Washington. They refused and indicated he was interfering. That is the immediate situation. The Taft-Hartley bill has been helpful in enabling the President to stop the Pan American Airlines from being shut down. In an attempt by the railroads to eliminate feather-bedding the railroad union called a strike which has been temporarily prevented by a court injunction. At this point we don't know what the outcome will be.

If there is some other way of meeting the situation, you may not go so far as a compulsory arbitration, but the public interest is certainly involved when you get to these national issues. You can't have a prolonged strike without affecting the wide public interest. There should be some way of having the public interest protected in these situations instead of considering only the rights of the employer and the unions. It is not only the companies and the unions that are involved, it is the whole public interest. The trend has been in the wrong direction, from my way of thinking.

Representative REUSS. Of course, the public interest has to be involved, and we must seek mechanisms for having it represented at the bargaining table along with labor and management.

I hope you will mull over a little bit whether we need now to adopt by law a nationwide policy which says that nobody can strike and that in every labor dispute there has to be compulsory arbitration. This I respectfully suggest goes much farther than is needed to handle problems of the dimensions we now have.

Chairman PATMAN. Senator JAVITS.

Senator JAVITS. Mr. Eccles, first I join in welcoming you to our committee and looking into this very critical subject.

I find it very interesting that you do two things which appeal to me very much: One, you advocate an immediate tax cut. The President has dashed the hopes for that and I think that settles it for now.

Mr. ECCLES. I recognize that.

Senator JAVITS. I am sure you do, Mr. Eccles.

Do you feel that this is an unnecessary risk we are running which may edge us over into a recession and not give us any correlative benefit, as you explain, in terms of dealing with the deficit question?

Mr. ECCLES. I do feel that it is a risk we were not justified in taking. I feel when the economy leveled out, the growth seemed to stop and, the unemployed did not decrease, there were certain factors that called for some action.

I don't say we are in a recession, but we are tending in that direction. When growth stops, your tendency is toward a recession. There is always a danger that a situation of that sort can become cumulative

and the cost of reversing it gets increasingly expensive as it turns down, so you don't economize by not facing it or meeting it at the time that it develops.

As I indicated before you came in, my tax proposal is temporary. I would favor a program of permanent tax reduction and adjustment. I believe that taxes, generally speaking, are too high, and there should be some adjustment in taxes. There should be some curbing in expenditures, particularly in our foreign-aid programs, and where there are obvious loopholes, something should be done about it.

Therefore, I think we need some tax reform that can wait until after the first of the year, so I am not opposed to the President's program. This was merely to meet a current situation.

Senator JAVITS. From your experience with the Government, would you say that the issue is dead in this session?

Mr. ECCLES. I would think it is possibly dead unless the situation should deteriorate so that it was necessary to call a special session. I would rather doubt that it would go that far so soon.

I think maybe we have enough built-in factors, such as unemployment insurance and public expenditures, to help hold up the economy. The present public deficit certainly tends to support the economy.

Senator JAVITS. I was very interested, too, in your feeling that a tax cut is not the only thing we can do, but we ought to tighten up our procedures with respect to labor and strikes which affect the national interest.

Would you feel that your alternative was the only one, or would you be willing to have considered, for example, the possibility of some limited seizure power on the part of the President?

For example, I have urged seizure and operation to the extent required by the national health and safety.

Mr. ECCLES. I would certainly think where it gets to the question of the airlines, such as Pan American, as large as that is and operating in the international market, or the railroads, that there certainly should be power of seizure. The public interest is so involved that matters of that sort simply can't be temporized with, and you could not permit the paralysis that some strikes would create.

We do need machinery to deal with things such as the west coast shipping situation, which lasted for months and months and months. The effect on the public and the effect on the economy generally was tragic.

This building situation that exists there today, with the outrageous demands for plumbers of \$7.55 an hour, \$14,000 or \$15,000 a year within 3 years, what does that do to the housing situation or construction generally?

Unless you inflate the whole economy and bring everybody up to the same relative income position, how do they pay rents, how do they build houses under these conditions?

Senator JAVITS. Mr. Eccles, the important thing that I think you understand, and that I agree with you on, is that quite apart from other matters, there is much which we can do. The President outlined six measures, all pretty much in the governmental field. We can have an impact upon the private economic system. That is what you recommended.

Mr. ECCLES. That is right.

Senator JAVITS. Therefore, do you feel if we did do something about tightening up our method of procedure on strikes and labor-management relations, that it would have an affirmative effect on the economy in terms of giving us a better opportunity to avoid a recession?

Mr. ECCLES. I certainly do.

Senator JAVITS. I couldn't agree with you more. There are so few people who, it seems to me, flag it quite that sharply, and I am very glad to see you say that.

Would the same thing be true in your opinion—and my time is up—with respect to a better technique in industry for enabling workers to absorb the transition period which automation brings to many of them? For example, there is a great deal of talk in industry now about automation funds, about early retirement, about other means of cushioning the shock upon the individual worker of a more efficient machining of American industry.

Would you feel that, too, falls in the same category?

Mr. ECCLES. Yes, I certainly do. I don't believe you can lay people off and ignore their welfare. I think there must be means provided to take care of those situations, very definitely.

If you can eliminate the job, that assists the entire economy. That can reflect itself in increased production. Our high standard of living is due to the technological development and we must keep it up if we expect to improve our standard of living.

We can eliminate the job, but we can't eliminate the people. They have got to be taken care of. Industry or the Government has to assist, perhaps. There has to be a program created to take care of the displacement of people who are now part of our featherbedding problems in nearly every industry and who are the basis for a lot of these strikes.

Senator JAVITS. I thank you, sir.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. Mr. Eccles, along with the other members of the committee I am delighted and honored to have you here although I find I am in almost complete and total disagreement with everything you said.

I cannot understand how a quickie tax cut can be justified particularly if you are going to sell bonds to the public, as Congressman Curtis brought out so well, absorb all the additional funds that are going into the economy. I cannot see on the basis of all the analysis you have so far why the international payments situation is as serious as you say it is.

I certainly do not agree with compulsory arbitration. I think we can cut foreign aid, but to cut military expenditures abroad now is very hard to justify. Foreign travel restriction, I cannot see how the international payments position justifies that kind of radical action.

Yesterday we had very, very impressive testimony by two distinguished professors both of whom served on the Federal Reserve Board and by one bank vice president, the Harris Bank, Mr. Sprinkel.

In the course of this testimony Mr. Sprinkel made this statement. He said all economic declines—this is on the basis of the Friedman-Meiselman study—all economic declines were preceded by monetary restriction that had reduced growth in the money supply thereby

supporting the argument that monetary restriction leads to less spending. All recoveries were preceded by monetary expansion thereby supporting the argument monetary expansion leads to higher spending.

He said it is worth noting that the consistent relation between monetary exchange and spending exchange is not unique in the United States. He shows in 1929, 1931, and 1937, the larger monetary contractions coincided with the largest economic declines.

He is not talking in generalities or terms of opinion, he is talking in terms of a very careful study of what is happening to our economy. Why does it make sense for us to follow a policy of monetary restriction which is likely to lead to higher interest rates under present circumstances when you feel we may be heading toward a recession and the economy is not growing as rapidly as it should.

Mr. ECCLES. I am not proposing a monetary restriction and I don't entirely agree with the witness that you refer to.

We have had situations in the past during the 1930's when excessively easy credit did not—

Senator PROXMIRE. I was here when you said that. Incidentally, the position taken by Mr. Sprinkel dealt with that situation. He said it was preceded by terrific monetary contraction in the late twenties.

Then at that time it is true we were not able to push our economy out of the depression by monetary ease. At the same time we were not able to do it with deficits. We had enormous deficits that would be equivalent to \$20 billion for 10 years and we still had 14 percent of our force out of work.

Mr. ECCLES. We waited too long. We had a deficit in 1932 in Mr. Hoover's last year; we had a deficit of \$2 billion with a budget of around \$4 billion. But the national product had gone down from \$80 billion to \$40 billion, so it took the war with the kind of deficit that we got then to put the economy back into production and employment.

Senator PROXMIRE. I think I understand what is troubling you. I think the experience of the thirties can be very useful to us. But the fact is this is not the thirties. These are the sixties.

The economic situation is far different and the opportunities that the Government has to prevent a real depression are so overwhelmingly stronger than at that time, the comparison is not very good.

I also wonder if you would feel that we can avoid any recession at any time in the future. It seems to me those who advocate a quickie tax cut now, when we have all kinds of records being broken for GNP, incomes, and so on and the economy is still expanding, are arguing that we should never have a recession.

Any time we have a recession coming up, cut taxes regardless of the deficit situation.

Mr. ECCLES. I don't think we should have recessions. I would certainly never permit one to go into a depression. I would be very much opposed to that.

Senator PROXMIRE. You say never a recession.

Mr. ECCLES. I should like to avoid it. We may get a change in the tempo of growth. I don't think you can always keep exactly the same tempo of growth in the economy. I certainly feel that we should make the effort to maintain adequate growth and to avoid unemployment.

Senator PROXMIRE. I certainly feel we should maintain our growth. But one of the prices we have to pay for a tremendous but free economic system is occasional dips in the economic activity.

Mr. ECCLES. That is right. I agree with that fully. Speaking of the twenties, I feel that the monetary policy was entirely wrong and not justified. Of course, during that time we didn't have the Open Market Committee. You didn't have a central bank functioning during the twenties.

One of the principal difficulties in the twenties was the manner in which the national product was distributed. I think there was too much saved. We had a situation where about 5 percent of the population got 38 percent of the income.

Senator PROXMIRE. You would agree that monetary policy is significant in its effect on the economy?

Mr. ECCLES. I agree it is very significant.

Senator PROXMIRE. Monetary restriction does tend to retard the economy and slow it down.

Mr. ECCLES. I think monetary restriction can stop entirely the growth of the economy.

Senator PROXMIRE. We had a situation as was brought out yesterday in which the money supply has not begun to keep pace with the GNP. We have a tighter relationship of the money supply to GNP than we had even in the 1920's in which you say the monetary situation contributed to our worst recession. We have a situation where the money supply is about 27 percent of the GNP.

Mr. ECCLES. We have a situation today that makes it a little difficult to determine the money supply.

Senator PROXMIRE. That is true.

Mr. ECCLES. There has been a large increase in savings due to the 4-percent interest paid since the first of the year and treating them as demand deposits in many parts of the country. Under these conditions you can't measure your money supply to the same extent that you could when you considered only demand deposits and currency. There is a very substantial part of time funds that are in effect your money supply.

The excess funds of corporations have gone into time certificates to an unusual extent. They are negotiable.

Senator PROXMIRE. This is true.

Mr. ECCLES. You have savings by individuals that in effect are equivalent to a demand deposit, so that the supply of money is not short. The interest rates relatively speaking are not high. I don't think a lower interest rate would be of any help. If the money was unavailable that would make a difference but there is an abundance of money available.

Senator PROXMIRE. I am not talking so much about lower interest rates. I recognize that interest rates are reasonably low on the basis of our historical experience and so forth. I am talking about avoiding higher interest rates in the future.

My time is almost up. I would like to ask my last question.

Mr. ECCLES. The corporate market and the mortgage market rates are not high. They are lower than they are in Europe, than they are in any other place in the world.

I am talking about the long rate primarily. I think our short rate is possibly competitive today with the short rates in England and on the continent.

Senator PROXMIRE. Let us get into that as my last question. Yesterday we had one of the few witnesses who made a study of international balance of payments and the effect of interest rates on capital flow, Dr. Bell, of Haverford University. He made, I thought, a very impressive analysis of the situation.

He said that study of the components of the recorded capital outflow and the movements of capital as well as the timing of the various movements in conjunction with the timing of interest rates changes does not support the hypothesis that U.S. short-term capital has been moving in recent years primarily or secondarily because of interest rate differentials.

Economist Robert Gemmill, of the Federal Reserve Board, made a study that showed that in recent years between \$600 million and \$1 billion is the maximum amount of switching which may take place as a result of interest rate differentials between this country and nations abroad.

And even in this less than one billion sum he suggests that two other considerations may well have swamped the interest rate factor. The other considerations in the high correlation of deviations from trend in interest rate differentials were the need to build up working balances, and speculative movements.

This was not based on opinion. It was based on very, very careful study, one by the Federal Reserve Board and one by a private economist.

Mr. ECCLES. What we are concerned about is the balance of payments. We are not concerned about American funds going abroad because of the interest rate.

Senator PROXMIRE. That is an important distinction.

Mr. ECCLES. There is a real distinction. We are concerned about the loss of the large amount, \$18 billion of short-term foreign funds, in this market on deposit and in Treasury bills and a deficiency in our free gold reserve of \$10 billion or more.

We have a free gold reserve today of about \$4 billion. So there would be about a \$14 billion deficiency in the gold reserve we have in relation to the short-term foreign funds. It wouldn't take much of a run to use up our free gold reserve.

The concern that we have here is being forced to devalue, or put an embargo on gold. Either one would affect us seriously in the world picture. Therefore, it is terribly important that we prevent these foreign funds running out of our market.

We must eliminate the deficiency in our international balance of payments. We must take action to do that. We could, as has been suggested, guarantee to those who have funds here the price of gold so they would have no concern about a devaluation.

Then we could do what we pleased about our interest rate. As it is, we are locked into a world situation.

If this free gold reserve continues to diminish and bank deposits continue to grow as a result of deficit financing, it is going to weaken the confidence of the foreigner in the dollar, just as we would be shaken in our confidence with reference to foreign currencies of a

country running deficits and doing their financing through the commercial banking system.

Senator PROXMIRE. I do feel very strongly that the \$4 billion that you talk about as the unit of our free gold is not the limit. Like that, we can knock out the \$12 billion gold we require to back our currency.

Mr. ECCLES. It ought to be done now. It is overdue.

Chairman PATMAN. There is a bill pending.

Mr. ECCLES. It ought to be done right now and not wait for an emergency.

Chairman PATMAN. Mr. Eccles, I would like to ask you about the policies of the banks to invest more and more in Government bonds and tax-exempt securities. The way it used to be in this country the local bank used the power to create money to help local people, to provide credit for industry, commerce, and farming in the community.

Most of the directors were local people. Some State laws required directors to live within a certain radius of where a bank was chartered to create the money in that community.

Forty years ago we had 31,000 plus banks; now we are down to about 13,000. In other words, we have 43 banks to every 100 we had 40 years ago. Normally, in view of the growth of the population and the growth of our economy we would expect to have 100,000 banks. But instead of that, we have gone down to much fewer banks.

I do not look with favor on the trends of the banks. They are getting away from local loans and are using the power to manufacture money—which is justified if used to help local people—merely to buy not only Government bonds, but tax-exempt bonds. In the recent past the number of purchases of tax-exempt bonds by commercial banks has gone up considerably—about 17 percent, I notice, in the last few weeks.

The commercial banks now hold 25 or 30 percent of all the tax-exempt bonds in the country. I can agree that some Government securities should be held by commercial banks—that is all right up to a point. But when they invest their funds in Government bonds and tax-exempt bonds to the extent that it interferes with their ability to make local loans, doesn't it occur to you that this trend should be called to the attention of the banks, in some way, and that some effort be made to reverse this?

Mr. ECCLES. I think you have a completely erroneous and wrong conception of the whole banking system and the way it is operating and its present condition.

In the first place, the banks are pretty heavily loaned up. I think where they have branch banks, which they have in every State in the West—and the West has not slowed up in its growth and there is no area in the country that has grown like the West—the people who know will tell you that it is due, to a considerable extent, in the way the banks financed the situation.

The banks in the western part of the country with which I am familiar—as a matter of fact, I had a lot to do with branch banking in two States and helped to get the legislation in 1933—most of the banks in the West are loaned up as heavily as they should be. They have to be loaned up to enable them to pay 4 percent on savings, which many of them pay.

Chairman PATMAN. When you say loans you mean loans and investments?

Mr. ECCLES. I mean loans. Investments are aside from that. The branch banks generally are loaned up, much heavier than the unit banks. Local unit banks carry larger amounts of Government securities for the very reason that most of them are nonmembers of the Federal Reserve and they do not have the spread that a branch banking system has and therefore need more liquidity.

Your branch banking systems are today loaned up 60 percent, many of them, and some over 60 percent, whereas you will find your local bank loans are down around 45 or 50 percent. Your large branch banking system takes care of the loans of the communities very much better than the average small banks do.

First, because they are departmentalized; they have real estate departments; they have consumer credit departments; they are better qualified; they can also take care of much larger loans and a person or a business in a community does not have to go outside of that community to finance their needs.

Chairman PATMAN. Getting back to my observation, which you dispute, the Federal Reserve Bulletin shows for June 27, all commercial banks' loans, \$129.2 billion; investments in U.S. Government obligations, \$64.2 billion; in other securities, \$30 billion, or a total investment in securities of \$94.2 billion. In other words, investments in securities are about 42 percent of total loans and investments.

I am very familiar with your arguments for branch banking, which I oppose, and though you say local people don't have to go outside the community to get a loan they have to go outside to get decisions made.

Mr. ECCLES. No, they don't have to.

Chairman PATMAN. The important ones?

Mr. ECCLES. If it is a large loan, yes. The limits are very substantial. I am sure you will find that the branch banking system has served the public well.

It is the unit bank that doesn't like the competition, that is against the branch system. It is not the public that is against it.

I think the branch banking system has better served the country as the chainstore has better served it. You can't say that Safeway or Penney, or other chainstores, are so successful because they have failed to better serve the public interest.

Chairman PATMAN. I do not agree with you on that. I think one of the reasons is because the banks would not furnish the local merchants credit for the purpose of competing with the chains. Otherwise, the local merchants would never have gotten in the predicament they are in now. I think the local banks are largely responsible for that.

I think they were going into investments in Government bonds, and things like that, and not paying enough attention to local loans.

Mr. ECCLES. Bank holdings of Government bonds have not gone up. The Government bond holdings have gone down generally.

Chairman PATMAN. But municipals have gone up considerably?

Mr. ECCLES. That is right. I will tell you why the municipal holdings have gone up. When the rate on savings went to 4 percent, it was necessary, in order for banks to pay that kind of rate, to buy

municipals. Municipals are yielding on an average  $3\frac{1}{4}$  to  $3\frac{1}{2}$ ; with the tax-free feature, it is equal to  $6\frac{1}{2}$  percent or better.

To buy Government's with savings funds, they were simply losing money. That is why the banks carry few long-term Government's. They carry, as a secondary reserve, a substantial amount of short-term Treasury bills and certificates and only a small amount of Government's maturing beyond 5 years.

The great bulk of the Government's carried by the banks are 1- to 2-year maturity. They are what is termed by bankers a secondary reserve. They have largely invested their savings funds in municipals and mortgages because they are the most profitable outlet for them.

Chairman PATMAN. I do not want to debate with you on the branch bank question. I am opposed to your views on that, Mr. Eccles, as you know.

Mr. ECCLES. Yes.

Chairman PATMAN. I do not want to take up too much time, since the other members would probably like to ask some more questions.

We have another witness, Mr. Byran, President of the Federal Reserve Bank of Atlanta, Ga., and a member of the Open Market Committee. We want to hear from him. But if we do not get through this morning, we will have a meeting this afternoon.

Representative CURTIS. I have one that is in the nature of a question. The other is more in the nature of a request for further information. I would like to make this comment, that we certainly are drawing on your resources, Mr. Eccles. One of us is asking you on debt management policies, next on monetary, and then on labor and so forth.

Mr. ECCLES. They are all related.

Representative CURTIS. You have been very kind to put up with us. One question I did want to pose. When you mentioned the fact that it was World War II deficits, as I understood—and I have heard others make this remark—that got us out of the depression, the assumption was that the deficits just hadn't been large enough.

Mr. ECCLES. That is right, they were not.

Representative CURTIS. I want to put this as a challenge, because this is the first time I have had an opportunity to hit this on the head, because there were 10 million people unemployed in 1938 after about 6 years of this theory.

Mr. ECCLES. It was 20 before that.

Representative CURTIS. No; not quite that. That is stretching it. The point I want to bring home, and I know you must agree with, these people that refer to World War II, we put 10 million men into uniform. We gave them an occupation. We had price and wage control and we had rationing and we had the psychology that goes with war.

I certainly think that those who want to advance their deficit financing theory certainly don't want to use an economy based on war as a suggestion that in any way relates to what might be accomplished in peacetime.

Mr. ECCLES. We certainly can do it in peacetime, I have said many times.

Representative CURTIS. How can we do it in peacetime unless you want to resort to price and wage controls and rationing and build up

some sort of psychological stimulus in the people's mind where they will put up with it, which they will do in periods of war because of the patriotism and everything else? That is certainly not a solution for a peacetime economy.

Mr. ECCLES. No; but you only do it in war after you get to the point where your manpower and goods are in short supply. You continue to run deficits in a war period. It seems to be impossible to finance a war currently out of taxes, even though you put on the very highest taxes you can get. The speed with which the economy moves at that time calls for a very large amount of bank financing to take care of the residual amount of spending that is in excess of the taxes you can collect and the bonds that you can sell to the public. You have a large residual amount left over that must be financed by the banking system.

Therefore, you have a growth in the money supply during a war period greatly in excess of the available supply of goods and labor. Therefore, you put on price control and rationing because a large part of your production is not going into capital or consumer goods for the public. It is being wasted on war.

During the peacetime economy in the depression, the deficit was insufficient to get our productive facilities and manpower operating. We could have a balanced budget and maybe a surplus if our productive facilities and manpower were fully used. I don't say you always have to run a deficit. I think the best way to slow up inflation is through a budgetary surplus as well as tight money. That is the best way to do it.

Certainly it is bad economy when we have a lot of idle men and idle facilities and try to balance the budget.

Representative CURTIS. That is why I say you begged the question. I don't happen to think that is the way you do it. I think there are others.

Mr. ECCLES. I don't know what they are.

Representative CURTIS. I have been in that over a period of years. Much as I would like to engage in that debate, I don't want to at this time. The thing I would like to leave the record open on is this question of the size of the debt.

When our committee examined with the Commission on Money and Credit on this matter, I asked some questions in regard to debt management and whether or not the theory was that we should have a debt for basic reasons, and so on, and got few responses. I think that maybe this committee ought to sometime make a study into the problems of debt management, the economic impact on them, particularly when in your remarks you were referring the size of the debt to the gross national product. I have heard that before, too.

Frankly, I think that is a very dangerous thing to say we are doing all right now because debt in relation to gross national product is only 60 percent of what it was at the end of World War II. I say it for this reason. If we went into a war now, we would need all the resiliency and flexibility possible in this debt because we would have to—just as you say about financing a war—go heavily into deficit financing. To say that our peacetime debt is only 60 percent of the gross national product, a low figure compared to the debt in wartime, is dangerous.

It may be all right. I don't know. But I have never seen an examination into that aspect of the problem of debt management. What

should the size be? What should it be related to? Gross national product is obviously one thing that is meaningful. Then the absolute size of the debt from the standpoint of just financing it becomes a difficult problem.

I simply want to leave the record open on that for any comments you may want to supply for the record on debt management, with a request, Mr. Chairman, that we think possibly of sometimes maybe holding some hearings on the subject of the problems involved in debt management.

Mr. ECCLES. After the war, I was one of the strongest advocates of keeping war taxes on and keeping price control and rationing for a longer period. We should have paid off much more of the debt than was paid during the period of the forties, and we would have had much less inflation.

We should have also been free—the Federal Reserve should have been free—to carry out a restrictive monetary policy to stop growth in the supply of money when it was already excessive. There was a case of bad management by the Treasury. I am as strongly in favor of balanced budgets as anyone else, and budgetary surpluses. But I think you must first have a balanced economy. The important thing is to utilize your manpower and productive facilities.

If you can manage it in that manner, through use strictly of the private sector of the economy and the private debt system, I am 100 percent for it. We have never quite succeeded in doing it. I think we might do a better job than we are doing.

I don't want anybody to get the idea that I advocate per se budgetary deficits. I don't. There may be ways of avoiding them. I don't think that we have always done the best that we could do. I realize in a democracy such as we have, there are lots of compromises. It is a pretty difficult job not to avoid the excesses that we have. I think we are always going to have what we call booms and recessions. But when we see them coming on the boom side, we should adopt a restrictive monetary policy and, if need be, supplement that with a balanced budget or budgetary surplus. Then, on the other side, I think we should reverse our policy. We should have an easy money policy and a budgetary deficit.

I would like to get free of the international situation that we are locked into. Maybe we should use other means than monetary policy to deal with it. Until we do use some other means, we simply can't discard monetary policy without danger.

Representative CURTIS. Thank you.

Senator PROXMIER. Let me ask a few questions along this very line, because I think we are really beginning to hit pay dirt.

You say in periods of slack in the economy that we should have monetary ease from a domestic standpoint, and this is beneficial to the economy, and that we should certainly not have monetary restraint under those circumstances?

Mr. ECCLES. That is right.

Senator PROXMIER. Before I go into that, I want to clear up one point. You indicated that you were not only concerned with our outflow, but also with the inflow of funds in response to interest rates. I call your attention to the fact that short-term claims on foreigners, representing foreign capital coming into this country, from the begin-

ning of 1960 up until the most recent figures, has doubled. It has gone from just over 2 billion to well over 4 billion in that brief period, although we did have this adverse interest rate differential. It didn't seem to interfere with the inflow of short-term capital.

Once again, I do hope you will have a chance to go over the very interesting study by Dr. Bell, because it does an excellent job of showing the very, very modest influence of interest rates on the international balance of payments.

Along this line, I want to ask you, Mr. Eccles, if you don't feel that from the standpoint of foreign trade, we are not doing quite well? Here we have commercial exports of 18.1 billion, imports of 15.9. If we include Government-aid-financed exports, we have a surplus of \$4.8 billion in trade on the first half of 1962. This is seasonably adjusted on an annual basis. This seems most encouraging.

Mr. ECCLES. I think the first half of the year has been encouraging. I hope the last is as good, but I don't expect it to be.

Senator PROXMIRE. We have the same kind of surplus on services, \$1.7 billion. In the areas where you indicated we should reduce our spending, this is within the control of our Government. That is, military outlays and economic grants account for \$5.2 billion of our adversity in this field, and in spite of all this, our overall deficit is \$1.2 billion.

In other words, we are doing extremely well everywhere except for the fact that we have this big foreign aid program and our troops committed overseas. Under these circumstances and in view of the fact that the studies we have suggest that interest rates do not significantly affect our balance-of-payments situation, it just makes no sense at all to me that we should follow a policy of monetary restraint now because of vague possible effect on international payments.

Mr. ECCLES. I am not advocating monetary restraint. What I am saying is, if the financing is done by putting out long-term securities into the capital market, we have to pay a higher rate.

The best example was the financing last week in which a 4¼-percent long-term bond was put out at a premium of one point, and they expected to sell 750 million and sold 300.

Senator PROXMIRE. Exactly.

Mr. ECCLES. It was not competitive.

Senator PROXMIRE. That was certainly an excellent indication of the fact that we have a situation of some monetary restraint, or at least unavailability of funds seeking investment.

Mr. ECCLES. No. In the case of short-term funds, they put out a 1-year certificate bearing 3½ percent, and it was oversubscribed very, very heavily. I think the subscribers only got 12 percent of their subscription to that issue. So there was an unwillingness to go into the long-term market because securities at the rate offered, were not competitive with other long-term securities.

Senator PROXMIRE. Isn't it also true that there has been constant talk by top officials and by almost all the financial commentators that we are going to try to follow a policy of fiscal ease and monetary tightness, of diminishing the money supply in relation to the GNP in such a way that long-term interest rates are going up?

There would be every logical reason for people taking advantage of attractive short-term paper, but this long-term obligation was a

commitment for 30 years, and you can have a big drop in the price of the bond if the interest rates rise to 5 or 5½ or 6 percent.

Mr. ECCLES. You have entirely different markets for the long-term and short-term securities. You have an investment market for the long term. In the short term the market is the corporations with surplus funds. It is investors who don't want to get their money tied up for a long period. There are some short-term securities that go into the banks. There are entirely different markets for short-term and long-term Government securities.

The free reserves in the Federal Reserve System tend to keep the short-term market rate low. You have bills today at a little less than 3 percent. They could eliminate free reserves. But they have maintained free reserves in the banking system of \$300 to \$400 million. You can't get a tight-money situation as long as there are free reserves.

Senator PROXMIRE. Let me say those free reserves have to be adjusted for the fact that we now have a vault cash counted as reserves. Almost all these free reserves are in country banks. Very few in the central reserve or Reserve banks.

Mr. ECCLES. Yes, but the free reserves are the reserves that tend to keep pressure on the market and hold the short-term rate down. There is an abundance of short-term credit for all purposes.

I don't believe that it would help stimulate business if, instead of a 3-percent short-term rate, that you had a 2½-percent rate.

Senator PROXMIRE. I agree with that. I am concerned about the long-term rate.

Mr. ECCLES. The long-term rate is not determined by the Federal Reserve. The long-term rate is based upon the supply of investment funds for the market. It is not determined by the Federal Reserve.

Senator PROXMIRE. My argument is that they could have more influence.

Mr. ECCLES. I don't think so. I think it might have the opposite influence. The investor may think that it is an inflationary action and steer away from the long term. I was opposed to bills-only policy. The Federal has gotten away from the bills-only policy. I have always been opposed to pegging the price of Government securities. The Federal Reserve has bought some long-term and middle-term securities. Now for them to go out and sell all their short term and buy only long term, the purpose would be to so far reduce the amount of long-term securities available in the market that you may force rates down.

Senator PROXMIRE. Let me ask: What factors does the Open Market Committee take into account in making monetary policies?

Mr. ECCLES. I don't know what they do now, but I would think they take into account the factors we always did. That is, the state of the economy, the matter of production, the matter of employment, and the gross national product. Those are the principal factors. If inflationary developments are indicated, a restrictive monetary policy should be adopted. This should be assisted by a fiscal policy of a budgetary balance or surplus. If the economy is not growing and a deflationary situation is indicated, an easy monetary policy should be adopted, supplemented by a budgetary deficit. Any action taken by the monetary authorities today must take into account the condition of our international balance of payments.

Senator PROXMIRE. The limits of monetary policy, the regulations of economy—maybe that is an improper word—the influence of the monetary authorities on the economy is concerned very deeply with the domestic situation. You would try to regulate the economy.

Mr. ECCLES. Entirely so if it was not for the balance-of-payments situation. I think it is the balance of payments that causes the problem. Otherwise your particular concern would be the domestic situation.

Senator PROXMIRE. So you have domestic goals as to what you are shooting for?

Mr. ECCLES. Absolutely.

Another thing that the Federal Reserve cannot ignore at all, and that is fiscal policy. Monetary policy is supplemental to fiscal policy. They have to work hand in glove. There has to be the closest possible relationship in my opinion between the central bank and the Treasury, and the White House, for that matter.

I was a strong advocate that the Chairman of the Federal Reserve Board should be appointed coterminous with that of the President. I think there must be a liaison maintained between the central bank and any government in power because the Federal Reserve possibly has the most important tool in the kit to deal with economic and social matters. Therefore, a President can't be elected and have his hands tied so he has no freedom at all in connection with the problems of monetary credit and fiscal policy. This idea of independence that we talk about is not realistic; independence, yes, to state your case, but not the freedom to enforce your will.

Senator PROXMIRE. I think that is an excellent statement. Thank you, Mr. Chairman.

Chairman PATMAN. Yes, sir.

Mr. Eccles, we appreciate your testimony, sir. If we were to submit a few questions to you in writing, would you mind answering them when you look over your transcript?

Mr. ECCLES. Yes, sir.

Chairman PATMAN. With that understanding, we will let you go.

Mr. ECCLES. Thank you.

Chairman PATMAN. Mr. Bryan, would it be all right for 2 o'clock this afternoon?

Mr. BRYAN. Perfectly all right, sir.

Chairman PATMAN. The committee will stand in recess until 2 o'clock this afternoon.

(Whereupon, at 12 noon, the committee recessed, to reconvene at 2 p.m. the same day.)

#### AFTERNOON SESSION

(Whereupon, at 2 p.m. the committee reconvened, Hon. Wright Chairman, chairman, presiding.)

Chairman PATMAN. The committee will come to order, please.

Will you come around, Mr. Bryan, please?

We are happy to welcome as our second witness today Mr. Malcolm Bryan, President of the Federal Reserve Bank of Atlanta. Mr. Bryan has long been a member of the Open Market Committee and before that had a distinguished career as an economist and professor

of economics. His comments are always welcome and enlightening. We are happy to have you with us again. You may proceed in your own way.

After you have completed your opening statement, the members of the committee may wish to propound questions to you under the 10-minute rule.

#### STATEMENT OF MALCOLM BRYAN, PRESIDENT OF THE FEDERAL RESERVE BANK OF ATLANTA

Mr. BRYAN. The statement is brief. I will read it if I may, and then do my best with the excellent questions that the committee has been putting to witnesses.

It is flattering to have been asked to appear before you today. After an examination of conscience, however, I find my sense of self-esteem greatly reduced by the necessity of confessing that I have no new figures and no new and revealing arrangement of old figures. I think I should also confess—and this is done out of no sense of false modesty—that I do not know the answers to the problems that beset us.

At the moment, without trying to support the point with figures, it seems to me that we are churning around at a high level of economic activity, perhaps even edging upward a little, all without going anywhere in a hurry. Whether this slowdown in our rate of expansion will be followed by a breakout on the upside, with continued recovery, or on the downside, I do not know; but I am sure that when the facts are in, it will appear to everyone, including myself, that I ought to have known.

Let me state a few convictions for whatever they may be worth:

1. If we break out of this pause on the downside, there is no presently visible, objective, rational reason why the period of adjustment should be long and deep. It will only be long and deep if we take counsel of our fears and frighten each other into panic. If we do this, then we are stupid.

2. It is inevitable, in the normal misjudgments of human beings, especially when correct judgments are made the more difficult by a long inflationary cycle such as this country has had, that there will appear a thousand and one misapplications of capital and manpower that find a less-than-expected market for their products and services.

It is possible, to be sure, that we shall be unpleasantly surprised by the magnitude and extent of the adjustments that may be necessary. I myself believe that they are of a size and magnitude small enough that our dynamic economic system can accommodate itself to them.

What chiefly scares me is that we shall attempt to overmanage the economy, wherein I think our last case may well be worse than our first. What is continuously needed is not a single adjustment but a myriad of adjustments. These can only be made by a flexible economy whose decisions related to manpower and capital are under the day-to-day guidance of free consumer and free investor choices.

I realize that an economy guided by a free market is often an uncomfortable thing to have around; a free market often seems to behave miserably. Unfortunately, in my judgment, there is no substitute for it.

So I bespeak my conviction that we should at this time be guided by two general philosophies:

(a) Speaking simply as an American citizen, I think we should see to it that the pains of readjustment do not fall with overwhelming and degrading force on the unemployed, which is the tragic and classic locale of most of those pains. I believe we are bound in conscience not to let that happen.

(b) Again, speaking simply as an American citizen, I believe we should do the things we know that Government can do and do well. We should see that competition is maintained in all sectors of the economy; we should see that the consumer is protected against the sharp practice of an occasional scoundrel; we should see that he is protected in those areas where his quality judgments do not suffice.

Even, if I dare say it, I think we should strive studiously to avoid rigidities introduced into the economy by Government itself. After that, I believe we shall be well advised to give the free market economy a chance to adjust itself before we intervene with massive medications. I shall make a slight further allusion to this point in a minute or so.

Now, as for monetary policy. As I see it, monetary policy in most of the postwar period can be interpreted around a few simple ideas.

First of all, we have been striving to bring inflation to an end, but to bring it to an end so gently and so gradually that American businesses, individuals, governments, and the managers of savings institutions could continually examine their commitments in the light of a gradually evolving situation, not in the light of a sudden and dramatic alteration in their environment, which would necessitate sudden, large, and dramatic adjustments.

Put in a different frame of reference, we have been feeling our way slowly toward a viable structure of interest rates that will attract from the American people, as savers, the large bulk of the funds that other Americans, American governments, and our offshore friends want to borrow. Note, however, a point so many times made:

The Federal Reserve System has had no intellectual or emotional preoccupation with either high interest rates or low interest rates, as such. We have merely wanted an interest rate—the price for money—that largely equates the supply of savings that Americans are willing to furnish at that price with the demand for American savings at that price.

At the same time, we have allowed for a growth of bank reserves intended to accommodate a growth in the money supply, which has been intended in turn to accommodate the increasing population and the increasing transactions of our country. That growth of reserves over the long postwar period exhibits a straight-line trend of 3 percent per annum.

I do not believe that this has been a tight money policy. Indeed, if it is to be criticized, I think the criticism over the long period is that it may have been too easy, delaying adjustments that, considering the constant change in a consumer-guided economy, are forever necessary and are the easier the more promptly they are made; if we are to be criticized, I suspect the criticism is properly taken on the point that we have allowed too much of the economy's expansion to be financed out of bank-created credit.

Second, speaking not to the long term, but to our reaction toward cyclical situations, we have had an extraordinarily simple pattern.

Whenever we could detect a downward trend in economic activities, we have acted promptly to increase the supply of bank reserves and thus to permit banks to seek loans and investments and, in turn, to increase the money supply.

By the same token, when we have detected the economy operating in conditions of boom, we have allowed borrowing demands to press against bank reserves and interest rates to call up a greater supply of real savings.

The pattern has been as simple as that. Our countercyclical actions, whether by luck or sophistication I do not know, seem to me to have had an excellent result. We have avoided in postwar America a long or severe depression of the sort that has characterized other postwar periods, and the economy has responded when we have tried to stimulate it by monetary means.

Now, let me go back to a point made a short while ago. In endeavoring to stimulate the economy we have increased bank reserves, after adjusting for changes in reserve requirements, from the low point in April 1960, of \$18.2 billion, to \$20 billion (daily average basis) in July 1962.

This has amounted to a 10 percent increase. Note that the figure for total reserves, both on a seasonally adjusted and unadjusted basis, stands comfortably above the long-run 3 percent growth rate in bank reserves. In short, we have had an easy money policy. The commercial banks of this country have responded to this easy money policy by expanding their loans and investments \$31.2 billion, seasonally adjusted, or 16.8 percent, between April 1960, and July 1962.

Still, we must all agree that the economy, while it has responded to monetary ease, has not recently been responding altogether to the heart's desire. Although the figures, I believe, give an exaggerated impression, we have an uncomfortable overcapacity in many lines. True, the figures for July were somewhat heartening, but unemployment remains higher than it should be.

This leads me to an uneasy suspicion that something is happening in the economic system that we do not quite understand. Since I must frankly say that I do not believe it to be a lack of money availability, I believe a search for what is happening to our economy must take other directions; we need an agonizing reappraisal for some of the other elements of our total national policy. Meanwhile, with so many doctors disagreeing, I think we would be smart to postpone any exploratory operations or massive medications.

It seems to me that the economy is like a man slightly afflicted with hypochondria who goes to his physician for a regular checkup and mentions that he has not been feeling as peppy of recent weeks as he had been. I think the physician in such a case would be wise and prudent to keep the patient under observation for a time before he begins dosing him either with tranquilizers or stimulants. Neither may be needed. With the art of economic diagnosis what it is, I feel that we should all be wise to pause a while and to find out, as best we can, what is actually happening in the economy before we begin dosing it. Such a suggestion may have the defect of being a little behindhand in the beginning of treatment, if treatment is needed; it has the enormous advantage of assuring that the patient is not treated with a medicine that aggravates, rather than remedies, his condition.

That leads to a further question. Do I believe that additional injections of easy money would help the economy at this time? I do not.

Now, I want to say—

Senator PROXMIRE. May I interrupt at this point to say, Mr. Chairman, there is a vote downstairs, and I will be back in about 3 minutes. I hesitate to run, but I will be right back.

Mr. BRYAN. I want to say, Mr. Chairman, that I do not mean tight money. I say additional injections of easy money.

Chairman PATMAN. What about your views on higher interest?

Mr. BRYAN. I don't think they are called for at the present time.

Chairman PATMAN. Mr. Bryan, I don't think everything the Fed has done is wrong. For example, I believe the recent requirements on stock margins have been generally good. If it had not been for the fact that the Fed maintained generally high margins prior to the crash on Black Monday, I suspect today we would be in the kind of depression we were in after the 1929 crash. In other words, if there had been as much bank-created money supporting the market directly, there would have been a tremendous contraction of the money supply as the banks called loans.

Do you believe that such a contraction of the money supply would have caused serious economic difficulty, Mr. Bryan?

Mr. BRYAN. Whenever, sir, you have a massive readjustment in any major market, whether it is the security market, the real estate market or any other, you have repercussions in other markets. I would agree, I think, that if we had not had restraint at least some degree of restraint, on the speculation in the stock market, our problem would have been worse today than it is.

Chairman PATMAN. Mr. Bryan, let me call your attention to a couple of relationships. At the end of 1953, the money supply on a seasonally adjusted basis was \$128.1 billion. That amounted to 36 percent of the gross national product of 1953. During the second quarter of 1962, the money supply has averaged \$145.5 billion. The gross national product is estimated at \$552 billion for this quarter on an annual basis, so it appears that the money supply is down from 36 percent in 1953 to 26 percent of the gross national product in 1962. Do you think that this relative shrinkage in the money supply since 1953 has had any causal influence on the relatively slow rate of economic growth and the high unemployment of recent years?

Mr. BRYAN. That is a fine question, Mr. Chairman, if I may say so, I do not believe that it has had. What I think we have had, as I have tried to emphasize in my paper, is a great many misapplications of capital and labor. We have continued to have a rather substantial inflation in the price level.

Now I suspect that a fall of the sort you have mentioned would not have been possible if we had not come out of the war with a vast liquidity. That may not be a very satisfactory answer. It is the best I can do with it, sir.

Chairman PATMAN. Has the Open Market Committee ever considered the possibility that it might be able to bring about a decline in the general price level by following a tight money policy?

Mr. BRYAN. Mr. Chairman, to my recollection, nobody in the Open Market Committee has ever discussed the idea of trying to deflate the economy. I, myself, lived through, as you did also, sir, one of the

great deflationary cycles of this country. I never want to live through another one.

Chairman PATMAN. Do you think that in recent years some members of the Open Market Committee have hoped to achieve a price rollback? I believe you said they never wanted to deflate the economy, but I wonder if some of the members have thought a moderate price rollback might be possible?

Mr. BRYAN. I am not sure, Mr. Chairman, that I get the distinction you make between a deflation and a price rollback.

Chairman PATMAN. I believe that I will not pursue that further in view of your answer to the first question.

When the Council of Economic Advisers presented their report in January, they made projections through the remainder of this year for the GNP they expected, for the amount of investment in plant equipment they expected, for the volume of income, the level of employment, and so on. But when Chairman Heller was before the committee last week, I asked him whether or not the Council had made any projection of money supply or of the reserve base. And he said "No."

Is it your opinion that economists can make projections of the gross national product, personal income, employment, and so on without also having a projection of what they expect in the way of a money supply or a reserve base?

Mr. BRYAN. I would love to avoid that one, but I won't. I think that if I were doing it, Mr. Chairman, I would want to have some idea of what I thought the reserve base was going to be.

Chairman PATMAN. That would influence the money supply?

Mr. BRYAN. It would influence it, yes. You may get me in terrible trouble, Mr. Chairman.

Chairman PATMAN. If you desire to elaborate on your answers when you look over your transcript, you may do so.

Mr. BRYAN. All right.

Chairman PATMAN. And insert anything that you consider germane.

Mr. BRYAN. Can I cut out something?

Chairman PATMAN. Does the Federal Open Market Committee consider projections of the money supply or the reserve base for some future period ahead?

Mr. BRYAN. The staff makes some projections, yes.

Chairman PATMAN. Who makes these projections, the staff?

Mr. BRYAN. The Board staff.

Chairman PATMAN. Mr. Bryan, we have heard a great deal about the so-called operations "nudge" and the fact that the long-term rate is supposed to have been lowered compared to the 90-day bill rate. I invite your attention to the chart on the easel over there. It was prepared by Prof. John G. Gurley. It shows that since 1958 the yield on long-term Government bonds has been extraordinarily high and out of line with yields on 90-day bills, as compared to the average relationship that has prevailed over the years.

Do you have any explanation for that phenomenon?

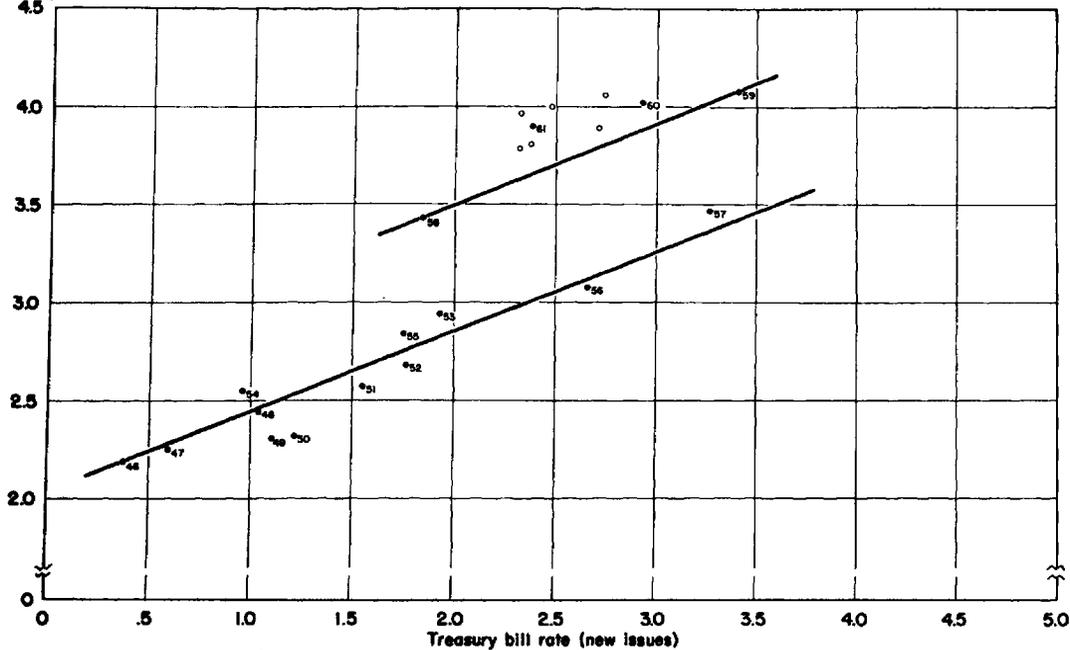
Mr. BRYAN. I have not had a chance to study the chart. I would like to be excused.

Chairman PATMAN. All right, sir. The chart will be in the record, and if you would like to elaborate on it, you may do so.

Mr. BRYAN. Thank you.

### Treasury Bill Rate<sup>1/</sup> and Yield on Long-Term U.S. Government Bonds<sup>2/</sup>

U.S. Gov't Bond Rate  
Long term



○ = quarterly coverages, 1961 (1) to 1962 (2).

<sup>1/</sup>Treasury bill rate new issues    <sup>2/</sup>Due or callable after 10 years

*Treasury bill rate and yield on long-term Government bonds—Market rates, short term and long term*

	3-month Treasury bills	Long-term bond yield		3-month Treasury bills	Long-term bond yield		3-month Treasury bills	Long-term bond yield
1946.....	0.375	2.19	1954.....	0.953	2.55	1961:		
1947.....	.594	2.25	1955.....	1.753	2.84	1st quarter..	2.376	3.83
1948.....	1.040	2.44	1956.....	2.658	3.08	2d quarter..	2.321	3.80
1949.....	1.102	2.31	1957.....	3.267	3.47	3d quarter..	2.324	3.97
1950.....	1.218	2.32	1958.....	1.839	3.43	4th quarter..	2.475	4.00
1951.....	1.552	2.57	1959.....	3.405	4.06	1962:		
1952.....	1.766	2.68	1960.....	2.928	4.02	1st quarter..	2.739	4.06
1953.....	1.931	2.94	1961.....	2.378	3.90	2d quarter..	2.712	3.89

(Mr. Bryan subsequently submitted the following:)

1. I have great respect for Dr. Gurley, and his chart deserves thoughtful study. In the time interval permitted to review the transcript, and in the absence of a description showing how the chart was constructed, and the trend lines selected, I cannot make an analysis that would be helpful to the committee.

I do know, however, that investor preferences constantly shift as between short, intermediate, and long markets; they shift between Governments, municipalities, corporates, and other markets; indeed, they shift from time to time as between borrowing industries. I also know that on the other side, borrowing demands in the market shift. If we were to have, therefore, a constant relationship between long and short rates, I should infer that rates had been pegged.

My inclination would be to argue that the shifts in investor and borrower preferences illustrate what I believe to be the great danger inherent in an attempt by the Federal Reserve System to peg—if I may be permitted a color word—the structure of interest rates and the shape of the yield curve.

Chairman PATMAN. With reference to member bank reserves and net free reserves today, these figures contain some amount of vault cash. When the vault cash provisions were being put into effect during 1960, was there any discussion at the meetings of the Open Market Committee to the effect that you were putting disproportionately large amounts of net free reserves into the country banks?

Mr. BRYAN. I don't recall, Mr. Chairman.

Chairman PATMAN. Was there also any discussion at the different meetings of the Open Market Committee in 1960 which recognized that the reserves made available to the country banks through the vault cash provision were not finding their way into the money market and were, in fact, having very little effect on the bill rate as compared to the effect you would expect if you had made the same amount of reserves available through the open market operations?

Mr. BRYAN. I have not reviewed the minutes of 1960. I see by the questions that I should have.

Chairman PATMAN. You attended all the meetings?

Mr. BRYAN. With some exceptions.

Chairman PATMAN. Would it be unfair to say that when the Federal Reserve made the vault cash available as reserves rather than engaging in open market operations, that it was trying to increase the profits of the banks?

Mr. BRYAN. I have never heard that argument made.

Chairman PATMAN. Would it be fair to say that when the Federal Reserve made the vault cash available as reserves, year before last, when it might have engaged in open market operations, the Open Market Committee was looking for a way to expand the reserve base that would have a minimum effect on interest rates?

Mr. BRYAN. I wouldn't have assumed so; no. I am not sure that I get the effect of the question.

Chairman PATMAN. Prior to December 1961 the rate on 90-day Treasury bills remained at the  $2\frac{1}{4}$  to  $2\frac{1}{2}$  percent range for a year. In December and January it rose rather sharply to about 2.7 percent, where it remained until late this past June. Would it be correct to say that during the latter half of the year 1960, the Open Market Committee pegged the minimum rate at 2 percent?

Mr. BRYAN. Of 1960, pegged it?

Chairman PATMAN. Yes.

Mr. BRYAN. At 2 percent? I do not believe we have engaged in a "pegging" operation.

Chairman PATMAN. At any time since the war years?

Mr. BRYAN. We have been deeply concerned about the possible effect, beginning in 1960 with the rapid outflow of funds, and with the possibility that the short rate might encourage the outflow of funds.

Chairman PATMAN. The upward adjustment of the bill rate last December and last January suggests some further moderate tightening with a deliberate upward adjustment in short-term rates. What was the reason for that apparent change in policy?

Mr. BRYAN. Will you read that again, sir?

Chairman PATMAN. Yes, sir. The upward adjustment of the bill rate last December and last January suggests some further moderate tightening with a deliberate upward adjustment in short-term rates. What was the reason for that apparent change in policy?

Mr. BRYAN. I don't believe there was a change of policy at that time, as I recall it. I think you may have a seasonal factor in there.

Chairman PATMAN. You are not conscious of any deliberate upward adjustment?

Mr. BRYAN. Not that I recall. I will have to stand on the record. (The following was later received for the record:)

My inclination is to think in terms of total reserves, generally speaking, and to use other information as supplementary aids in judging the adequacy of the total reserve figure and the correctness of its trend. While I was not a member of the Federal Open Market Committee in 1961, in December total reserves, on both a seasonally adjusted and unadjusted basis, were well above the long-term trend line of 3 percent and seemed to me to provide an ample credit base for the expansion of the economy.

I find that the committee's position, as discussed in the published annual policy record for December 19, 1961, contained in the 48th annual report of the Board of Governors, describes its policy action and the reasons therefor.

Chairman PATMAN. Since June of this year, there seems to have been a further upward adjustment in both the short and long rates. Are you able to tell us, first, what the reasons for this apparent further change in policy were, and whether or not you were in agreement with the increase in rates since last June?

Mr. BRYAN. There can be many reasons for a shift in rates other than what we have done. The demands in the market, the supply of savings in the market, the proportion of savings going into the short and long market. All of those factors have a bearing. I have not reviewed the particular things that may have caused it. I have been in agreement with our policy, but I have been in agreement because of the fact that I thought the reserve supply, the credit base of the country, was growing at an appropriate rate, which is now well above, as I said in my paper, the 3-percent trend line.

Chairman PATMAN. Is the reason for the relatively high interest rates at present in part to check the flow abroad of short-term funds?

Mr. BRYAN. The Open Market Committee is, of course, conscious that we have a serious balance-of-payments problem. I think I would be fair to say, though, sir, that we have not created a reserve situation that would generally tighten rates. We have not made an interest rate correction to the balance-of-payments difficulty.

We have, however, not driven the short rate down as far as we did in other situations in which economic expansion was wanted.

Chairman PATMAN. Is the purpose of the present high interest rates also, in part, to try to solve our balance-of-payments problem by holding down prices, while prices in Europe advance?

Mr. BRYAN. I think, sir, we have been trying, but this is pretty consistent for many years, to end the inflation in this country. We have not changed our stance in that regard.

Chairman PATMAN. Thank you, sir.

Senator PROXMIRE, you have to go answer rollcalls occasionally. Maybe you would like to ask some questions now to make sure you get them in.

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Bryan, do you speak under restraint? Do you feel an obligation to the Federal Reserve System that you must speak, not a party line, but sort of an agreed reply to these questions we ask? Are you giving us more or less your understanding of the Federal Reserve viewpoint or your personal viewpoint?

Mr. BRYAN. As I sit on the Open Market Committee, I sit there as an individual. Of course, the individual, if from a Reserve bank has to be a president or first vice president. But I would hope that I would be perfectly candid with you and will certainly try to be. I wrote the paper I presented. I have not submitted it to anyone for clearance. Its errors, if there are such, are my own, and I apologize for them.

Senator PROXMIRE. I think this is a very competent paper. I am impressed by your ability. I am just wondering if there is the same restraint in the Federal Reserve Board that there sometimes is in an executive agency, where people who come up representing the Defense Department are likely to feel under constraint. They have to present the viewpoint of the Defense Department, some of them. General LeMay seems to be an exception. Most of them seem to follow those restrictions. Do you feel you have any such restrictions?

Mr. BRYAN. No; I do not. Obviously, sir, I have a lifetime of devotion to the Federal Reserve System. I have a feeling that it is a

great institution. If it were making consistent and big blunders, I would have no choice but to resign. I naturally have a loyalty to the Federal Reserve System, such as you gentlemen have to your constituents. You don't agree with all of them all the time, but by and large you want to serve them as well as the American people.

Senator PROXMIRE. That last puzzles me a little bit, you know. Depending on the Congressman and the Senator and the mood, and how close you think the next election is going to be, those can be pretty close restraints, giving you very little discretion. I am not saying they are in my case necessarily.

Mr. BRYAN. Maybe I used an unfortunate figure of speech. If so, I am sorry.

Senator PROXMIRE. Let me proceed.

Early in your statement you talk of your concern about unemployment and you recognize the very great importance of preventing unemployment and seeing that the pains of readjustment do not fall with overwhelming force on the unemployed. This is one of your criteria, I take it, in determining monetary policy.

Another criterion seems to be inflation. These are two of the principal ones that you mentioned, at least. The indicators suggest, as you suggest, that we have had very good experience with inflation. Over the past 5 years or so, wholesale prices have been stable. As a matter of fact, the latest figure in the indicators shows 100.1 as the present index of wholesale prices which is one-tenth of 1 percent above the 1957-59 average. You can't do any better than that. That is perfect.

It is true that retail prices have gone up somewhat about the rate of 1 percent a year. We deplore any increase, but it is modest.

At the same time we have very serious unemployment, so serious that the President of the United States has announced he will ask for a tax cut next year, although he must certainly anticipate this means a bigger deficit. It is a pretty drastic suggestion by the President under the circumstances.

Almost every economist who has come before this panel the last few days has indicated his concern about the economy and feels economic activity is likely to turn down. Many have suggested tax cuts for this reason. Yet you seem to feel that no change in monetary policy is called for, that we go along with about the same policy in the future that we have had in the past.

Mr. BRYAN. Sir, that is a wonderful statement. I am suggesting that no change is necessary at this time. I am suggesting it because I believe that we have done as much as can reasonably be done at this time with our total reserve supply, which is approximately \$300 million above a long-run 3-percent trend line. That does not mean that if employment should worsen, if the economy breaks out on the downside, that I would not favor doing some more on the reserve picture.

Senator PROXMIRE. We have a situation, as I understand it, where we have almost no free reserves in the system except in country banks. The country banks reserves are largely the result of the vault cash system, central reserve and reserve city banks are in a position where they have no free reserves. In many areas one would suspect that

there may well be credit rationing and businessmen and others who want to borrow cannot borrow; where they would like to borrow to build a home, they can't do it.

As a result, business activity is impeded, employment is retarded. We have our heaviest unemployment in the construction industry which is exactly the industry most sensitive to interest rates.

Mr. BRYAN. We have been talking to mortgage lenders all around the South, and we find that rates are tending to ease rather nicely and that terms are rapidly going down. I mean rapidly liberalizing.

Senator PROXMIRE. The figures that I have seen fairly recently suggest they are still, I feel, at a restraining level. Perhaps in some areas of the country and perhaps in your own area this may not be the case. I am wondering now about this other matter.

Mr. BRYAN. Do you mean a restraining level?

Senator PROXMIRE. The figures I have show conventional rates, July 5.95, April 5.95, October 5.95, July 1961 they were down to 5.90. January of 1960 was the alltime high, as I understand, 6.24. I feel that these are still high. While we have had activity in homebuilding, the fact is that when you recognize the enormous increase in population and the increase in family formation, the increase in income, and so forth, the money supply really has not kept pace.

We have had about a 10-year recession, 1950 being the best year in housing starts, and we have never come back to that.

Mr. BRYAN. I am not an expert in housing, and I ought to be the first to confess that I am not. My impression of the situation of a rapidly increasing ease in that and no lack of money has come from our very recent telephone survey of mortgage lenders in my district. I have no figure out of it, simply the statement that they are easing now.

Senator PROXMIRE. You say that we merely want—

an interest rate—the price for money—that largely equates the supply of savings that Americans are willing to furnish at that price with the demand for American savings at that price.

Yesterday we had a distinguished economist, before this committee, a professor at New York University, who was formerly an economist with the New York Federal Reserve, and he said:

Of course, the Fed pegs interest rates.

Of course they do. They may do it at a high level or low level, but whatever action they take is the only conscious action to determine the supply of money that we have in our economy. If they do nothing, just that inaction will mean that you get a certain level of interest rates. If they follow a policy of ease, then this more or less establishes the rate. If you follow a policy of restraint, then this will establish rates. You can't escape from the fact that you gentlemen have the responsibility. You gentlemen have the power to determine what the level of interest rates is by determining what our money supply is.

You go on to say that we have allowed for a growth of bank reserves and tend to accommodate consumer growth with a growth in

money supply which has been intended to keep pace with the increasing population and the increasing transactions or GNP of our country.

I submit we have not had growth in money supply that comes close to paralleling the growth in the gross national product. Nowhere near it. As a matter of fact, it has been dropping steadily and dropping quite sharply. I am not talking about money supply on my own terms. I am talking about them on the basis of a definition that the Federal Reserve uses on its own bulletin on page 853 of the current issue, Money Supply and Related Data. They include demand deposits and currency only.

The same definition is used by the Council of Economic Advisers in their economic indicators, demand deposits, and currency.

Mr. BRYAN. That is correct.

Senator PROXMIRE. On this basis, the money supply has been dropping sharply in relation to gross national product and the result, in my judgment, has been that we are following a policy of restraint, of some tightness, at a time when most economists feel we may be moving toward recession.

Mr. BRYAN. I think that is well stated, sir, and a very challenging statement. Undoubtedly, if we supply reserves to the banking system, we encourage a fall in interest rates. Undoubtedly if we fail to supply reserves to the banks and borrowing demand is heavy, then, of course, interest rates tighten.

The matter of the money supply, I must frankly confess, is one that puzzles me. I have been on every side of that argument since about 1936. As you know, some scholars include in the money supply time and savings deposits.

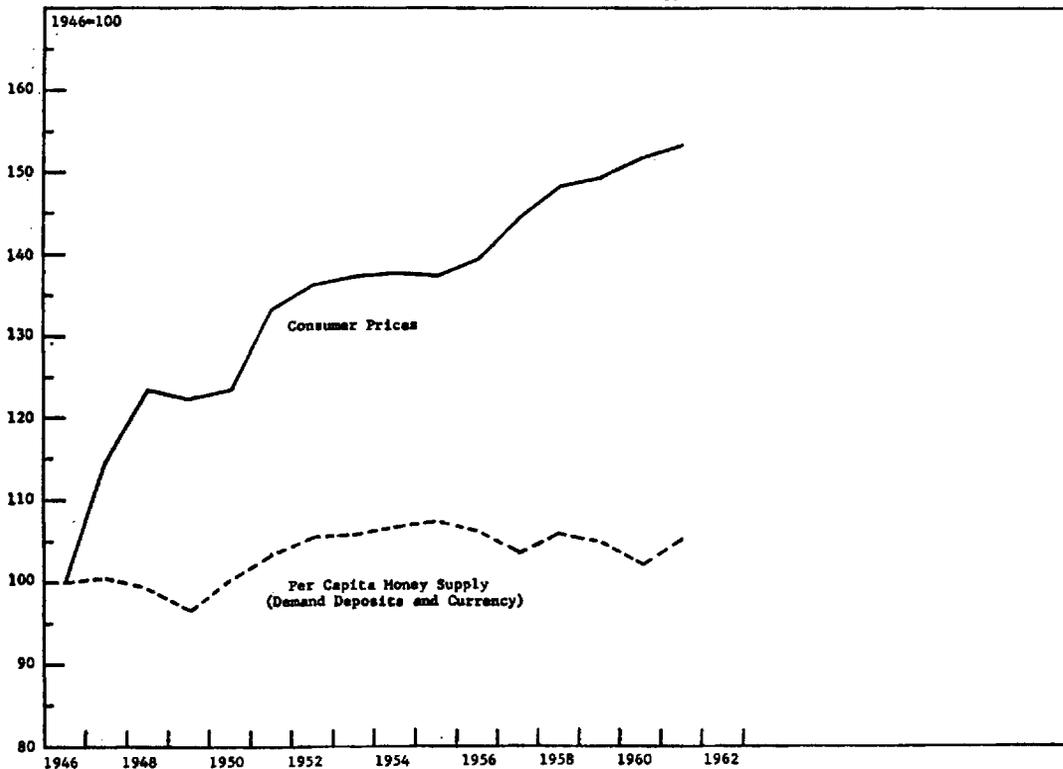
I have, myself, tended to hold to the view that the money supply is demand deposits and currency, but I am deeply puzzled about the present situation. I ought very frankly to speak my puzzlement. The Federal Reserve can supply reserves.

Senator PROXMIRE. Let me interrupt to say that if you do define money this way, then your statement is not true. It is not accurate. You say in your paper we have had a growth in the money supply, which has been tended in turn to accommodate the increasing population and the increasing transactions of our country. Increasing transactions are GNP; it has not begun to keep pace with that.

Mr. BRYAN. Can I introduce a chart into the record?

Chairman PATMAN. Certainly. Without objection, it is so ordered. (The chart referred to follows:)

CONSUMER PRICES & PER CAPITA MONEY SUPPLY (Demand Deposits and Currency)



Mr. BRYAN. The attached chart is the familiar scissors diagram starting both series at the same base year.

The reserve growth, amounting to about 3 percent per annum since 1947, has exceeded the average annual rate of increase in population, which amounted to 1.7 percent. This expansion in bank reserves, adjusted for changes in reserve requirements, permitted an increase in the money supply conventionally defined, of 1.9 percent per annum. Those who also include time and savings deposits at commercial banks in their definition of money supply can point to a 3-percent annual increase for the 1947-61 period.

How is it that these lines could diverge so sharply? I believe the main part of the answer is to be found in the preceding vast wartime increase in most measures of liquidity, principally including the money supply (demand deposits and currency) which went up from 38.7 billion to 102.3 billion from June 30, 1940, to December 31, 1945. The chart is merely illustrative of a problem we have been confronting in the postwar world.

I do not wish to be interpreted as implying that the postwar increase, either in the reserve base or the money supply, is to be deemed appropriate in other circumstances.

The thing that is bothering me about this present situation is this, Senator Proxmire. We supply reserves to the banks. The banks, as was pointed out by the chairman, may use them either to make bank loans or invest. Once that has been done, the Federal Reserve System loses control of where those deposits appear. The people who are the final recipients of a municipal bond issue in Huntsville, Ala., or Texas, or any place, have the choice as to whether they will put those in demand deposits, savings deposits, or time deposits.

For quite a while now, the American people have been putting the deposits, the final recipients of the money, increasingly in savings and time deposits. I think the bulletin recently published something on that. The question that bothers me, and I am sincerely troubled about it, is whether or not some considerable portion of the time and savings deposits are not now properly counted a part of the money supply.

I will not go with those people who say that the total of savings and time deposits is a part of the money supply. I think that is stretching the case.

Senator PROXMIRE. Even if we take that extreme case and include time deposits with demand deposits and currency in the money supply, and savings and loan, we still find that there is a steady drop in the liquid asset relationship to GNP. We find it was something like 85 percent in the middle of 1954, and it has dropped down to some 76 percent or so in the beginning of 1961, the last time for which figures are available in the Federal Reserve Bulletin.

So there does seem to be a drop in liquidity in the economy in terms of the job liquidity has to do. Every time this is brought to Mr. Martin, he says, "Yes, but you have a difference in velocity." But there is always a speedup. By definition you can't have anything else. So it would seem to me that the statistical data reinforce the argument that the monetary authorities are following or seem to be following a policy, a gentle and gradual policy, but it is a policy, which you say so well, of discouraging inflation, and you have succeeded brilliantly in this regard.

But when we have a situation of 4½ million people unemployed, when we have a situation of operating far below our capacity in virtually all of our industries, the fear of inflation is very slim. However, the fact that the economy is moving so slowly is persuading the President to suggest what I think is radical medicine.

You say you would like to give the free market economy time to adjust itself before we intervene with massive medications. I agree. That is why I think it would be so wise for the Federal Reserve to ease up on the monetary situation so that we can avoid a big deficit, a tax cut, this decisive fiscal action which is so much more substantial and so much greater experience and is a brandnew approach. We have always used monetary policy. But to use fiscal policy will be breaking new ground.

Mr. BRYAN. The gross national product and its relation to the money supply is, as pointed out by the chairman, falling. We, nonetheless, have had over a series of years a gradual deterioration in the purchasing power of the dollar. Recently it has been small. It still has been something. We have had relative stability recently. You said that is perfect. That is in the wholesale price level.

By the same token, that is not where it hurts me when I go out to buy things. I am buying them at retail. I am very much a believer in our supplying on a reasonably steady basis, as steady as we possibly can, a base of reserves.

When I talk of reserves, I am talking about total reserves, not free reserves or anything else. I make a distinction there.

Senator PROXMIRE. It is just very hard for me to see that there has been this deterioration in the purchasing power of the dollar. We buy at retail. The wholesale prices are the ones which would be very sensitive to a monetary policy, and they have been stable.

No. 2, we have frictions in our economy which we are all conscious of: Organized labor pushing up wages, big business with the power to administer prices which is common knowledge, and we have those frictions, independent of monetary policy.

Under these circumstances, it seems to me to maintain only a 1-percent-a-year increase roughly in retail cost of living is a real accomplishment. It is probably about the best we can do with monetary policy. I can't see that deterioration is likely to develop because of a somewhat easier monetary policy at a time when we have this great opportunity for employment and for fuller utilization of resources in the economy.

I don't want to repeat myself, but I just feel that monetary policy does seem to be so faulty on this score.

Mr. BRYAN. Let us grant that 1 percent a year is neither as deep as a well or as wide as a church door, but it is considerable. For the person buying a savings bond, it is reducing his interest earnings by 1 percent per year.

Senator PROXMIRE. I would agree that it is something to be concerned about. This is the one criterion, Mr. Bryan, which you have suggested to us this afternoon, the overwhelming criterion, for not adopting a policy of somewhat easier money. Does the Open Market Committee feel that they should achieve a perfect price stability in the retail area?

Mr. BRYAN. I don't either.

Senator PROXMIRE. Haven't you come very close to that?

Mr. BRYAN. Where, sir?

Senator PROXMIRE. I don't say you have said it. I said hasn't the Open Market Committee come very close to achieving this ideal of price stability?

Mr. BRYAN. I think it has become about as close as we can come by monetary policy.

Senator PROXMIRE. Having done so, your big job now is with unemployment.

Mr. BRYAN. Our big job, I think, is to give a supply of reserves that will create the environment in which employment can be full. However, we do have this sort of a problem. If you will notice, I talked a good deal about misapplications of capital and labor. That is perfectly reconcilable with what has been said about the loss of total productivity in the country. It is, however, a different sort of approach to the problem because it presents the thing in terms of the real world.

Let me explain what I mean there, sir. I believe your Subcommittee on Economic Statistics had a great deal of testimony to the effect that we have made a considerable misapplication of capital and labor in the aluminum industry.

Chairman PATMAN. Senator Proxmire is chairman of that subcommittee.

Mr. BRYAN. I should have addressed him in that capacity. Let me give an illustration of the sort of thing that I do not believe can be corrected by monetary policy.

The other day I learned in Atlanta that we have had a plant in the textile industry going on a 4-day week. That plant is manufacturing corduroys. Its market is being taken away from it. It is a perfectly good plant. Its market is being taken away from it by foreign competition. I, myself, do not see how by monetary policy we correct that.

Let me give another couple of illustrations from the textile industry. We have a considerable capacity to produce velveteens in this country. The velveteens have been taken away from us almost wholly by foreign competition. To be sure, the velveteen industry was never very great, but there is a loss of job opportunity. Capital and labor must be reallocated.

Until we can get that done, I don't see what monetary policy can do on that.

May I give still another illustration? We have a very large capacity to produce gingham. That has been taken away from us by foreign competition. I do not believe that there is any possibility for monetary policy to correct that. What we have to do is to create a supply of reserves and credit that will allow other industries to expand. We do have some massive readjustments that have gone on in the economy that I think are a great tribute to the adjusting capacity of our economic system.

I am tending to say that our problems are these problems of capital maladjustments.

Senator PROXMIRE. I would agree, but it seems to me that one answer is to permit and encourage the expansion of capital in other areas where we can do a more efficient job. Certainly on the basis of

our success so far, a very favorable balance of trade, \$4.8 billion so far this year in the first half on an annually adjusted basis, it looks as if we will be able to do it.

The President's trade bill perhaps will encourage that. However, if we are going to follow a policy of some restraint and credit rationing and no free reserves, then it will be difficult for business to expand if the capital is not readily available. I recognize the monetary policy can't and should not be expected to do all these things.

I can't see why the answer to the problems you raise is to go along on the basis of what I would feel is a rationing of credit because the money supply is not being made available.

Mr. BRYAN. I hate to disagree. Well, I just hate to disagree. But I don't see that we have credit rationing at the present time.

Senator PROXMIRE. Certainly where we have no free reserves except in country banks, it would seem we would have in some areas restraint exercised by bankers, and they have to decide to whom to make loans and to whom they won't make loans. When we have a situation which provides, as I pointed out, for a relatively quite high conventional 20-year rate, 5.95 percent, this must be as the result of borrowers bidding up the rate.

Let me ask you this, because I want to apologize both to the chairman and to you, Mr. Bryan, you have been very patient and very cooperative and very responsive. I do want to ask this one final series of questions, and these relate to something that was raised by Mr. Eccles this morning. He said that monetary policy is the most effective economic tool that we have. He felt that it was unfortunate that the President of the United States is deprived of being able to use that tool.

We have a bill pending in our Senate Banking Committee, of which I am a member, to provide that the term of the Chairman of the Federal Reserve Board shall coincide with that of the President of the United States, so he can make his own appointment when he comes in and have this opportunity to influence our monetary policy.

This was recommended by a very distinguished and very well balanced group of experts, the Commission on Money and Credit, including David Rockefeller of the Chase Manhattan Bank, and Frazar B. Wilde of the Connecticut Life Insurance Co., and a number of other outstanding businessmen and labor leaders and farm people, as I say, well balanced and certainly could not be considered to be overbalanced in any direction.

Would you favor this kind of opportunity for the President to have more influence over monetary policy?

Mr. BRYAN. Completely.

Senator PROXMIRE. You support that?

Mr. BRYAN. Completely.

Senator PROXMIRE. That would be very helpful to us.

Mr. BRYAN. Without the slightest reservation. Total economic policy, whether monetary or otherwise, can't be going in opposite directions for very long. I would say that, subject only to the circumstance that the Congress has a certain responsibility in the field of money—it is a vital constitutional responsibility—the President certainly ought to have that power to appoint the Chairman.

My understanding of the thing is, that is what was originally intended, and some loose draftsmanship was involved.

Senator PROXMIRE. We feel so helpless in this area. It has been our traditional economic weapon. We had a distinguished professor from California, Professor Weston, appear and talk about fiscal policy to us, and when we asked him why he didn't make recommendations on monetary policy, he said there is nothing Congress can do about it.

Here the Constitution makes it clear this is a congressional responsibility. We created the Federal Reserve to act as our agent in this regard. Now a distinguished economist comes before us and says monetary power is beyond the power of you gentlemen. You can raise and lower taxes, but you can do nothing about the supply of money. Unfortunately, this is the feeling generally in the country. This is something we have given to you men who are on Mount Olympus, and you decide with infinite wisdom what should happen to the economy, and no matter how deeply we feel you are in error, we feel helpless to do anything about it. The President can't do anything about it. This is an utterly helpless feeling.

Mr. BRYAN. I read that in Professor Weston's statement, and I jumped 15 feet in the air. It is obvious that you gentlemen can call us up here and point out the errors of our ways, and then you can chew us and admonish us, among other things, and finally you can abolish us. Does it take three readings of a bill to get it through?

Senator PROXMIRE. In Wisconsin we used to follow a policy, everytime a new administration would come in, usually with the same party, they would abolish and re-create. It worked quite well. I am not suggesting that we would necessarily be able to get that kind of a bill through the Congress. With great respect and admiration for many of you gentlemen on the Federal Reserve Board, it would be mighty tempting to try sometimes.

Mr. BRYAN. We have had much the same system in Georgia, so I am familiar with how it works.

Senator PROXMIRE. Thank you, Mr. Chairman. And thank you, Mr. Bryan, very, very much. You have been very helpful.

Chairman PATMAN. That reminds me that the first bank in the United States had a charter of 25 years and expired. The second bank had a charter for 25 years, and it expired. The Federal Reserve Act in 1913 had a charter of 25 years, but along when nobody was looking, they got that through Congress to make it a perpetual charter. That was back in 1926, 1927, 1928, or 1929. I don't recall. Do you recall when it was?

Mr. BRYAN. I don't remember that exactly.

Chairman PATMAN. They could probably foresee the possibilities. I think a better phrase, Senator Proxmire, is that Congress has "farmed out" to the Federal Reserve the privilege of handling our money. And they are doing it for us. It is true that Congress can change the law, Mr. Bryan, and if the Federal Reserve ever makes a real bad mistake and you get us into a depression, you know things can happen awfully fast, and you suggested them a while ago.

Senator PROXMIRE. If the chairman would yield, he used the words "farm out." I am sure that doesn't mean that the Federal Reserve is in the minor leagues. I would say it was just the opposite.

Chairman PATMAN. I am not trying to minimize the importance of their functions. But you can farm out big things as well as little things. In this case we farmed out big things, the biggest thing, I think, in the American Government today—monetary policy—and you gentlemen have more power than the Congress. You have more power than the Executive. It can be taken away, and it can be changed, but you would have to have an unusual situation that would create public sentiment that would support a change.

You mentioned a while ago, Mr. Bryan, that as a member of the Open Market Committee you act as an individual. That is my understanding. A member of the board of governors acts as a public servant.

Mr. BRYAN. I am not a member of the board of governors.

Chairman PATMAN. I mean those that are members. They are acting as officials. You are acting as an official as president of the Federal Reserve Bank of Atlanta. You hold up your hand and take the oath to support the Constitution of the United States, and so on.

Mr. BRYAN. That is right.

Chairman PATMAN. When you come on the Open Market Committee, you come on about every third year, do you not?

Mr. BRYAN. Yes.

Chairman PATMAN. You alternate. When you are on the Open Market Committee for a particular year, you take an oath there as a member of the Open Market Committee?

Mr. BRYAN. Yes.

Chairman PATMAN. The years that you are not on, you don't take an oath, do you?

Mr. BRYAN. No.

Chairman PATMAN. Therefore, you don't have the obligations as a nonmember sitting in on the Open Market Committee that you have when you are a bona fide member of the Open Market Committee.

Mr. BRYAN. No, I disagree with that, Mr. Patman, and I hate to say so. Do you mind if I say something?

Chairman PATMAN. Certainly you can say anything you want to. I am glad to have your viewpoint.

Mr. BRYAN. In the first place, I would be delighted with the opportunity of taking an oath either as an alternate or as a nonmember of the Open Market Committee, or as a president of the Federal Reserve Bank of Atlanta. I regard myself as a public servant without any question whatsoever.

Chairman PATMAN. We had an awful time getting that ad hoc report in our record one time. It got in under the Republican chairman, when Senator Flanders was chairman of the subcommittee. We made a motion to put that ad hoc committee report in the record in 1954, and it was over the objection of the Federal Reserve Board, but it was put in the record. That ad hoc committee report discloses that the members of the Open Market Committee assume the attitude that you mentioned a while ago, that they are responsible only to themselves as individuals.

In other words, they don't have the obligation to the Government that a Board member has. They don't have the obligation that you have as President of the Federal Reserve Bank of Atlanta. On that

committee you act as an individual, as you said a while ago. You are obligated only to your own conscience and God.

Mr. BRYAN. No, I can't agree with that. I am sorry, Mr. Patman, but I just can't agree with that.

Chairman PATMAN. Where is your obligation?

Mr. BRYAN. I do not change my obligation to the American people or my capacity as a public servant merely because of the fact that the law says that the president of the Federal Reserve Bank of Atlanta shall occasionally sit there.

Chairman PATMAN. You have a different hat on. One time you have on a hat of an official member. But then, the next year you are on the outside. You don't have any hat as a member of the Open Market Committee, but they let you come in—seven of you. That makes 12 bank presidents there, 7 not really official members. They have not taken the oath as members, but they are allowed to sit and participate in the discussions. They are called on for views, just like the rest. They have influence, evidently, in the discussions just the same as a member. I think, Mr. Bryan, that is in violation of the law. Not that I distrust any of you. And certainly my observation is not any personal attack on anyone or the organization as such.

But just looking at the law which says that 12 members shall constitute the Open Market Committee, I think the law means that.

Normally you have about 40 people there in that room where you have that Open Market Committee meeting.

Mr. BRYAN. I have not counted them recently. It is a considerable group, staff and everybody else.

Chairman PATMAN. And the information and knowledge they get there could be worth a lot to a person if he wanted to use it for his personal advantage, couldn't it?

Mr. BRYAN. With this exception, and this is an exception. The Federal Reserve System operates in a fish bowl. I do not know any central bank anywhere that publishes as revealing statements as we do. The result is that anybody, you, Senator Proxmire, a financial writer, or anybody who wants to follow what we are doing, knows a few seasonal adjustments to make, can very readily detect it.

Chairman PATMAN. I will ask you these questions.

The Federal Open Market Committee meets approximately every 3 weeks?

Mr. BRYAN. That is right.

Chairman PATMAN. It meets in Washington, D.C.?

Mr. BRYAN. That is right.

Chairman PATMAN. Have there been occasions in recent years when the committee adopted a policy to ease credit and then discovered, 10 weeks later, or 3 meetings later, that what actually had been done was to tighten the credit?

Mr. BRYAN. You will have to let me review the record on that.

Chairman PATMAN. Then you will answer it when you look at the transcript?

Mr. BRYAN. I will try to.

(Material referred to follows:)

The chairman probably had in mind a statement by a staff member of the Federal Open Market Committee made at a meeting when I was absent. He may have had in mind some statements of my own. During parts of 1960, I

was arguing that the free reserve concept was creating an unfortunate impression; I was arguing that, in the light of prevailing circumstances, we should pay a great deal more attention to the level and trend of total reserves.

Chairman PATMAN. Has there been any dissatisfaction within the Federal Open Market Committee, itself, on the vagueness of its so-called directive and the lack of quantitative standards given to the manager of the account?

Mr. BRYAN. That is correct.

Chairman PATMAN. There has been dissatisfaction?

Mr. BRYAN. Yes.

Chairman PATMAN. Has it been existing over a long period of time?

Mr. BRYAN. How long I don't know, but I, myself, have experimented considerably in trying to get a more exact instruction.

Chairman PATMAN. The Open Market Committee's directive is to the New York Federal Reserve Bank, operated by officers and employees of the Federal Reserve Bank of New York, is it not?

Mr. BRYAN. That is correct.

Chairman PATMAN. And paid by the Federal Reserve Bank of New York?

Mr. BRYAN. We have no budget of our own.

Chairman PATMAN. In case of doubt, the Federal Reserve Bank of New York uses judgment, I presume.

Mr. BRYAN. With the exception, of course, that there will ordinarily be a member of the Open Market Committee outside of New York who will be on the call, and how much consultation they do with the Chairman of the Board of Governors, I do not know. Not constant, I would assume, but nonetheless I would also assume he is in rather frequent consultation with them. I do not know that for a fact.

Chairman PATMAN. Do you feel that when the Open Market Committee instructs the manager of the Open Market account to operate on "the tone and feel of the market," there is a general understanding among the members of the Committee as to precisely what its manager is instructed to do?

Mr. BRYAN. Mr. Chairman, that goes back to a considerable difference of philosophy in the Committee. As you know, I have felt that we ought to give more quantitative and less qualitative instructions, because I have felt that it is not proper to hold an agent responsible unless your instructions tell what you want him to do, at least reasonably.

The problem, however, is a very real problem. I would like to speak to that problem just a second. I have felt that we ought to give instructions in more quantitative terms. After all, the only thing we can do is to add to at some rate, maybe even subtract from, the supply of reserves. We may want to influence the supply of money. We may want to influence other things, but that we can't do directly. Once the reserves are supplied, they are out of our hands.

I have felt that we ought to give a quantitative instruction since it is quantitative means that we are using. That, I think, over a period of time is a practicable thing to do. Unfortunately, the manager of the account and the agent bank are compelled to deal in day-to-day terms where they get tremendous swings in Treasury cash balances, in

float, and in other things determining reserves. So a considerable degree of discretion on a day-to-day basis must, I think, be left with the agent bank and the manager.

Nonetheless, I do believe that we need very carefully to consider our supply of total reserves so that we don't start out headed for Le Havre and wind up in Lisbon.

Chairman PATMAN. Have you recommended any of these quantitative standards?

Mr. BRYAN. I have, sir. I have tinkered a lot with a lot of them. The only one I recommended is the use of total reserves, which I believe over a period of time would be helpful in establishing a reasonable and adjustable target. On a day-to-day, week-to-week basis, I don't think the "desk" could or should be required to adhere to it strictly.

Chairman PATMAN. Mr. Bryan, back to the Open Market Committee, just briefly, the Federal Reserve Board has the exclusive power to establish the discount rate. I know that the Board as a matter of custom, or tradition, permits the various Federal Reserve banks to suggest a discount rate. In fact, I believe the law requires that every 2 weeks the discount rate be fixed by each Federal Reserve bank and the Federal Reserve Board be notified as to the rate proposed to be fixed. That gives the Board, every 2 weeks, an opportunity to review the rate and to change it any way the Board sees fit. The law says the Board shall "establish" the discount rate, and the real power is in the Board, because the law says "establish," doesn't it?

Mr. BRYAN. Yes.

Chairman PATMAN. So these banks really don't have power over that?

Mr. BRYAN. Does it say "establish" or "review and determine"?

Chairman PATMAN. I think it says "establish." I could be mistaken.

Mr. BRYAN. Very well.

Chairman PATMAN. The other power that the Board has is over the reserve requirements of the member banks. But the third power that enters into the fixing of monetary policy is in the Open Market Committee, the power to buy and sell securities, to increase or decrease the reserves of the member banks. Isn't it a fact though that the Open Market Committee really passes on all three of those powers? I mean the first two as well as the last one? Don't they openly discuss and agree on discount rates and the reserve requirements?

Mr. BRYAN. My belief on that matter is that there is some discussion from time to time of discount rates, especially when some member may believe that a discount rate change is indicated. I recall very little discussion of reserve requirements. I think there has been some, however.

Chairman PATMAN. Discussion?

Mr. BRYAN. Yes.

Chairman PATMAN. But as between the powers—let us say for the sake of this discussion that the Federal Reserve Board fixes the discount rate, passes on reserve requirements of banks—isn't the third power greater than the other two? And isn't it a fact that the third power could overrule or veto what is done on the other two?

Mr. BRYAN. I wouldn't think so, sir. The discount rate operation—there has been a lot of discussion before your committee and others—

is by no means a particularly important power at the present time. Historically it has been important; it may get to be again. The reserve requirement and the open market operation are extraordinarily important.

Chairman PATMAN. The discount rate is more of a psychological recommendation than anything else: the way I have always considered it, when the rate is increased, that is notice to the banks that interest rates are going up.

Mr. BRYAN. That may be a somewhat oversimplification, but I would not quarrel with it.

Chairman PATMAN. Senator?

Senator PROXMIRE. I would like to thank you for this very fine testimony. I wonder if you would go along with other recommendation of the Commission on Money and Credit which was unanimous. The determination of open market policy should be vested in the Board in establishing its open market policy, and it should be required to consult with the 12 Fed presidents. Instead of having the Open Market Committee, the open market policies would be vested with the Board on the discount rate and the determination of reserve requirements.

Mr. BRYAN. Senator, that is a hard one for me to testify on. I think I would have to adopt almost word for word the statement of Mr. Allan Sproul, made to this committee last year. I can be accused of testifying on that on the ground of self-interest in serving my sense of prestige and feeling of participation in national affairs. I believe, however, that you will excuse me if I do adopt Mr. Allan Sproul's statement on the point, which I thought was very eloquent and very well put.

Senator PROXMIRE. I will look it up.

Mr. Chairman, you said earlier that we had farmed out to the Federal Reserve these important functions. When the big leagues farm out a player, they have a reserve clause.

Mr. BRYAN. Yes.

Senator PROXMIRE. That means they can trade him, call him up, they can sell him; they can do whatever they wish. Unfortunately, we farmed out these powers without a reserve clause, which seems to be our difficulty.

Mr. BRYAN. I think, Senator, you have that.

Senator PROXMIRE. Mr. Roy Moor made that contribution.

Mr. BRYAN. I think you have ample reserve power.

Senator PROXMIRE. We paralyzed ourselves by not using it. I have one other area. Do you think the Federal Reserve carried on Operation Nudge as effectively as it might?

Mr. BRYAN. I am a poor person to testify to that, Senator, because I didn't believe in Operation Nudge.

Senator PROXMIRE. You said "didn't" as if it were dead. Is it dead?

Mr. BRYAN. I don't think so. I think it comes up in the proper place. The powers have not been used recently, but they have not been withdrawn. The committee has not withdrawn them at all.

Senator PROXMIRE. Are there real limits to the size of purchases of long-term bonds?

Mr. BRYAN. By us?

Senator PROXMIRE. Yes.

Mr. BRYAN. Are there real limits?

Senator PROXMIRE. Are there any real limits?

Mr. BRYAN. I believe there are, sir.

Senator PROXMIRE. If we are interested in lowering long-term interest rates and maintaining high interest rates, the chart indicates Operation Nudge is not only dead, but buried 6 deep, because we have gone in reverse on Operation Nudge. The long-term interest rates are up, relative to short-term interest term rates in 1960 and 1961. This is exactly the opposite of the purpose of Operation Nudge.

If we can lower long-term interest rates, we can stimulate the economy without much danger to the balance of payments, because the flow is usually a short-term flow.

Why can't we be effective in lowering interest rates on long-term obligations by open market operations?

Mr. BRYAN. The most dangerous thing in that whole business, in my judgment, is that by a manipulated rate we dry up the supply of investment funds available in that market. I also want to reserve judgment on your apparent belief that long-term rates have no influence on the flow of capital out of the market or rather out of the country. I feel that that is not the crucial factor by any manner of means in our balance-of-payments problem. I do feel that it has an influence.

Senator PROXMIRE. The study made by the Federal Reserve economist indicated the influence was not very important. Dr. Bell, of Haverford, yesterday had a paper which was most persuasive on this. I have not seen any studies that indicate anything else. There are lots of opinions, but there is no data and no statistical study of the kind Bell and Gemmill have given us which suggest that interest rates, either long or short term, have any significant influence on the outflow or inflow of capital.

I want to commend you for this entire discussion in the paper without using as an alibi for high interest rates the balance of payments. I think that added strength to your paper in my judgment.

Chairman PATMAN. You didn't use inflation as of this time. Of course, in the past he did.

Senator PROXMIRE. In the colloquy that was the principal argument.

Mr. BRYAN. I appreciate the niceness of what you said, sir. I genuinely appreciate it. I also genuinely appreciate Mr. Patman's very tolerant and nice treatment of me.

Senator PROXMIRE. I want to call your attention to one statistic before we are through. Three-month bill rate, 1959, 4.49 percent. Government bonds, 10 years or more, 4.27. In other words, the short-term rate was actually above the long-term rate. But, 3-month bill rate, 1961, 2.6; Government bonds, 10 years or more, 4.06.

Mr. BRYAN. That is right.

Senator PROXMIRE. In other words, we are going in just the reverse of Operation Nudge, and the effect on the economy, I would think, would be bound to be adverse.

Mr. BRYAN. I will have to review the long-run history. Incidentally, on some of these questions, am I allowed to supplement?

Chairman PATMAN. Yes; you may elaborate on them. Of course, under the rules, you are not supposed to change the meaning.

Mr. BRYAN. I understand. But where I am looking up facts?

Chairman PATMAN. Yes, sir; you may supplement your statements with any information you believe is germane.

Mr. BRYAN. All right.

Senator PROXMIRE. What do you mean by drying up funds in the long end of the market? Define that "drying up."

Mr. BRYAN. We have a situation now in which it seems to me, Senator, that we have the capital markets behaving very well. The new issues market is going over very well. Everything is going over very well.

Senator PROXMIRE. Except for the 30-year Treasury sale at  $4\frac{1}{4}$  percent, which went over like a lead balloon. It was a real flop and a great disappointment, I am sure you agree. We wanted to sell 750 million; we sold 316.

Mr. BRYAN. Actually that, I think, illustrates perfectly well what I think is the danger—and I genuinely believe is the danger—of trying to establish a market that is out of line with going rates. I do not want to comment on the Treasury's operation there. But one of the difficulties in an interest rate is that you must price your issue to hit the market. I believe a great deal of the Treasury's problem on that issue was on the pricing. I think the Treasury—I am not sure of this—that they did not expect to get the 750 million. The guesses in the market were that they would get a little more than they did get.

I would like to point out on that, that just prior to the issue there were a number of corporate issues in the market going at much higher yields. What I am saying here is not criticizing the Treasury on the close pricing of its issue. If I had been they, I would have done the close pricing just as the Treasury did.

Senator PROXMIRE. The big difficulty is that here is what seems to be a very attractive rate. Four and one-fourth percent is really pretty high. There is no risk. This is the Government of the United States. If we can't borrow money at  $4\frac{1}{4}$  percent, it seems to me the situation is not good, particularly at a time when there are so many indications according to you money managers that we have easy money. I would appreciate it if you would give me a fuller definition in your remarks of "drying up the long end of the market."

Mr. BRYAN. I will do my best, sir.

(The following was later received for the record:)

I think in terms of an equilibrium rate established by the decisions of borrowers and investors. If we drive the long rate, say, to a level lower than would be established in the market, I assume private investors would tend to avoid the long end of the market. They will seek to disengage themselves from it. Then, as the ultimate result of the policy, the severity of the result being dependent on the degree of artificiality we have created, the Federal Reserve System can only maintain the rate by swallowing all the long bonds that are thrown at us.

Chairman PATMAN. Just one or two more questions, Mr. Bryan. You have been very patient, and we appreciate your patience with us.

The discount rate has been kept at 3 percent for the last 2 years during business recession and expansion. Since the amount of borrowings at the discount window have been negligible during almost the whole of this period, why was it necessary to maintain the rate at this level? Would it have made any difference if you had dropped the rate to  $2\frac{1}{2}$  percent? What would happen if the discount were lowered now?

Mr. BRYAN. As you yourself suggested, Mr. Chairman, it would have had an announcement effect in the short market.

Chairman PATMAN. Do you believe this bill that we have reported out of the Banking and Currency Committee of the House, which will come up soon, which, if passed, will permit banks that have foreign deposits to pay a higher rate of interest, will have any material effect on the balance of payments?

Mr. BRYAN. No.

Chairman PATMAN. You don't think it will?

Mr. BRYAN. I am in favor of it, but I don't think that it is going to have any material effect.

Chairman PATMAN. There is one part of the statute here that I often wonder how far it goes. It is section 10, subsection 6, about the reservation of powers of the Secretary of the Treasury. I bring this up because there appears to be occasionally conflict in policies. This law which was written way back when the Secretary of the Treasury was on the Board and was Chairman of the Board. When the law was changed in 1935, and the Secretary of the Treasury and the Comptroller of the Currency were taken off the Board, this section remains a part of the basic law. Subsection 6 (reservation of powers of the Secretary of the Treasury) :

Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the suspension, management and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Board of Governors of the Federal Reserve System or the Federal Reserve Act appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary of the Treasury.

Do you ever have any conflicts where this particular statute is applicable?

Mr. BRYAN. Mr. Chairman, I have not studied that section of the act for so long that I have forgotten all about it. I must confess it freely. I have never realized any such conflict as you imply.

Chairman PATMAN. We are grateful to you. Thank you, Mr. Bryan, for your appearance here today.

Mr. BRYAN. I am grateful to you for letting me appear.

Chairman PATMAN. You may elaborate upon your answers and insert any material that you consider germane to the inquiry.

Mr. BRYAN. I will do so.

Chairman PATMAN. Without objection, the committee will stand in recess until 10 o'clock in the morning.

(Whereupon, at 3:40 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, August 16, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

THURSDAY, AUGUST 16, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman and Reuss; Senators Proxmire, Pell, and Javits.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will come to order.

We continue hearings on the state of the economy and policies to achieve maximum employment, production, and purchasing power.

Our concern today is mostly with monetary policies and we are fortunate to have as witnesses some of the country's top policymakers in this field.

Our first witness will be Mr. Alfred Hayes, president of the Federal Reserve Bank of New York.

Mr. Hayes, we are delighted to have you with us. You may proceed in your own way.

After you have completed your statement, the members of the committee may wish to propound questions under the 10-minute rule. You may identify the gentlemen with you if you please.

**STATEMENT OF ALFRED HAYES, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK; ACCOMPANIED BY CHARLES A. COOMBS, VICE PRESIDENT AND SPECIAL MANAGER, FEDERAL OPEN MARKET COMMITTEE; GEORGE GARVY, ADVISER, RESEARCH DEPARTMENT; AND PETER STERNLIGHT, MANAGER, SECURITIES DEPARTMENT, FEDERAL RESERVE BANK OF NEW YORK**

Mr. HAYES. Thank you, Mr. Patman. I am glad to be here.

This is Mr. Charles A. Coombs, vice president in charge of our foreign function and special manager of the Federal Open Market Committee.

Mr. George Garvy, adviser in our research department; and Mr. Peter Sternlight, manager of our securities department.

Chairman PATMAN. We are glad to have you gentlemen.

Mr. HAYES. May I proceed with my statement?

Chairman PATMAN. You may proceed in your own way. You have a prepared statement, I notice.

Mr. HAYES. Yes, I have, Mr. Chairman.

Mr. Chairman and members of the committee: The United States has achieved, thus far in 1962, a substantial expansion in domestic economic activity as well as a further improvement in its international payments position.

During the first half of 1962, production, employment, and incomes all achieved record levels. Available data for July clearly indicate that the expansion is continuing.

Nevertheless, it must be admitted that progress in speeding up the country's rate of economic growth has been less rapid than many of us considered possible at the beginning of the year, and in our international accounts we cannot be satisfied until the balance-of-payments gap has been eliminated.

Economic performance must be appraised not only against the past, but also against what might be achieved if we made reasonably full use of human and material resources. Measured by this latter yardstick, our recent performance cannot be rated wholly satisfactory. Although the percentage of people out of work has dropped substantially during the current upswing, I do not question that we must aim for a more ambitious target. In short, unemployment has been and remains too high.

Business outlays on new plant and equipment must expand sharply if the economy is to move into higher ground. Business investment has, in fact, rebounded smartly from its recession lows, but in this vital area, too, the rate of improvement has been short of the need.

An important stimulus has now been given to business investment by a revision in the depreciation schedule, and another would be provided by the enactment of the investment credit proposal now before Congress.

These changes, and the promise of reduced corporate tax rates next year, are desirable not only as likely to produce expansion in the economy but also as a means to achieve greater productivity and lower costs in an increasingly competitive world market.

We are concerned that the forward thrust of the economy has been losing some of its force, even if one excludes from consideration the temporarily depressing effects of the unraveling of the steel situation.

On the other hand, the generally stable level of prices, coupled with unused industrial capacity at home and ready availability of goods from abroad, has militated against the accumulation of large inventories as a hedge against shortages and higher prices.

The fact that we have avoided excessive inventory accumulation during the current expansion is encouraging, since it diminishes the danger that such accumulation might set off a recessionary movement or contribute to such a movement, if the business tide should turn for other reasons.

Throughout the current business expansion, and despite some criticism at home and abroad, the Federal Reserve has maintained conditions of monetary ease.

As a matter of fact, an examination of business annals is unlikely to produce another example of a strong recovery proceeding so far in an atmosphere of ready availability of credit. Large amounts of bank reserves have been made available, more than offsetting the losses

resulting from the gold outflow. Banks remain comfortably liquid and anxious to lend.

Bank holdings of mortgage loans and municipal obligations spurted by a total of \$6 billion over the first 7 months of the year, more than during any other similar span of time. Installment lending has also increased substantially.

At the same time, loan demand and security flotations by business borrowers have been disappointing, despite the fact that interest rates for such credit are little changed from those prevailing at the trough of the recession.

One important reason for the lackluster performance of bank lending is the moderate business demand for inventories. A look at the volume of reserves supplied by the system, together with the maintenance of a relatively high level of free reserves since the beginning of the recession, should be persuasive evidence that the Federal Reserve authorities have been consistently replenishing reserves which the banks have put to work.

It is true that the money supply—narrowly defined as checking accounts and currency—has increased comparatively slowly of late, but this development has to be viewed together with an unprecedented spurt in commercial bank time and savings deposits. Such deposits, which, for most holders, provide almost as much financial maneuverability as checking accounts, have spurted by \$10 billion, or 12 percent, so far this year.

The public's holdings of short-term U.S. Government securities, which can be readily turned into cash, have also expanded substantially.

So long as the short fall of economic activity from what I regard as a reasonable goal persists, it seems to me that monetary policy should properly remain concerned with maintaining the maximum degree of credit ease consistent with its other objectives.

At the same time, we must keep in mind that attainment of our economic goals depends on many factors, of which credit and monetary conditions, over which the central bank exerts direct influence, represent only one—though an important—element. The job of instilling new vigor into the business expansion must, I believe, be done largely by means other than monetary policy.

I should like to turn now more specifically to developments in our international position.

The balance of payments, as you know, has shown some needed improvement in the first half of 1962. However, a part of the improvement, although by no means all of it, has occurred because of a temporary flow of funds, now reversed, from Canada to the United States as pressures developed on that country's currency.

It is therefore clear that unremitting efforts to make further progress in reducing the overall deficit remain the order of the day.

The administration, as you are aware, is pursuing a multipronged attack on the problem, including an export promotion program, reduction of military spending abroad, negotiations for both additional foreign defense purchases in this country and a wider sharing of aid to underdeveloped countries, and further "tying" of U.S. aid to those nations.

Right now, as well as over the longer terms, emphasis must be kept upon increasing the competitiveness and productivity of the U.S. economy. For this reason, the recent record of lower unit wage costs has been most welcome, especially at a time when wage pressures continue strong in Western Europe and elsewhere.

Bringing our international payments into balance and keeping them under close control is a necessary condition for protecting the dollar's position as the world's leading currency and as the keystone of a stable international currency and payments system.

The rebuilding of foreign monetary reserves and the redistribution of international gold reserves have resulted in a decline in our gold stock and in a rapid rise of foreign short-term claims on the United States.

These short-term claims are like money in the bank to those that own them; and, just as any of us would, they look to the banker, the United States, to provide assurance that the bank is being managed wisely.

If we expect people to keep their money in U.S. dollars we must give them both confidence in the soundness of our currency and some inducement to stay with us, rather than moving to another currency or to gold.

It is for this reason that the System has cooperated in efforts to avoid unnecessarily low short-term interest rates and thus to reduce disruptive short-term capital outflows and their actual or potential effects on our gold stock.

In this connection, I should like to emphasize my strong conviction that if we achieve a balance in international payments and avoid actions that damage confidence, our gold stock is ample for our requirements both as a major trading nation and as bankers for the world.

I was surprised, by the way, that several witnesses have proposed to this committee that the United States extend a gold guarantee to foreign holders of dollars. I wish to emphasize my strong conviction that such a guarantee would be an exceedingly harmful measure, besides being ineffective.

In my judgment, this type of protection would be illusory and, in any case, is not warranted in view of the Government's determination to maintain the gold price and to take the basic measures needed to assure attainment of this objective. Indeed, a guarantee would merely becloud this larger issue.

The potential of monetary policy in protecting a currency against sudden speculative pressures is well recognized, hence Federal Reserve policy must remain flexible and prepared to deal with any contingency. We should try to avoid conditions of excessive credit ease that make reserves so ample that our banks and other lenders are induced to seek more remunerative outlets abroad because credit availability greatly exceeds domestic loan demands.

Rate differentials are an important, but not the only, reason for international capital movements. For instance, the sheer size, efficiency, and ease of access of our capital and short-term credit markets constitute a strong attraction to foreign borrowers. And, as you know, a variety of rate differentials are involved, both hedged and unhedged, while their respective significance in pulling in or repelling money may change over time.

The Federal Reserve System has to be continuously alert to the pressures on the dollar which may arise from rate and credit developments, or from any other cause. In essence, the challenge to monetary policy in recent years has been to provide an adequate availability of credit to support a sustainable growth of our economy while guarding against a spilling over of excess liquidity into channels that would weaken the international position of the dollar or renew inflationary pressures domestically.

Meanwhile, the external defenses of the dollar have been strengthened so that monetary policy will not be overburdened while more basic balance-of-payments adjustments are still taking place. Such a strengthening would have been required, it might be added, even without a U.S. payments problem.

Convertibility has greatly increased the volume and volatility of internationally movable funds; this is a natural consequence of the considerable degree of our success in approaching the kind of world we have been seeking to achieve since World War II.

Nevertheless, it does mean that proper resources must be at hand to meet sudden shifts of funds and pressures that may be expected to be temporary. There is encouraging evidence that this problem can be handled through such avenues as the activity of the Treasury and the Federal Reserve in the exchange markets, the increasingly close central bank cooperation of the past 18 months, and the IMF expansion agreement (still requiring final congressional action, of course), which will vastly enlarge our access to currencies that we may need.

Official U.S. exchange operations undertaken so far have basically been designed to protect the U.S. dollar against disturbingly large pressures at a time when we are making steady progress toward bringing our balance of payments into equilibrium.

Treasury operations in convertible currencies began in the spring of 1961 when the Federal Reserve Bank of New York, acting for the Treasury, undertook operations in the market for German marks designed to deal with the abnormal conditions that had developed following the revaluations of the German and Dutch currencies in March 1961.

This operation was followed by other Treasury transactions in Swiss francs, Italian lire, and Dutch guilders, which are continuing up to the present.

The Federal Reserve System with the full concurrence of the Treasury, concluded that the central bank of this country should play a more active and direct role in defending the international value of the dollar. The Federal Open Market Committee therefore authorized the Federal Reserve Bank of New York on February 13, 1962, to undertake transactions in foreign currencies for System open market account in accordance with the committee's instructions.

Since that time the System has acquired a substantial amount of convertible foreign currencies, primarily through a series of reciprocal currency agreements with foreign central banks, and has begun to use these resources in defense of the dollar.

The possibility of acquiring substantial amounts of foreign currencies through such currency swaps with foreign central banks rests upon a mutuality of interest. That interest is to make the present

international financial system, under which world trade and investments are expanding rapidly, work reliably and efficiently.

Therefore countries relying upon the dollar as an important part of their international reserve assets are glad to participate in arrangements that reduce the possibility of temporary and capricious pressures on the dollar.

Furthermore, since currency swaps and standby agreements are tantamount to a mutual credit facility, foreign countries as well as ourselves obtain access to additional resources in case of need. Over the years ahead, these arrangements can also make a useful contribution to world liquidity needs.

In carrying out exchange transactions for both the Treasury and the System, we have made a point of establishing the closest and most harmonious possible relations with foreign central banks—an indispensable requirement when working in the exchange markets for their currencies.

We have found that, with this cooperation, our use of foreign currency resources has in fact been effective; we have helped to strengthen the dollar in the exchange markets, reduced cumulative or snowballing speculative flows, and eased the immediate impact upon the U.S. gold stock of foreign central bank accumulations of dollars.

You will realize that official U.S. exchange operations rest upon the assumption that the pressures they have to meet are of a temporary and transitional nature. In a number of important instances, this has already turned out to be the case so that the commitments undertaken could be liquidated without a gold loss.

Such success, however, cannot be taken for granted. In particular, an indefinite continuation of large U.S. payments deficits would assure that the pressure upon the dollar becomes permanent rather than temporary.

Hence, these exchange operations in no way detract from the urgency of our task in correcting the payments deficit.

Furthermore, while the initial development of close international cooperation has clearly been stimulated by the very strains it is designed to combat, foreign countries are counting upon us, as we are counting upon them, to take the national actions necessary to make certain that such strains upon any one currency will in fact pass.

Thus far we have met to a remarkable degree the challenge of harmonizing the domestic and international aspects of our financial policies. I believe we have the needed flexibility to continue to meet this challenge under the changing conditions that may confront us.

Chairman PATMAN. Thank you, Mr. Hayes.

Mr. Klopstock of your staff testified earlier this week and gave us a great deal of information on the flow of funds between the United States and other countries. I want to congratulate you on the careful research that is being done on this and other subjects which influence policy decisions.

It now seems pretty clear from the work done by Mr. Klopstock and others, particularly Prof. Philip Bell, that the amount of funds which flow in and out of the country because of interest rate differentials is very small indeed.

Now, Mr. Hayes, I want to call your attention to the chart on the case which correlates interest yields on long-term Government bonds

with interest yield on 90-day bills. Interest yields on long-term bonds are plotted on the vertical axis, and the bill rate on the horizontal axis.

You may note that from 1947 through 1957 there seems to have been almost a straight-line relationship between long-term and short-term rates.

The average relationship for 1947-1957 is shown on the lower curve. But from 1958 through 1961 long-term rates seemed to have jumped much higher than would have been expected from their past relationships to short-term rates. The average relationship of these years is shown in the shorter, upper curve.

This is a very interesting situation which has been brought out by Prof. John Gurley. I wonder if you are aware of it, Mr. Hayes?

Mr. HAYES. No, I am not. This is the first time I have seen the chart. (See p. 550.)

Chairman PATMAN. You know of course that there has been a great deal of testimony and discussion over the last year about the abandonment of the "bills only" policy. When the announcement was first made, in February 1961, and when Mr. Martin testified shortly thereafter, some of us got an impression that the "bills only" policy had been changed by the Open Market Committee, as a gesture of cooperation with the new administration.

We also understood that this announcement meant the Open Market Committee would try to reduce long-term rates relative to short-term rates, narrowing the gap between the two.

Would you tell us what the Open Market Committee has actually done, if anything, in an effort to reduce rates on bonds of more than 10 years' maturity, Mr. Hayes?

Mr. HAYES. I think the way you expressed or described that change of policy to my mind conveys a slightly wrong impression.

Chairman PATMAN. About the gesture of cooperation with the administration. You take exception to that?

Mr. HAYES. Yes, I would. I think the primary reason lying behind that change of policy, which incidentally I was wholly for, the primary occasion for it, I should say, was that we were increasingly concerned with the possible effects of excessively low short-term rates on our balance of payments and felt that under those conditions, when we wanted to make credit amply available to facilitate domestic expansion, it was incumbent on us to use all the flexibility we might have in our techniques to put in reserves without making, as I say, short-term rates unnecessarily low.

That, I think, was the main reason for the change, although I think the change in essence was a desirable one simply as a move toward greater flexibility over the longer run.

Of course, under the conditions that we were in at that time, which was at the bottom of a recession, it was quite useful that this kind of activity might have, and I think did have, a beneficial effect on the flow of longer-term funds into capital investment.

I do not think we ever had any particular rate objective. We were not terribly concerned about what rate level was achieved. We certainly were not trying to press rates down to any preconceived level.

But we did note that by a certain amount of activity in the longer end of the market we think we eased the position of certain investors and made it easier for them to take up corporate and other issues that facilitated domestic recovery.

Chairman PATMAN. You touched on the question that I wanted to ask next. Mr. Martin has told us several times that the Open Market Committee is not concerned with interest rates as such, nor with the money supply as such, but that it is concerned with a proper flow of funds.

Do you think that is a correct statement of the objectives the Open Market Committee, Mr. Hayes?

Mr. HAYES. Mr. Patman, without seeing the full context of the chairman's remarks, I would not comment on the merit of his contention. But I would like to say this for myself: I think all those factors you mentioned are of definite interest to us and factors that we pay a lot of attention to.

Chairman PATMAN. What is meant by proper flow of funds?

Mr. HAYES. Proper flow of funds is a smooth translation of savings into credit requirements with a minimum of friction, or knots, or psychological difficulties in the process, I should think.

Chairman PATMAN. Mr. Hayes, Professor Ritter of New York University testified on Tuesday. In response to a question he made a statement which strikes me as very interesting. I would like to read it to you and ask you whether or not you agree with it. Professor Ritter said:

To return to your original question—

it was: Would the Federal Reserve by buying strongly in the long-term market return to a peg and wouldn't it be interfering with the free market forces?

I think it is important to reiterate that the Federal Reserve, no matter what it does, is interfering with free market forces. The Fed's purpose is to interfere with free market forces in the monetary area. That is why we have a Federal Reserve. We don't want a commodity standard. We want monetary management; and monetary management has to be management and therefore interference with free market forces.

Furthermore, this is not returning to a peg because by definition, at least in my book, a peg means maintaining a structure of interest rates through thick and thin regardless of economic conditions. It is not a peg to deliberately lower rates in a recession and raise them in a boom.

Mr. Hayes, do you have any substantial disagreement with that statement?

Mr. HAYES. I think I would differ from it in degree rather than in kind. It seems to me that obviously a central bank does have an influence on interest rates. That is inevitable.

I think we have our primary interest in the shorter rates, but there is also clearly an influence on longer-term rates as to what we do on availability of credit and interest rate levels on the shorter end.

I think, however, we have to be awfully careful in exercising that influence because there is a great danger of our becoming dominant factors in the market. I think when we have a free market in Government securities, it is a highly desirable thing for the entire country that it remain essentially free.

When I say "essentially free" I am not denying that we influence it. I think at any time when we are operating in it, we must always

have in mind some necessary limit on our operation so that we won't become too important in it and approach some kind of pegging operation.

There are various degrees of pegging and I hope we can avoid all of those degrees. I think Mr. Ritter is confining pegging to the most extreme case of it. I think in the early part of 1961, for a variety of reasons, it was possible to operate rather substantially in this end of the market without having an unduly dominating influence and with some useful effects.

For one thing, the banks, having seen the turn or expecting a turn in business, were inclined to put themselves in a liquid position and were in a mood to sell a substantial number of offerings in the intermediate term area, which we were able to buy and facilitate that process without risking too much effect of dominating the market.

Chairman PATMAN. Mr. Hayes, now and in the recent past, at least the last few months, and possibly the past year or two, you have been trying to keep short-term interest rates up and long-term rates down. That is correct, is it not?

Mr. HAYES. In recent months I don't think there has been any conscious effort to keep long-term rates down. We have been trying to keep short-term rates up.

Chairman PATMAN. You have been trying to do that arbitrarily? In other words, do what is necessary to keep them up?

In a competitive free money market, isn't it a fact that the short-term rates normally are lower than the long-term rates?

Mr. HAYES. I would think that short-term rates would have a tendency to fluctuate more widely than long-terms. They might be higher and they might be lower. Most times they have been lower.

Chairman PATMAN. Looking back over a half century, Mr. Hayes, do you know of any time when the short-term rates were close to or above long-term rates, except during the pegging period that we have been talking about?

Mr. HAYES. I think back around 1920 they were higher than the long rate.

Chairman PATMAN. From just my recollection I thought that normally in a competitive market the short rate was much lower than the long-term rate?

Mr. HAYES. I find that at times in 1959 short rates were higher than long. I find in 1929 they were substantially higher and in most of 1920 they were somewhat higher.

Chairman PATMAN. Those could be considered exceptional cases, could they not?

Mr. HAYES. It certainly was true that in most years short rates have been lower.

Chairman PATMAN. Mr. Reuss, would you like to interrogate the witness?

Representative REUSS. Thank you, Mr. Chairman.

Mr. Hayes, at the time of the hearings earlier this spring before the House Committee on Banking and Currency on the proposed \$6 billion standby credit arrangement with the International Monetary Fund, the Federal Reserve suggested that it was about to enter into certain arrangements or agreements with various foreign countries.

At that time I requested, and I thought that I had received a satisfactory answer, that we of the Banking and Currency Committee were to be kept informed of what those arrangements were as they were made, on a classified basis, in accordance with the wishes of the Federal Reserve.

I have not been given any information whatever on them. I was a little embarrassed earlier this week when a witness we had from Switzerland told me all that I know about our agreement with Switzerland.

I am under the impression that in the last few weeks you have entered into five or six other agreements. Is there any reason why, on whatever security basis the Federal Reserve wishes, the members of the Banking and Currency Committee should not be informed of at least the substance of these agreements as they are made?

Mr. HAYES. Mr. REUSS, in the first place—

Representative REUSS. I thought I was to be informed. I am disturbed that I was not.

Mr. HAYES. I have to plead ignorance on that because I was not directly involved myself.

Representative REUSS. If not, may I say that the internal communications in the Federal Reserve are not very good because we had a long colloquy with the Chairman of the Board of Governors on it.

Mr. HAYES. I think you will have a chance to talk to him directly on that.

Representative REUSS. I would much sooner have the papers than have the grievance. Can I have the papers?

Mr. HAYES. I presume that the Federal Open Market Committee and the Treasury would be glad to consider that possibility. I would certainly be glad to take it up with them.

Representative REUSS. May I make a formal request that I and any other interested members of the Joint Economic Committee and the Banking and Currency Committee of both bodies be immediately informed of these agreements which have been made in the last few weeks and kept informed on a current basis, with whatever security classification the Fed desires. After all, we are the constitutional custodians of our monetary policy which has been delegated to you gentlemen. I think we would be derelict in our duty if we said we do not want to know about it.

Mr. HAYES. I point this out, Mr. Reuss, that we have publicized these swaps at the time of their initiation. There was an announcement in each case. As a matter of fact, in the recent Monthly Review of the Federal Reserve Bank of New York there is a list of them.

Representative REUSS. The list merely whets my appetite because it tells me that you made these swap agreements but does not tell me what they are.

I really think I should be able to go to you rather than Swiss sources to find out what we did. As a matter of urgency—

Mr. HAYES. Yes; I would be glad to take that up with the committee. I would stress that I am glad you mentioned the security aspects of it because all of these things by their nature involve close negotiations with our friends abroad and there has to be a mutual understanding as to how much becomes public.

Representative REUSS. I appreciate that. If after I have had a chance to inspect and understand the basic papers, I have questions, I would want any colloquys we have on that to be conducted in executive session unless there were good reason to the contrary.

But I do think Congress has to know.

I was interested in your refutation of the gold guarantee suggestion which was made by a unanimous group of visitors from abroad the other day. I may say I have grave doubts about this one, too.

I note that you call it an exceedingly harmful measure besides being ineffective. Referring to these foreign exchange swaps which you have made in the recent past, I assume they carry a fixed exchange rate for settlement at maturity. Is that not the equivalent of giving a gold guarantee?

Mr. HAYES. I think you must make a distinction, in my opinion, between a gold guarantee and an exchange guarantee, in the first place.

In the second place, these exchange guarantees affect only this specialized single operation, and I would point out as a result of that it does not necessarily carry any implications or obligations to extend it to holdings in general and it is a reciprocal arrangement so there is a benefit on both sides.

We get a guarantee of the holding of foreign currency with respect to the same amount of currency. I think you can easily argue that an exchange guarantee there is wholly sound, where a general gold guarantee would be highly unsound.

Representative REUSS. I was not critical of your swap agreements. I recognize that they affect \$700 million rather than the \$17 billion of foreign short-term claims, public and private. However, I am not sure I see the distinction between a gold guarantee and an exchange guarantee. You would not want to press that too far, would you? Are they not about the same thing?

Mr. HAYES. May I digress a second to say that the arrangements in those swaps are in keeping with normal commercial practice of forward exchange markets and spot markets. There is simply one transaction in the spot market and an offsetting transaction 3 months forward.

So it is a very standard way of obtaining exchange protection. I would think the differences between a gold guarantee and exchange guarantee are considerable. I think the gold guarantee, however, is the one that really horrifies me. I think it has very serious implications.

Representative REUSS. Both of them say, however, to a foreigner, "Look, sir, you keep holding that hundred million dollars worth of dollars that you have and we will see if there is a devaluation, which God forbid, you will not suffer harm." That is the economic effect of them, is it not?

Mr. HAYES. These swaps are just a 3-month affair.

Representative REUSS. I appreciate that.

Mr. HAYES. We know darn well there will not be any change.

Representative REUSS. I will say unhesitatingly that one of the things wrong with a gold guarantee is that it is open end and goes from now to eternity, and that is quite a long time, whereas, ninety days is reasonable.

Mr. HAYES. Yes. I think a gold guarantee has very serious drawbacks in perhaps creating an illusion that we can treat our balance of payments with considerable carelessness and not worry too much because we are not endangering our international position by following rather sloppy policies. I think it would tend to divert attention from the necessity of doing what I would consider to be the fundamental measures to strengthen confidence in the dollar.

Furthermore, I think it is unnecessary because of the very obvious determination of the Government to maintain the gold price which is the keystone of our whole international financial structure. I think in the process of being debated it would weaken confidence. I think there would always be questions of whether a guarantee would be kept or could be kept, whether the funds would be forthcoming to keep it.

I think it would involve exposure to abuse. You would have to decide who got the guarantee and who did not. Then other people would try to get in under the umbrella. You would have the problem of discrimination against American holders of dollars saying the foreigners are getting this protection.

I have the same very strong feeling in opposition to this scheme that I would have, for example, to French index bonds, where they try to protect the value of a bond by making it payable in commodities, or gold, or in accordance with some index of electric power production, and all kinds of schemes of that kind, which I was delighted to see France sweep away when they had their financial reform.

I would certainly hope fervently that the United States would never feel called upon to play with that kind of scheme.

Representative REUSS. Thank you for spelling that out.

I have just one more question. You say in your statement that a look at the volume of reserves supplied by the System should be persuasive evidence that the Federal Reserve authorities have been consistently replenishing reserves which the banks have put to work.

I would call your attention, Mr. Hayes, to the current Federal Reserve position in the release of August 10, 1962, which shows that the free reserves of the banking system are really very maldistributed. It shows that as to central reserve city banks, New York and Chicago, and Reserve city banks in the 12 leading cities, there actually are no free reserves. They are in hock to the Fed. They cannot lend anything. They cannot buy a security without selling one.

The free reserves, \$460 million of them, are entirely concentrated in the country banks, banks which traditionally are not able to enter the bill market in any very massive way and banks, furthermore, where big borrowers are not usually able to go.

Is it not therefore, to use your phrase, illusory to talk about generous reserves supplied to the banking system, and should not this maldistribution be a cause of soul searching?

Mr. HAYES. I do not think so for this primary reason: The man who is running the money position of a big bank in your home city or mine would probably be ashamed to face his colleagues if he went to bed with big excess reserves.

The fact of the matter is that a well run big bank that is able to place funds in the market readily never has substantial excess reserves. They try very hard to keep everything at work. The only reason you have substantial excess reserves probably is because there

is a large number of smaller organizations that have a hard time putting these marginal funds to work on a short-term basis. They are not able to predict quite as well ahead of time, and they are not quite as well able to participate in the Federal funds market which gives a means of distributing these funds between banks that are short and banks that are long.

I think the real test of credit policy in any reasonably long period of time, the real payoff of monetary policy must be in the extent to which reserves have been made available, because by and large if they are made available they will be used.

If we look back over the last year, we find that reserves have been absorbed and used by the banks at a very substantial rate. We find, for instance, in the 12 months ending July, that we have had about a billion dollars increase in total reserves, about the same amount in required reserves.

We have provided or we have injected about \$2.5 billion into the open market account by purchase of Government securities, which— together with other reserve gains—has not only permitted that increase in reserves, but also has taken care of a substantial gold loss of about a billion and a quarter, and an increase in currency of a billion and a quarter.

Representative REUSS. What you have just said, Mr. Hayes, translates to me simply as a statement that the banking system in the reserve cities where we really have our banking system centralized is loaned up and cannot make any more loans. This seems to me an unwarranted degree of tightness at a time when we are all worrying about our economy as much as we are.

Mr. HAYES. Mr. Reuss, my observation, talking with bankers from all over the country, and also looking at figures, is that most of the banks feel far from loaned up. They have been very much disappointed in the fact that the loan volume this year by and large has not measured up to their expectations. They would love to make more loans.

Representative REUSS. Loaned or invested up?

Mr. HAYES. As I say, a well-run bank will always use whatever reserves it has to invest if they cannot find the loans to put the funds to work in. While there has been a good increase in real estate loans, a big increase, the demand in most types of loans has been moderate. They have been in a position to buy substantial investments.

I know they are looking avidly for loans both here and abroad. It is the fact that they are looking for them avidly abroad that gives me some concern.

Representative REUSS. Thank you. My time is up.

Senator PROXMIRE. Mr. Hayes, you indicate that your conclusion is that domestic economic activity has improved and during the first half, as we all know, it achieved record levels. You feel that the indicators for July suggest expansion is continuing, but you are not satisfied. You see one principal difficulty in the domestic situation, that is unemployment, I take it?

Mr. HAYES. Yes, sir.

Senator PROXMIRE. Would you not also add excess plant capacity on the basis of the Federal Reserve study, Fortune study, McGraw-

Hill study, all of which show there is at least 5 percent below the optimum 90 percent rate?

Mr. HAYES. Yes, I have some concern for that. I think there is some excess capacity. It is awfully hard to know how much weight to give those measures and to what extent that capacity is obsolete or really is usable. I think we have only rather approximate ideas of the extent of unused capacity. I think there are investment opportunities in modernizing plant that are very important.

I would be somewhat concerned about that, but more concerned about the unemployment because of the human element involved.

Senator PROXMIRE. The reason I stress this is because we have had complete stability in wholesale prices since 1957-59. The June index was 100.1; that is 0.1 of 1 percent above the 1957-59 average which is about as perfect stability as we will ever get.

Retail prices have risen moderately. I think the 1 percent rise per year on the basis of the past record is a pretty good showing. Since we do have excess manpower, and excess factory capacity, it seems to me that from a domestic standpoint this would seem to be a situation in which the money managers would do what they could to provide monetary ease to increase the supply of money as the gross national product increases.

Does this not seem logical from the domestic standpoint for the time being, leaving out the international flow situation?

Mr. HAYES. Let me say this: I think this price record extremely gratifying. I think it should be a source of satisfaction to everyone because the record has been a lot better than it was in the preceding years.

Senator PROXMIRE. Yes, indeed.

Mr. HAYES. I would not, however, feel complete complacency on the danger of inflationary influences cropping up again. I think there are factors in the economy that could cause that although I fortunately see no likelihood of their imminence.

Senator PROXMIRE. The factors causing this, however, are not monetary factors. The factors likely to cause it are the frictions we have in the economy with administered prices, with powerful unions able to push up wages, and that kind of thing rather than a superabundance of money.

Mr. HAYES. I would think the wage push was the primary likely cause of future inflation if we get it. I would agree with you that it has not been a primary concern lately and is not at the moment.

I would say that we have been making money very easy and very available, as I have tried to point out.

I think there comes a point where you can carry that kind of measure to an undesirable extreme in terms of the domestic economy. I think you can find that the credit you are encouraging is finding its way into unsound, speculative ventures.

Senator PROXMIRE. The statistics just seem to force me to disagree. The fact is that the money supply has not been increasing. I don't care how you define the money supply. The fact is that liquidity in the economy has not been increasing as rapidly as the gross national product.

I have the annual report of the Joint Economic Committee for January and it shows since 1955 liquid assets to GNP, and this includes

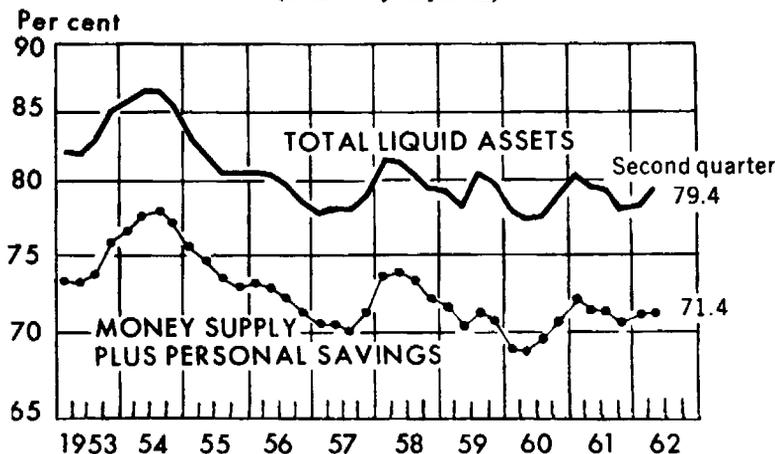
not only demand deposits and currency, the usual definition of money, it also includes savings deposits, savings and loan deposits, as well as time deposits, and this has been going down quite steadily. It has been going down since the middle of 1954 sharply, but the trend line has been steadily downward.

Mr. HAYES. Senator, I have a chart here entitled "Nonbank Liquid Assets as a Percent of GNP," and this shows virtual stability since the end of 1955.

(The chart and note referred to follows:)

## NONBANK LIQUID ASSETS AS A PER CENT OF GNP

(Seasonally adjusted)



NOTE.—Total nonbank liquid assets equal holdings by the public, other than banks, of currency, demand deposits, time deposits at commercial and mutual savings banks, savings and loan shares, U.S. Government savings bonds and U.S. Government securities maturing within 1 year. This series has been adjusted by the Federal Reserve Bank of New York to allow for a reclassification of deposits made in May 1961 and for certain special transactions affecting the period from February through August 1961. Money supply plus personal savings includes all of the assets listed above except U.S. Government securities maturing within 1 year.

Senator PROXMIER. I am sure it does. But that is nonbank. What is the matter with including the bank liquidity also?

Mr. HAYES. I think we are entitled to look at the banks separately. As I have said, I think the banks' liquidity, their position to make loans, has been well sustained.

For example, we have here a ratio, short-term liquid assets in banks in New York City, and this shows that these liquid assets are now approximately 21 percent of their total assets, which is substantially higher than it was in the comparable period of either of the two previous business cycles.

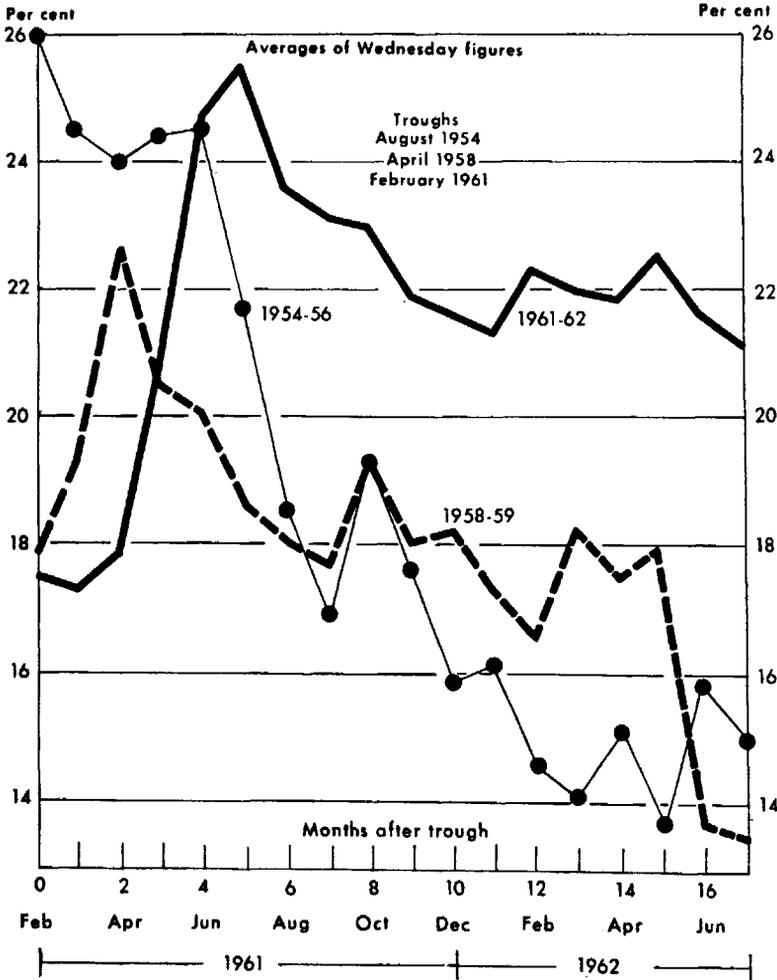
Outside of New York this same ratio is a little over 16 percent, which is also very substantially higher than the comparable figure in the two previous business recoveries.

So that the banks' position, statistically as well as on the basis of common impressions and conversations, seems to me amply liquid.

We turn, therefore, to a consideration of the entire economy outside of the banks—and that liquidity includes the money supply proper and the savings and time deposits and short-term government holdings and so on—and I find that in the second quarter this liquid asset figure was 79.4 percent of GNP, which was slightly higher than it was in the middle of 1957.

If you draw a line through the years from 1957 to date you get almost a level trend.

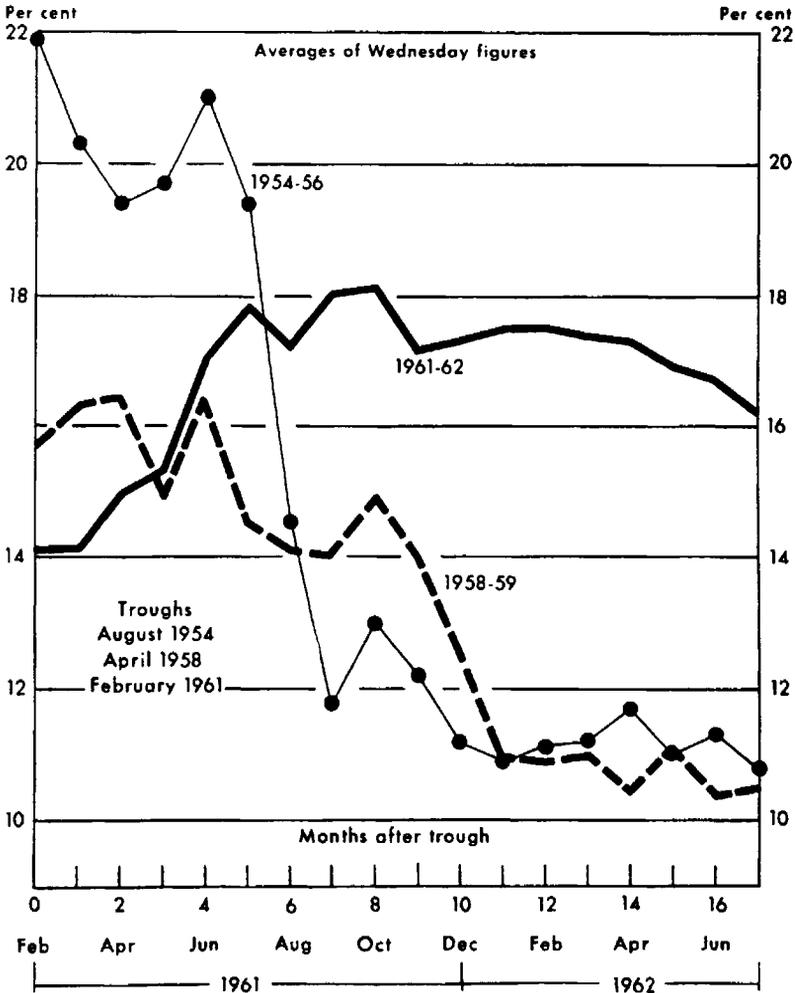
**SHORT-TERM LIQUID ASSETS RATIO NEW YORK CITY**



Senator PROXMIRE. The figures I have for total liquid assets to GNP go from 85 percent to 79 percent from mid 1954 to the beginning of 1962. They are lower now than they have been at any time in this chart.

Mr. HAYES. Senator, may I point out that mid-1954 was a period of extremely easy money and shows a very high point in my curve.

**SHORT-TERM LIQUID ASSETS RATIO OUTSIDE NEW YORK CITY**



NOTE. The short-term liquid assets ratio of weekly reporting member banks outside New York City measures total holdings of vault cash, balances with domestic banks, loans to banks, loans to brokers and dealers and Government securities maturing within 1 year, less borrowings, as a percent of total deposits less cash items in process of collection and reserves held at Federal Reserve banks.

Senator PROXMIRE. You will find that the latest figure represents the lowest liquidity to GNP relationship on the entire chart.

Mr. HAYES. I will be glad to provide the chart.

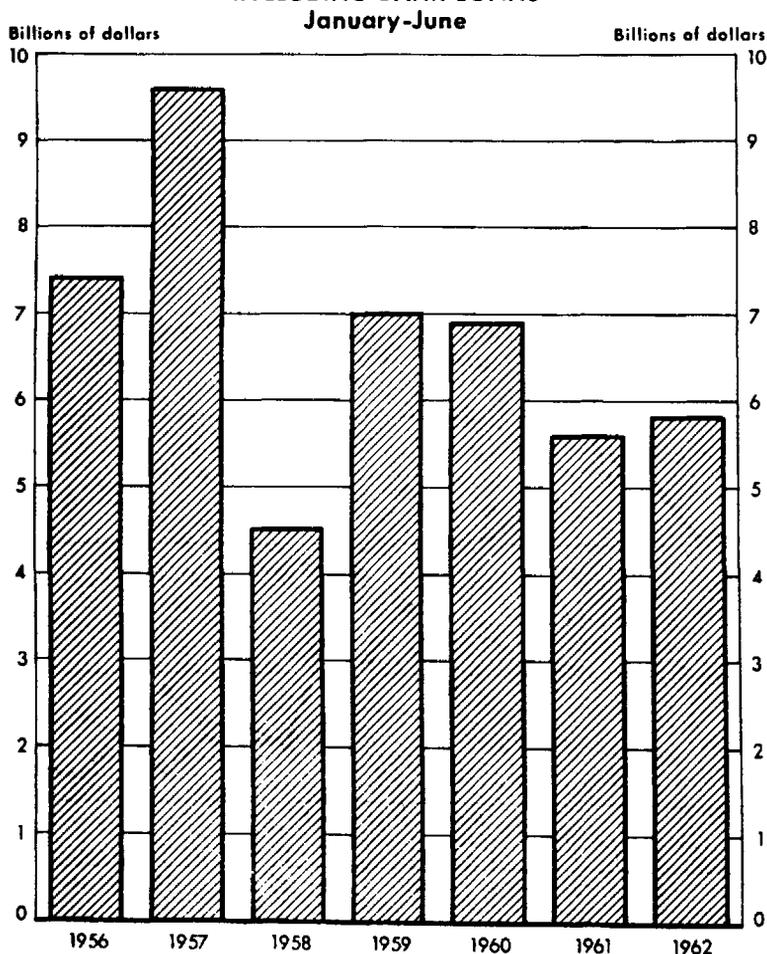
Chairman PATMAN. Would you like to insert these charts?

Mr. HAYES. Yes.

Chairman PATMAN. Without objection.

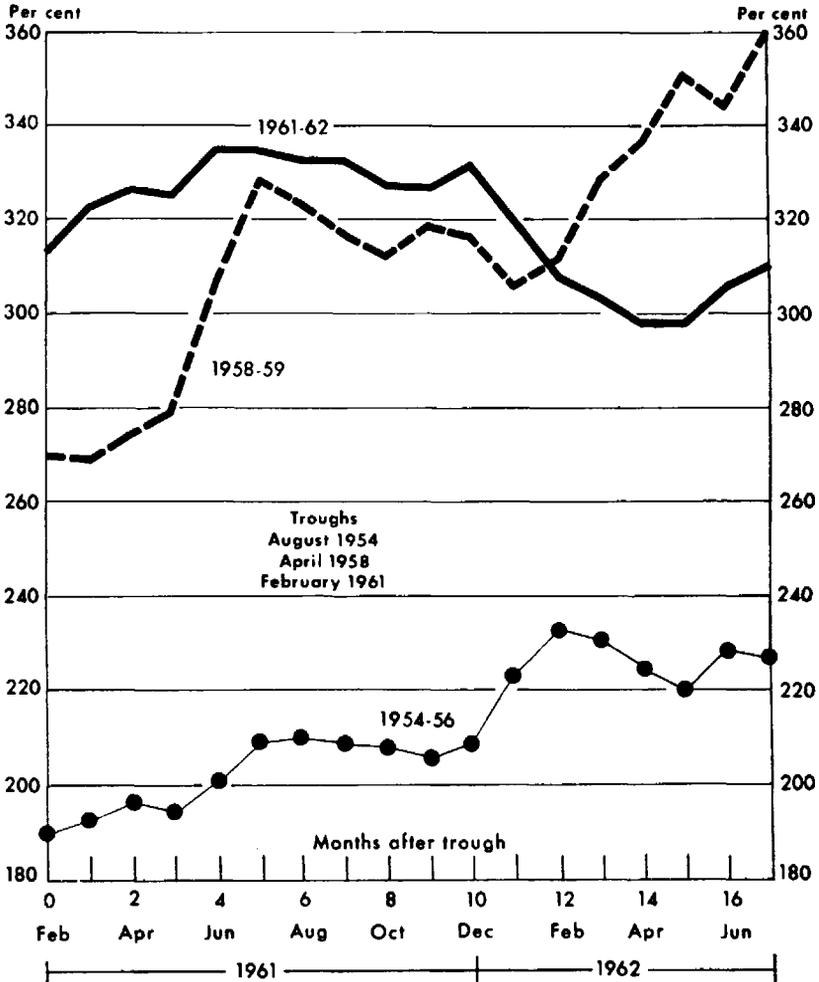
(The charts referred to follow:)

### CHANGES IN TOTAL BUSINESS FINANCING INCLUDING BANK LOANS

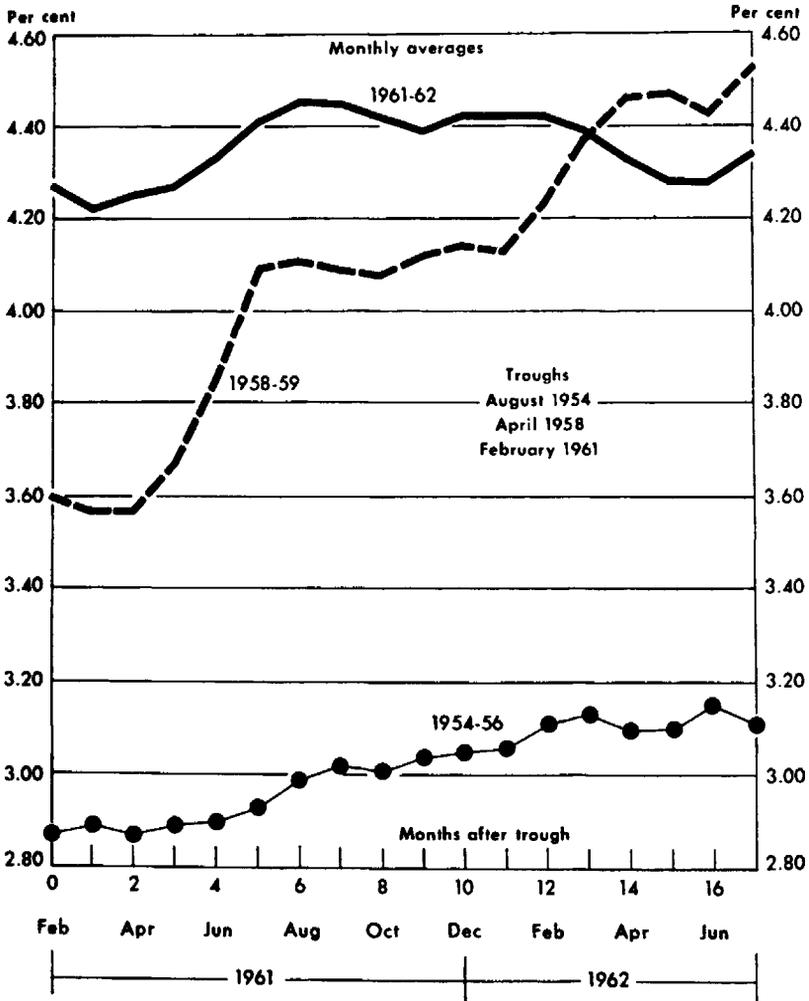


NOTE.—Total business financing (including bank loans) equals new capital from sales of stocks and bonds by corporations other than finance companies, sales finance company business credit, dealer-placed commercial paper and dollar acceptances outside of banks, and gross business loans at commercial banks (excluding loans to finance companies as reported by weekly reporting member banks).

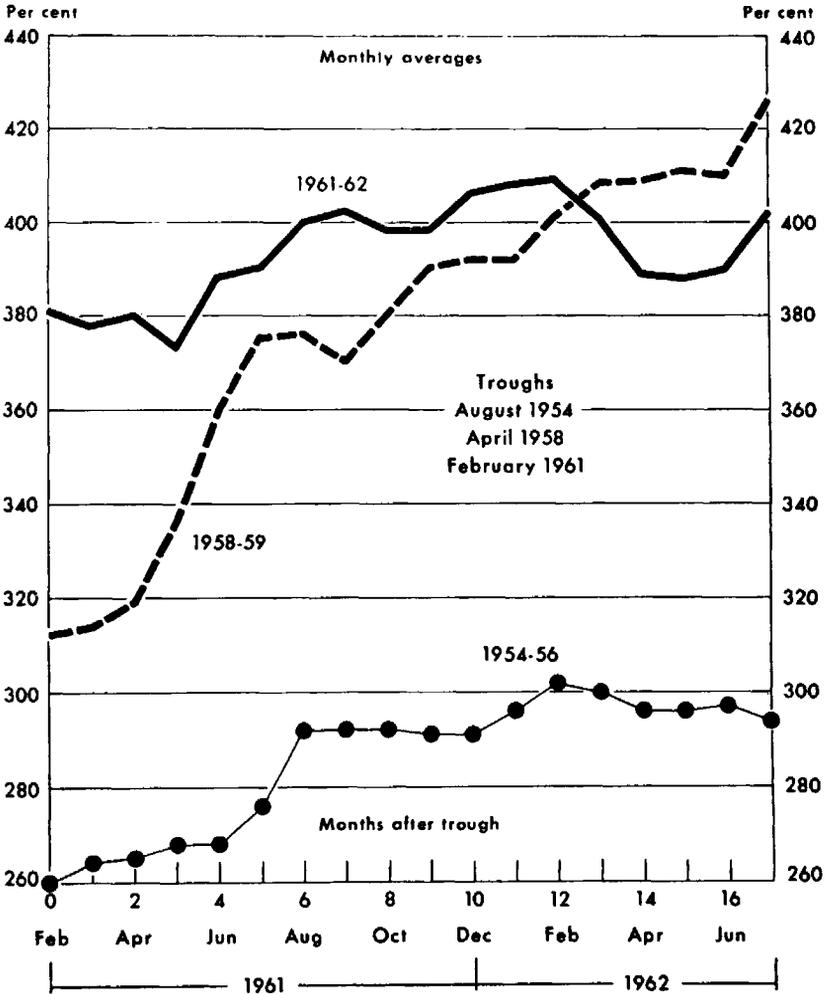
MOODY'S Aaa-RATED STATE AND LOCAL GOVERNMENT BOND YIELDS



MOODY'S Aaa-RATED CORPORATE BOND YIELDS



UNITED STATES GOVERNMENT LONG-TERM BOND YIELDS



Senator PROXMIRE. I do not want to hammer away too persistently on this point, but I cannot understand what kind of answer you can give to Congressman Reuss' point. It seems to me it is irrefutable.

The fact is, if you have no bank reserves, you have no bank reserves. You are saying that the difficulty is when you give bank reserves they use them. They go out and buy government securities, or make loans. It seems to me that is exactly what they ought to do.

At a time when the President is so deeply concerned with our economy so that he is going to ask for a tax cut next year although we are going to run a deficit anyway, and when most economists who testified before us feel our economy is leveling off, that to have our banking system without any reserves at all except in country banks,

25 percent of which are vault cash, is not a situation of monetary ease or abundance of funds.

Mr. HAYES. Senator, I agree it is exactly what they ought to do. It is what they do. I take satisfaction in expansion of bank loans and investments and deposits over the last year or year and a half, whatever period you measure.

I would say this about free reserves: that the figure has some significance as an indication of ease or lack of ease, but it has been given a great deal too much emphasis in my opinion by the press and other commentators. I do not think that single figure of the level of free reserves necessarily has a great deal to do with whether we are providing sufficient funds for the community.

Senator PROXMIRE. Let us take interest rates. Interest rates have been rising. Furthermore, long-term interest rates, as the chairman showed so well on this chart, have been rising more rapidly in recent years than short-term rates. So that Operation Nudge which was supposed to do exactly the opposite, has in fact pushed up long-term rates relative to short-term rates and has become Operation Fudge.

We have a reverse situation in which the long-term rates are rising more rapidly.

Mr. HAYES. May I point out another fact about the developments of the past 18 months? U.S. Government long-term bond yields have gone from 3.80 in February of 1961 to slightly over 4 percent when this chart ended, last month.

Senator PROXMIRE. What was the first date?

Mr. HAYES. February 1961. Slightly over 4 percent in July 1962, which is a change of only 20 basis points during a period of very strong recovery.

I also find that in 1958 to 1959 the previous cycle—

Senator PROXMIRE. Let me interrupt at this point. Here I think is the real crux of our difference. Most economists say this is not a period of strong recovery. Quite the contrary; every expectation is that we are leveling off at best and may be heading toward some kind of recession. They feel we are not in a period of strong recovery now and during the past 3 or 4 months we have not been.

Mr. HAYES. I would say over the period as a whole we have been going up rather nicely. I will admit there is always a question of where we are going from here. But I would say in the past 18 months when we have had what I believe is a good rate of expansion by comparison with the rate of expansion coming out of troughs earlier—

Senator PROXMIRE. And heavy unemployment all during the period and excess capacity during the period.

Mr. HAYES. Granted. But we had a surprising flat trend of long-term Government bond yields. If we look at triple A corporate bond yields, we find in that same period the yield has gone up from 4.27 in February 1961 to about 4.34 in July of this year, which is almost no change at all.

We also find in State and local government bonds, triple A, the yield has actually declined from about 3.14 in February 1961 to about 3.10 in July of 1962. I think that is a remarkable showing. I think we can take satisfaction from that.

Senator PROXMIRE. Thank you.

Chairman PATMAN. Senator Pell.

Senator PELL. Mr. Hayes, I extend my personal greetings to you.

Mr. HAYES. Thank you.

Senator PELL. I was struck by one thought you had and that was your opposition to the theory of the French index bond where they tie in the payment with various real values. I have always been worried by the thought that our total gold supply is in the hands of the Soviet Union which is not exactly a friendly nation and the Union of South Africa which is not exactly stable.

Do you think the reverse is true, that for the long haul gold should always be the peg on which we can hang our currency?

Mr. HAYES. I think the gold standard with all its imperfections has worked pretty well so far. I see every reason to think, with the kind of modifications that have been made in it in the last few years, the development of what I would call a reasonably streamlined gold exchange standard in conjunction with it, or dollar exchange standard, that it gives promise of doing the job for us very effectively over the coming years.

I would think with regard to the availability of new gold, I would think it highly unlikely that whatever regime was controlling South Africa they would forgo the pleasure of selling their gold at a fixed price of approximately \$35. I doubt if they would hang onto that and prevent its reaching the markets of the world.

We also know, or we suspect, that the intentions of some of our other friends that you mentioned may not be always of the best towards us, but on the whole they have sold a certain amount of gold in the markets pretty regularly. I think Russia has provided approximately a quarter of a billion dollars on the average, year in and year out.

Senator PELL. The thought that Russia might be holding a vast amount of bullion with which she could upset the world market does not worry you?

Mr. HAYES. It does not worry me, no.

Senator PELL. One other question: Accepting the premise that our money supply is not increasing in proportion to our GNP, do you see any possibility or danger of deflation?

Mr. HAYES. In looking ahead we always have to weigh the dangers of inflation and deflation. We have already touched on those of inflation. I think there is always a possibility of getting into a softer business situation. But I see no likelihood of its developing in the near future.

I think, on the contrary, the outlook is fairly good. Deflation I know is an unpleasant word with all its connotations and I share the concern over deflation as it is generally understood. But I would also like to say this: A moderate and slight decline in prices might be a rather desirable development in the way of giving some of the benefits of productivity to the long forgotten consumer.

Senator PELL. Do you also believe or do you think an effort should be made to keep the increase in GNP in line with the increase in money supply?

Mr. HAYES. I think over an extended period of time it is quite probable that you will want to have the money supply bearing some

reasonably close relation to GNP. I think you probably intended the reverse relationship. It is the money supply that should adjust itself to the GNP. I think that is a long-run relationship and from one year to another you can get very wide variations in it, depending upon how actively the money supply is being used.

I also think it was clear in the war we expanded the money supply to an inordinate level in relation to the then GNP and it took us a good many years to get back to a more normal relationship.

Senator PELL. Thank you very much, sir.

Chairman PATMAN. Mr. Hayes, vault cash was made available to the member banks as reserves in five different steps, some prior to December 1959, some in December 1959, and some in August 1960, September 1960, and finally November 1960. Prior to the time that some of these last steps were taken, was there any discussion in the Open Market Committee which recognized that making vault cash available as reserves was putting a disproportionately large amount of reserves into the country banks?

Mr. HAYES. Mr. Patman, I remember at the time of these actions, which incidentally were taken not by the Open Market Committee but by the Board of Governors, although we discussed it from time to time on an advisory basis, there was consideration given to the way in which these moves would affect the various classes of banks.

My recollection is a little hazy. My recollection is that there were some offsetting changes in reserve requirements in connection with the final release of this vault cash to tend to equalize the effect you mentioned.

Chairman PATMAN. Was there any discussion in the Open Market Committee to the effect that substantial parts of the new reserves made available to the country banks were not finding their way into the money market and that a given amount of net free reserves was not having the effect on credit availability, and on interest rates, that such an amount of net free reserves previously had?

Mr. HAYES. Yes, there was discussion of this. I think there was recognition of the fact that it would take bankers a little while to get used to the new idea and regulations. I think that for a temporary period of transition, as a result, there may have been a time when a given level of free reserves was perhaps not quite as significant as it had been before.

I think that was a purely temporary phenomenon. I think the banks are used to the new rule.

Chairman PATMAN. Has there been any dissatisfaction within the Fed's Open Market Committee itself as to the vagueness of the so-called directive given to the manager of the account or to the lack of quantitative standards in use for reaching policy decisions?

Mr. HAYES. This is a subject, I guess, we have been talking about for the last 10 years and we will always be trying to improve our procedures. I think we have gone into this in previous meetings, Mr. Patman.

Chairman PATMAN. Yes, sir, we have.

Mr. HAYES. On the whole, we feel that the manager does get the kind of clear instructions that he needs to proceed. But we are always willing to try to improve our techniques and from time to time we have made certain changes in that direction.

Chairman PATMAN. Have there been occasions in recent years when the Open Market Committee adopted a policy to ease credit and then discovered 10 weeks later, or three meetings later, that what actually had been done was to tighten credit?

Mr. HAYES. I don't remember whether this has happened or not. I can't readily conceive of a situation.

Chairman PATMAN. About 1960.

Mr. HAYES. It is possible, Mr. Patman. I don't recall. It is perfectly possible because market factors can often go contrary to the way you are expecting them to develop. Over a short period you may not be able to accomplish what you set out to accomplish.

Chairman PATMAN. Have there been occasions within the last 2 or 3 years when the Open Market Committee changed its policy with reference to the degree of monetary ease or tightness it wished to achieve but without changing the wording of its directive?

Mr. HAYES. My impression would be that if that was done, it was such a minor modification that we felt it was unnecessary to change the directive. The directive for some time was couched in pretty general terms and within those general terms there was room for shading and the manager would get the impression of what shading was desired by having attended the meeting and listened to the entire discussion and hearing what the consensus of the meeting was.

Chairman PATMAN. That is the object of their attendance at the meeting, I assume?

Mr. HAYES. It is partly that. It is also to inform the meeting of all the facts and figures at his command.

Chairman PATMAN. Mr. Hayes, let me call your attention to a couple of relationships. At the end of 1953, the money supply, on a seasonally adjusted basis, was \$128.1 billion. That amounted to 36 percent of the gross national product of 1953. During the second quarter of 1962 the money supply has averaged \$145.5 billion. The gross national product is estimated at \$552 billion for that quarter, on an annual basis.

So it appears that now the money supply is down to 26 percent of the gross national product. This relative strangulation of the money supply since 1953 seems to me to have been an influence on the slow rate of economic growth and the high unemployment of recent years.

Do you disagree with that? I assume that you do, Mr. Hayes.

Mr. HAYES. Yes; I do, Mr. Patman, because I feel that the subject we were discussing earlier, total liquidity, has a great deal to do with the case. I would also reiterate that I think the money supply had reached a grossly inflated level with relation to the size of the economy during the war years. It retained that characteristic for a good many years of adjustment while the country was growing up to this money supply.

So the fact that it is down considerably since 1953 in itself I don't think is indicative of any undesirable development, particularly when we view that change in the light of what has happened to savings deposits, time deposits, and total liquid assets of the public in the same period.

Chairman PATMAN. Thank you. I would like to have an understanding with you, if it is all right, that we may submit questions to

you, in writing and that you will answer them when you look over the transcript of your testimony. Would that be satisfactory?

Mr. HAYES. Yes, sir; I will be glad to do that.

Chairman PATMAN. We will have a short recess.

(Brief recess.)

Chairman PATMAN. The committee will please come to order.

Are there any other questions?

Representative REUSS. No questions, Mr. Chairman.

Senator PROXMIRE. I would like to ask one or two quick questions, if I might. I have been trying to find out from the staff, can you tell me whether there has ever been a time in the history of this Nation when the money supply has been smaller in relationship to the gross national product than it is today?

The Federal Reserve has made all kinds of explanations, including the notion that time deposits have become equivalent to demand deposits, but nevertheless the statistics are pretty stubborn. They indicate the ratio of money supply to GNP is now down to 26.4 percent in the second quarter of 1962. I think that is lower than it was during much of the period of the twenties and perhaps lower than it has ever been.

Mr. HAYES. I would have to check that. I have the impression that it is close to the low point in recent years. I think it was approximately at this level in relation to the GNP during several years in the late twenties.

I think the subject of money supply is a very fascinating one and we certainly don't purport to know all about it. I certainly don't. It is something that we are studying all the time and trying to learn the significance of it.

I feel in monetary theory increasing attention is properly being paid to total liquidity. You will recall that was brought out in the Radcliffe report in England, that total liquidity had a great deal of significance.

I think the kind of measures we have been discussing showing total liquidity must be considered along with this consideration of money supply proper which is merely our definition of money supply. I don't think we need feel disturbed by that figure that you have mentioned in the light of these other circumstances.

But this is a subject that we are constantly studying and perhaps we will be able to know more about the significance of money supply as time goes on.

Senator PROXMIRE. The day before yesterday we had testimony by a very distinguished economist, vice president of the Harris Bank in Chicago, who argued that in every single recession we had without exception the recession had been preceded by monetary restraint and the tighter the restraint the deeper the retrenchment. He went back to 1918 to show this. It was quite persuasive. He argued that the Federal Reserve is following exactly those policies of monetary restraint now and in his judgment this restraint, as he defined it, and he said it makes very little difference whether you include time deposits or not, is likely to get us into the same kind of domestic economic trouble in coming years and months as we have had in the past.

Mr. HAYES. Senator, let me say first—

**Senator PROXMIRE.** He was pretty well backstopped by a distinguished professor of business and commerce from the University of Wisconsin and by a New York University professor, all of whom had served on the Federal Reserve Board as economists, either the Federal Reserve Board in Washington or the New York Federal Reserve Bank.

**Mr. HAYES.** Senator, I have been gratified to observe that the severity and depth of recessions in the last few business cycles seems to me was less than we used to think was normal. In fact, the latest dip was a very shallow recession. I would hope that similar experience would be true in the future.

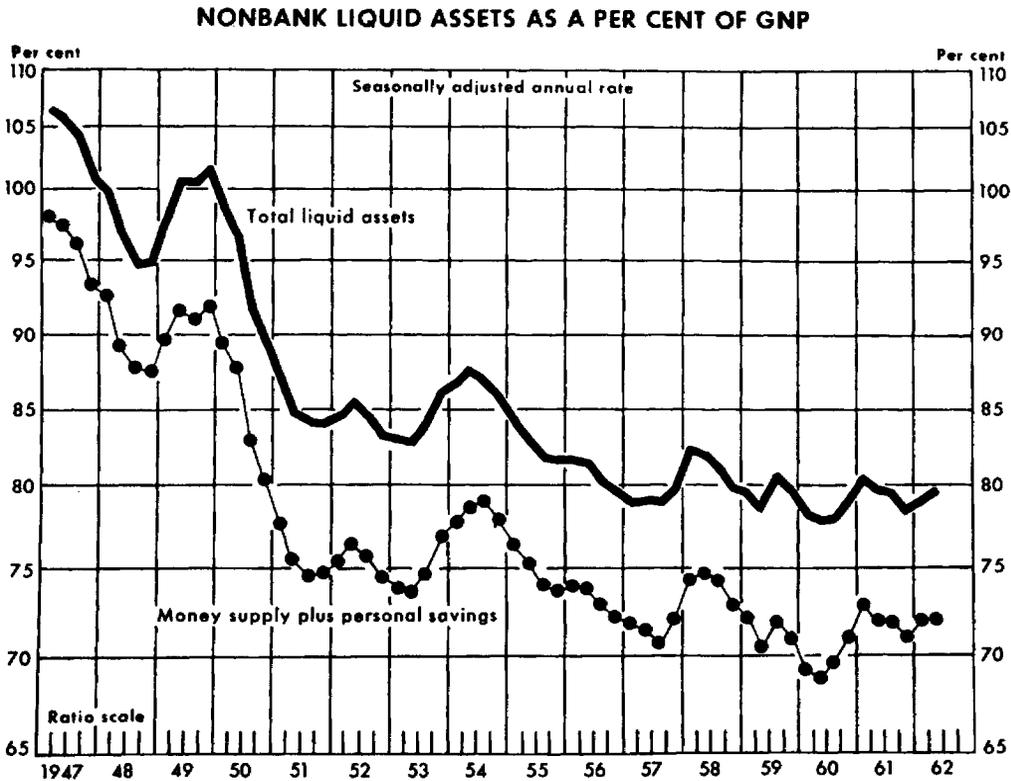
If we should get a business turn, of which I see no evidence now, I think there is a good chance that it would again be a pretty shallow dip.

Furthermore, I would like to take this opportunity again to say that I don't think we have anything remotely resembling a tight money policy at the present time. I think it is distinctly easy policy and it seems to me from the common sense standpoint of asking bankers how they feel and their willingness to entertain credit applications, their avid search for outlets for their funds, it is obvious to me it is a fairly easy money atmosphere.

**Senator PROXMIRE.** Would you submit for the record the historical relationship between liquidity and GNP?

**Mr. HAYES.** Yes.

(The following was later received for the record:)



Senator PROXMIRE. What kind of goals does the Open Market Committee have for the economy? That is, do you have specific unemployment level goals, capacity operation goals, and goals of this kind?

Mr. HAYES. We have general goals such as the achievement of sustainable economic growth and reasonable price stability and a viable international balance of payments.

Senator PROXMIRE. In terms of arithmetic.

Mr. HAYES. We don't set specific goals ahead of time with figures that we are shooting for in those areas.

Senator PROXMIRE. Yes, sir, Mr. Eccles, who was formerly Chairman of the Federal Reserve Board, was very emphatic in insisting on the absolute imperative necessity of having goals. The great importance of monetary policy for the health of the economy and the deep and profound influence on it.

Mr. HAYES. I think in that connection I have always been impressed by the fact that monetary policy is one of the few measures of governmental action that is exceedingly flexible. It can be varied from day to day even. Certainly from week to week. We have a meeting every 3 weeks and we are in constant touch with each other even every day during the week.

It seems to me in the light of that it would be undesirable for us to get too fixed a notion at any one time of a definite goal that may turn out to be quite impractical and quite undesirable a month later. I think these general goals are constantly before us.

We are always trying to achieve them. We never lose sight of what we are supposed to be trying to do. The idea of spelling out a specific figure as a target, I think, has some drawbacks aside from this loss of flexibility. It may also lead to disappointment if you fail to measure up to it. I would question the wisdom of that technique as applied to our activities.

Senator PROXMIRE. Thank you very much.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Hayes, I just want to make this observation: If you are restraining private debt and thereby keeping down the expansion of private economic activity, as many people believe, then you are making it necessary for the Government to make more expenditures for public works, for purposes of giving people jobs, and to assume more debt—the President has already warned us that we will have to do something. If our money supply were greater, and the people had more money and more credit, they could do a lot more for themselves. But if you gentlemen restrain the supply of money and credit, they cannot do for themselves, and that forces a greater burden on the Government.

I note that you are not in a position that the members of this committee are in. You have no constituents to go before and ask for their votes. You have a constituency but they are understanding, sophisticated people, and they will go along with you people.

Senator PELL. They are captive constituents.

Chairman PATMAN. I guess you could call them that. Naturally you are satisfying them, Mr. Hayes.

I am not impugning your motives or discrediting you in the least. I have confidence in you, Mr. Hayes. I have observed you as a witness

for a long period of time, and I think you are trying to be a public servant as hard as you can in the position you occupy.

But you have a different constituency than we have. I know you don't have to run for office, but you have to get along with your board of directors, and two-thirds of them are bankers. Sometimes they have a different idea from what we have here.

I just want to invite your attention humbly, but sincerely, to the fact that although you cannot be defeated for office and you cannot be put out by the people or the Members of the Congress who have no control, there is a great challenge right now that you have as a permanent member, and the only Federal Reserve bank president who is a permanent member of the Open Market Committee, to look carefully at this situation, because the money supply has been going down and is down now, probably the lowest in the history of the Nation.

We recognize that some of the greatest upheavals we have ever had in history were caused by the lack of money and credit. Do not let us approach them again, Mr. Hayes. You know, although you gentlemen are exercising your powers and your functions as though you were a fourth branch of Government, almost, there can be upheavals in this country and a change in sentiment. I just hope you take another look at this shortage of money and credit and see if you cannot help us out by easing it some.

We will not take up any more time.

Would you like to comment?

Mr. HAYES. Might I, Mr. Patman?

Chairman PATMAN. Certainly.

Mr. HAYES. Thank you for your expression of confidence.

You made some reference to our squeezing of private debt. I would like to say that I don't believe we have been squeezing the amount of private debt in any sense. In fact, mortgage debt has been growing at a very excellent rate. Outstanding corporate debt has also been going up. The mortgage money has been so available that in spite of the substantial increase in new mortgages placed, the rates have tended to go down right through the last 6 or 7 months.

So again I would say we believe thoroughly that we are following a policy of ease and not one of tightness.

Secondly, I would like to correct one comment on the makeup of our Board of Directors, which does not include six bankers. As a matter of fact—

Chairman PATMAN. Wait just a minute. You say the bankers don't elect six of them?

Mr. HAYES. I understood you to say, Mr. Patman, that two-thirds of our board—

Chairman PATMAN. You can't dispute me on that because the bankers elect two-thirds of those directors. You agree to that?

Mr. HAYES. I agree the bankers elect two-thirds. But I understood you to say that two-thirds of them were bankers. There is a difference.

Chairman PATMAN. I asked Mr. Martin to interrogate class B directors at one time, and I believe he found that over half of them owned stock in banks. That was by a poll by the Chairman of the Federal Reserve Board. The member banks elect two-thirds of the

directors of the Federal Reserve banks, and over half of these directors we know were bankers at that time. The others were borrowers. I don't say they were captives but they were in a position to be talked to and subject to little moral suasion.

Mr. HAYES. I can only speak for our own bank. I might point out in our own bank the B directors, the three directors who are not bankers and are elected by bankers, do not own any bank stock.

Chairman PATMAN. That is news.

Mr. HAYES. That has been true for many years.

Chairman PATMAN. I hope when you run for reelection these six are for you. You have nine constituents.

Mr. HAYES. May I say, in my opinion, the only constituency we have is the public of the United States and the public of the Second Federal Reserve District.

Chairman PATMAN. Thank you very much, Mr. Hayes. We appreciate your testimony.

Chairman PATMAN. Our second witness today is Mr. William McChesney Martin, Jr., Chairman of the Board of Governors, Federal Reserve System.

Mr. Martin, it is good to see you again, as it always is. You may proceed in your own way and after you have enlightened us with your opening remarks, the members of the committee may wish to interrogate you.

We have a rule of 10 minutes each and go around as long as it is necessary to ask the important questions. So you may proceed in your own way, sir.

#### **STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Mr. MARTIN. Mr. Patman, it is nice to be here again. It may be that just about everything that can be said about matters of interest to the members of this committee has already been said by other witnesses, but I should like, nevertheless, to be as helpful as possible in discussing economic and credit conditions today.

Much in the recent flow of statistical information has indicated a definite loss of momentum in the pace of economic expansion. This was particularly true of the June reports. In that month, there were declines in durable goods orders, average hours of work at factories, retail sales and housing starts, and only small gains in industrial production, employment, and personal income. Altogether, the impression of slowdown seemed to be confirmed.

There has been a popular tendency to view the various signs of slowdown as foreshadowing an imminent upper turning point in the economic cycle. Judged from the perspective of cyclical indicators, which in the past have shown a tendency to run ahead of the overall data, this view has perhaps been reasonable.

I sometimes wonder though if we have not become overly sensitive to cyclical indicators—we read, watch, study, and talk about them so much that we may have become like medical students who acquire each disease as they read about its symptoms in their textbooks. We ought to remember that, while leading indicators have correctly foretold some recessions, they have also on occasions given portents of recession that did not occur.

In June, our economic data were subject to certain special influences and, if allowance is made for these, the situation does not appear so persuasively discouraging as appeared at first sight. Thus, using up the inventory accumulated in anticipation of a steel strike that did not occur affected not only new orders for steel but also employment and hours of work in the steel industry, and unemployment claims in steel centers.

The steel industry is so large that declines in that one industry can at times result in declines in overall manufacturing orders, employment, hours of work, and many other measures of economic activity. Observers who simply count the pluses and minuses among the cyclical indicators run the risk of being overly influenced by the reflections of a decline in one industry, not of cyclical origin, showing up several times in their lists of unfavorable omens. In addition to the steel situation, though of less importance, a strike at some auto plants affected production and sales in June. The adverse effect of this on the June data should not be interpreted as being of cyclical significance.

Nevertheless, the June showing as a whole was not strong. And it certainly made clear that the economy was moving ahead more slowly than the optimistic goals widely discussed at the turn of the year.

From data now available for July, the economic situation appears improved. The unemployment rate was down slightly, nonagricultural employment rose somewhat further, and labor market data were definitely encouraging in another respect: they showed a fairly large decline in the number of longtime unemployed.

Among other information on July, retail sales rose briskly, with new domestic auto sales and department store sales both making a strong showing. Private construction activity, seasonally adjusted, held its advanced level. The Board's index of industrial production, which was released early this week, gained almost a full point, advancing to a new record high approximately one-fifth above the 1957 level.

Preliminary indications from production schedules and weekly sales reports suggest that the general improvement of the economy carried forward in early August.

The information on consumers' purchase plans obtained in July by the survey conducted for the Board each quarter by the Census Bureau gave two important indications. First, consumer buying plans had not been adversely affected overall by the recent stock market decline and the mixed economic tendencies shown for June. Second, as you may recall from earlier testimony by a member of our staff, the data show some strengthening of consumer purchase plans since early this year, especially for household durable goods.

Consumers are in a good financial position. Their incomes rose further in July to a new record high, and so did their savings. The payments on debt that consumers are obligated to make each month have risen less rapidly than their incomes. Furthermore, defaults on installment credit have declined sharply over the past 18 months to levels at or close to the lows for recent years.

Business concerns' retained earnings and depreciation allowances in recent months have also been large, in many instances considerably in excess of current needs for replacement and expansion. This form

of saving has been used in providing an additional flow of funds into credit markets and into extensions of trade credit as well. Meanwhile, business demand for bank loans has been less vigorous than in this stage of previous upswings. Banks, therefore, have sought other outlets for their funds and have increased other loans and investments, especially their holdings of State and local securities and real estate loans. Demand deposits have changed little so far this year, while time and savings deposits grew very rapidly in the first quarter and then continued to expand substantially, but at a lesser rate.

Over the first half of the year, short-term interest rates fluctuated within a narrow range around a  $2\frac{3}{4}$  percent level. Since late June, the level has been a little higher, with the range on 3-month Treasury bills running between 2.80 and 3 percent. Yields on longer term U.S. Government, State and local government, and corporate issues meanwhile declined through midspring and subsequently moved moderately upward, but they remain below the earlier highs for the year. Throughout the year, mortgage yields have moved downward.

The decline that has taken place in long-term interest rates has reflected in large part the increased availability of funds in long-term sectors of the market, as the rapid increase in time and savings deposits at commercial banks was accompanied by continued large inflows of funds to mutual savings banks and savings and loan associations. Demand for long-term funds in recent months has been generally moderate.

My comments would be incomplete if I neglected to mention the persistent problem of restoring balance in our international accounts. The problem of domestic expansion is interrelated with our international problems and all of them must be thought about at the same time.

The United States has been making progress in reducing its overall deficit in international transactions. The deficit came down from nearly \$4 billion in 1960 to about \$2 $\frac{1}{2}$  billion last year, and to an annual rate of just under \$1 $\frac{1}{2}$  billion in the first half of 1962. Even so, we have no grounds for complacency. We must move further toward international balance next year, and we must also achieve and maintain equilibrium in the accounts in future years.

U.S. foreign trade has developed in an encouraging way this year. Total exports have been rising, with exports to Western European countries especially strong. While imports also have risen, they have not spurted ahead as they did in the preceding period of cyclical expansion and so have remained lower in relation to the gross national product. Both our export and our import performances would indicate that we have been competing effectively in international trade, and international price trends support this interpretation. The level of wholesale prices has been stable in this country for some time, while prices in industrial countries abroad have risen and are rising.

The merchandise trade surplus, at an annual rate of \$5 billion in the first half of 1962, is large but not large enough to match our large net payments for aid, for military expenditures, and for net private U.S. lending and investment abroad. And it would probably be unrealistic to expect the whole of the remaining adjustment to

come through yet further expansion of the trade surplus. That is why the Government has been working, both from the procurement side and through negotiations with our allies abroad, to reduce the balance-of-payments burden of our foreign aid and military programs. That is why we have had to pay close attention to the possible effects that monetary and credit policies may have on international movements of capital.

Taken together, domestic economic and balance-of-payments developments have posed a problem for monetary policy, but in my judgment that problem has not yet constituted as clear cut a dilemma as some observers suggest. While it has been necessary to formulate policy in the light both of the credit needs of the domestic economy and the potential effects on international capital movements, up to the present time it has not been a matter of choosing between domestic and international goals.

With the rare exception of an internal liquidity crisis, such as that experienced in the early 1930's, it is never helpful to sound recovery or economic expansion to flood credit markets with redundant funds. When resources are not fully employed, credit should be readily available to meet the legitimate needs of commerce, industry and agriculture—as it is now—but no constructive purpose is served by expanding the credit stream to the point where it overflows its banks. So far, we have been able to pursue policies which have not interfered with the ready availability of credit in the domestic markets at rates generally about even with those prevailing in early 1961, and in some critical areas substantially lower.

Fortunately, we have been free from inflation and the expectation of imminent inflation. This has made possible a more liberal policy with respect to reserve availability, a greater growth in bank credit, and less upward movement of interest rates than in any other recovery and expansion in recent history. In the last 12 months alone, we have added almost a billion dollars to bank reserves, bank credit has expanded by \$17 billion, and high-grade, long-term corporate bonds and State and municipal securities are about one-fourth of 1 percentage point below their year-ago levels.

At the same time, we have generally maintained short-term rate relationships with other major financial markets such as to avoid encouraging outflows of short-term funds. The fact that we have done and are continuing to do this, as we strive to improve our basic balance-of-payments situation, is bound to strengthen confidence in the dollar at home and abroad. In my judgment, this enhanced confidence is essential if we are to solve our balance-of-payments problem and promote domestic prosperity.

This leads me to the matter of deficit financing. It now seems most likely that we shall experience some deficit in our budget for fiscal 1963. That deficit would, of course, be increased if taxes are reduced during the current fiscal year.

I have stated quite explicitly my belief that such deficits as we may experience, whether they are due to a shortfall of receipts under the existing tax structure, an increase in expenditures, or a reduction in tax rates, should be met by borrowing from the real savings of businesses and individuals, not through the creation of money through the banking system.

This does not mean that we will experience less easy conditions in credit markets. What happens will depend on many things—most importantly on the rate of activity in the economy: credit conditions may be tighter, or easier, or the same.

It is also helpful to recognize that in the American banking system there is an important distinction between total bank credit *expansion* and that portion of it which can be traced to the *creation* of money and credit.

The loans and investments of commercial banks in the United States can grow in two ways: one, through people placing more savings in banks in the form of time and savings deposits; or, two, through the creation of demand deposits. Hence, bank credit can expand substantially, without any significant money creation, as it has done in some periods—and in my judgment this is true of the first half of 1962. Alternatively, growth in bank assets can be—as at times it has been—associated almost entirely with money creation.

Analysis of these processes would be simpler if we had an institutional structure in this country in which the money creation function was entirely separate from what is called the savings intermediary function—the collection of small savings and their investment for the benefit of depositors, of shareholders, and of policyholders—but that is not the case. To the extent that individuals place their savings with banks and that banks, in turn, invest these savings in Government securities, the deficit which led to the issuance of the securities is being financed by real savings just as surely as if the individuals had purchased savings bonds in the first instance.

Moreover, a certain amount of money creation to meet the legitimate needs of a growing economy is a necessary and normal function of the banking system, and it is expected reserves will be provided for expansion to meet such needs. That is why we have the Federal Reserve System. Some part of the normal growth in banks' assets which accompanies this money supply expansion must, as a simple matter of banking prudence, take the form of additions to the secondary reserves of the banking system, which consist largely of Government securities. Additions to banks' holdings of Government securities due to additional flows of savings through this particular intermediary or to normal growth in the money supply do not represent the financing of Government deficits with bank-created or "printing press" money. Such additions are not inflationary and do not pose any threat to the soundness of the dollar.

What would be damaging to the strength of the dollar would be the deliberate expansion of the credit base, above and beyond the needs of the economy, in order to provide a ready market for the Government's borrowing. This was done in the United States during World War II, and in other countries both at that time and during the economic chaos that followed. It is still being done in some unfortunate countries today. The results have invariably been bad, and have ranged from damaging, as they were here, to nearly disastrous, as they have been in some other countries. The process of withdrawal and correction is always painful and difficult.

The only sure safeguard against the financing of deficits through bank credit creation lies in careful control over the process by which bank credit and money are created. As I have said, the Federal Re-

serve is determined to provide, on the one hand, the reserves needed to support the necessary and healthy expansion of bank credit and money required to meet the needs of a growing economy, and on the other, not to again become entangled in the vicious circle of financing Government deficits with bank credit created solely for that purpose.

In closing, let me summarize as specifically as I can my view with respect to the economic situation today.

All in all, the performance of the economy has been disappointing in that it thus far has failed to reach the goals set for it by some and predicted for it by others. Yet the economy has withstood some rather severe shocks—last fall an auto strike, this year a major steel inventory adjustment, and the sharpest stock market break since the 1930's—and still it has moved forward. This last month is a new high in our industrial index. On the one side it has not achieved the levels of manpower or physical resource utilization we would all like to see; on the other, the latest data do not, in our judgment, confirm that we have reached or passed a turning point in the cycle at this time. The most likely possibility in the period immediately ahead seems to be for a continuation of mixed movements in the more sensitive indicators and some further growth in the broad aggregate measures of economic activities.

Now a final word, about monetary policy and credit conditions. The one factor over which the Federal Reserve has anything like complete control, and not too complete, is the volume of reserves available to the banking system. In my judgment we have supplied—and are now supplying—and it is certainly our intention to continue to supply, all the reserves the banking system requires to meet the American economy's needs for credit today and to foster its further economic progress.

Chairman PATMAN. Thank you, Mr. Martin.

Mr. Martin, I believe you have told us on previous occasions that the Federal Open Market Committee is not interested in interest rates, as such, and not interested in the money supply, as such, but rather you are interested in a proper flow of funds. Is that correct?

Mr. MARTIN. We are indeed interested in the proper flow of funds.

Chairman PATMAN. What do you mean by proper flow of funds?

Mr. MARTIN. That is a judgment that has to be determined and is determined by a group of men who are sitting together every 3 weeks.

Chairman PATMAN. That is the Open Market Committee?

Mr. MARTIN. Yes, sir; the one that you described as the most powerful committee in the world.

Chairman PATMAN. That is right. I want to invite your attention to a further point to supplement and corroborate my charge that they are operating in violation of law. Yesterday it came out again.

The law says the Open Market Committee is composed of 12 members, 7 members of the Federal Reserve Board and 5 Federal Reserve bank presidents.

Mr. MARTIN. That is right.

Chairman PATMAN. Now then, you not only let the 12 come into the meetings, but you let 7 more Federal Reserve bank presidents come in, all elected by the directors of the Federal Reserve banks. So you have 19 in those meetings.

Now when you have the first meeting of the year, I assume that when they qualify as members of the Open Market Committee that year they hold up their hands and swear that they will support the Constitution of the United States; is that right?

Mr. MARTIN. They do.

Chairman PATMAN. Only the five member presidents that are officially members of the Open Market Committee at that time take that oath; is that right?

Mr. MARTIN. I believe that is correct, Mr. Patman.

Chairman PATMAN. These other seven do not swear?

Mr. MARTIN. Their votes are not counted.

Chairman PATMAN. I know, but they have a say, and their views are considered when you decide policy.

Mr. MARTIN. I have other staff members who are also in the room at the same time. Mr. Young who accompanies me today, the secretary of the Committee, is there.

Chairman PATMAN. That is correct, you have about 40 people in those meetings, almost a townhall meeting.

Mr. MARTIN. We get the benefit of all the advice we can.

Chairman PATMAN. You have the benefit of the advice of all of the bank presidents, such as it is. I do not mean it is not good advice, from a certain point of view. It is good from their standpoint.

But the point is, Mr. Martin, the five presidents, they have their hat on, as members of the Open Market Committee, but these seven presidents that you let come into the meetings without authority of law, they do not have a hat at all. They do not take an oath. They are not officially members of that Committee.

Yet they are consulted in fixing monetary policy, in determining the supply of money and interest rates, the vital and necessary monetary policies of this Nation which can be of great benefit to the people or great harm to the people.

I do not claim they are using these meetings for any improper purpose. I won't charge that. There is no evidence of it, I am mighty glad to say. But it is worth a lot to a person who has that inside information.

I want to reiterate the charge that you are operating in violation of the law, and I hope you reconsider it.

Mr. MARTIN. I insist, Mr. Patman, that we are not operating in violation of the law. Only the 12 men who have a right to vote, vote.

Chairman PATMAN. You do not have many votes. You tell them what the score is, do you not?

Mr. MARTIN. Mr. Patman, we have gone over this many times and I appreciate your great confidence in me. It is not my modesty that causes me to describe it the way I do.

Chairman PATMAN. You start in this corner of the room, and you have the statements from each and every one of them, clear around, and finally it comes down to you and you tell them what they have said. You evaluate all their statements and you state the conclusion, or the consensus of the whole group, you have few votes.

Mr. MARTIN. I appreciate the confidence you have in my persuasive powers.

Chairman PATMAN. When funds are flowing properly or improperly is this something you know intuitively, or do you have some objective guidelines?

Mr. MARTIN. We are working constantly to try to find out whether there are guidelines that would be workable. The one thing that I feel strongly about in this field, and we have discussed this many times, is that the most important asset a member of the Open Market Committee can have is humility with respect to the use of any guidelines.

Chairman PATMAN. You are talking about guides.

Mr. MARTIN. We should not let our intuitive judgments or our biases or predilections control us; we should do our best to try to view all the factors objectively.

Chairman PATMAN. You mentioned awhile ago about how terrible it is to finance a deficit with bank-created funds. You have been bearing down on that lately. You refer to that as bank-created or "printing-press" money. You put bank-created and printing press in the same class, I notice.

Mr. MARTIN. No; I made a very careful distinction.

Chairman PATMAN. I thought you said that in your statement.

Mr. MARTIN. I did. Whenever you supply funds to cover a deficit for the Treasury in such a way as to hold rates at such a level that they could not be attractive to nonbank investors, I am sure that is what we are talking about, printing-press money.

Chairman PATMAN. Mr. Eisenhower had quite a big deficit in 1958, \$12 billion. I did not hear you say anything about that.

Mr. MARTIN. Then you were not listening very well. Because that is all I talked about, Mr. Patman.

Chairman PATMAN. But they did finance it with created money.

Mr. MARTIN. I object to that. I don't believe that. This is an analysis and judgment passed on that. I believe the reason we had the "magic fives" as they were referred to—and they did bring out a lot of nonbank investment money—was due entirely to that deficit.

Chairman PATMAN. You think the deficit was helpful?

Mr. MARTIN. We are not talking about that. We are talking about how it was financed. I say that nonbank investors were attracted by the higher interest rates during that period. I am sure the Eisenhower administration would have been a lot happier if the Federal Reserve had just printed the money to meet its deficit problem.

Chairman PATMAN. Do you have in mind a certain percentage of the national income that should go into savings, Mr. Martin?

Mr. MARTIN. No. I keep away from percentages or from guidelines the same as I do on unemployment. I don't think we should fix levels and say this is it. We naturally want to do a balanced job.

Chairman PATMAN. I wonder if you would submit for the record a statement along these lines: First, give us all the relevant statistical information you have by which you make judgments as to whether or not there is a proper or improper flow of funds. Arrange the information in the way you normally arrange it, so it is most meaningful to you, in making your analysis. I would like to see this information covering the past 10 years.

Mr. MARTIN. You are getting more modest, Mr. Patman. You used to ask for 20 years.

Chairman PATMAN. Well, I am getting older.

And second, include with it a commentary indicating for each particular time period whether or not the flow of funds was satisfactory or unsatisfactory and your reasoning as to why the flow was satisfactory or unsatisfactory. Also, if you will, state what steps the Open Market Committee took in an effort to prevent an unsatisfactory funds flow or to correct an unsatisfactory funds flow.

Mr. MARTIN. We will do the best we can, Mr. Patman.

(The material referred to follows:)

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,*  
*Washington, D.C.*

DEAR MR. CHAIRMAN: You will recall that at the Joint Economic Committee's recent hearing you asked that we supply statistical information with regard to flows of funds for the past decade, together with a commentary indicating for each period of time whether the flow of funds was satisfactory or unsatisfactory, and our reason as to why the flow was satisfactory or unsatisfactory; and, also, what steps the Open Market Committee took in an effort to prevent or correct unsatisfactory conditions.

We are presently in the process of developing seasonal adjustment factors for the quarterly flow of funds data, which will make it much easier to analyze and discuss this information in terms of quarter-to-quarter changes. It will be highly advantageous from both the point of view of the authors and the readers if the analysis can be expressed in terms of these new seasonally adjusted figures, which should be developed within a few weeks, rather than the cumbersome unadjusted figures which require repeated comparisons with changes in the same quarter of earlier years in order to describe the current quarter-to-quarter movements.

We would like to do a very thorough and careful job of responding to your question, both because we feel it will be helpful to those outside the Federal Reserve System who are interested in studying financial developments over the past decade and the role monetary policy has played in these developments, and because such a careful review will undoubtedly add to our own insight into the workings of financial markets.

We will proceed as expeditiously as possible, but we will probably need at least 90 days to provide you with the sort of painstaking analysis I am sure you want and for which we should wish to take responsibility.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

AUGUST 31, 1962.

HON. WILLIAM MCCHESNEY MARTIN, Jr.,  
*Chairman, Board of Governors, Federal Reserve System,*  
*Washington, D.C.*

DEAR CHAIRMAN MARTIN: This is in response to your letter of August 29 stating that you will probably need at least 90 days to provide an answer to the question I raised while you were testifying, concerning proper and improper flow of funds.

Frankly, I am somewhat puzzled by this advice, because when I raised this question I thought I made it clear that I was not asking that you undertake research to develop new information or make new analyses; rather, I was asking that you supply the data that were considered, and the analyses that were made and on which Federal open market policy was based.

If you continue to feel, however, that the kind of analysis for which you would wish to take responsibility will require several months, or even several weeks, it will be necessary that we plan to publish your analysis as a separate document. We would not wish to delay printing of the committee's hearing record for any such length of time; in fact, we feel that because of the interest in this record it should be published within the next week or 10 days.

I am,

Sincerely,

WRIGHT PATMAN.

Chairman PATMAN. I believe we agree on what the term pegging meant during the war and other postwar years. It meant that the Federal Reserve set a maximum ceiling beyond which interest rates on Government bonds and other Government securities would not be allowed to go. Now may I ask you whether or not in the latter half of 1960 the Federal Open Market Committee gave instructions or suggestions to the manager of the account as to the minimum below which the bill rates should not be allowed to fall?

Mr. MARTIN. We discussed the bill rate during that period. We did not peg the bill rate. We did discuss the fact that we would not like to see the bill rate become a factor in the flow of funds abroad. We tried to conduct our operations in that way.

Chairman PATMAN. Since the manager of the account is necessarily in the Open Market Committee meetings, do you think that he would get from what was said there, about the bill rate and about your wanting a high bill rate, that it is his duty, in carrying out his work with the Open Market Committee, at the New York Federal Reserve Bank, to keep that rate up and not let it fall below a certain peg?

Mr. MARTIN. We have a meeting every 3 weeks. There is not going to be a very drastic change within the period that we are talking about. Certainly we keep in close touch with the manager of the account. We have a daily call, as you know. We have submitted reports on all the calls for 1960. The call takes place every day at 11 o'clock. Sometimes I sit in on it. Most of the time I don't. We have one of the presidents that is on the Open Market Committee participate in it. Our object is to keep a balanced money market.

Chairman PATMAN. I know about those calls, these 17 dealers getting on that country telephone at the same time, making the market.

Mr. MARTIN. And the fortunes they are making.

Chairman PATMAN. Is the reason for the relatively high interest rates at present in part to check the flow abroad of short-term funds, Mr. Martin?

Mr. MARTIN. There are not any high interest rates at the moment. Our rates are lower than abroad; there is a differential.

Chairman PATMAN. Are you for higher interest rates than we have now?

Mr. MARTIN. I don't make any comments on high interest rates. I think the proper approach to it is that we want the right interest rate, the interest rate that will be the most effective in promoting an appropriate flow of funds. As you earlier pointed out, it is the flow of funds that we are concerned with. It is our judgment that at the present time there is an adequate supply of reserves and that there is no shortage of funds anywhere in the country. Mortgage rates are still continuing to decline. We have been able to keep a balance.

Chairman PATMAN. Is part of the purpose for the present high interest rates also in part to try to solve our balance-of-payments problem by holding down prices while prices in Europe advance?

Mr. MARTIN. I want to stick to my point, Mr. Patman. I don't think there are any present high interest rates. I think that we want to keep a level of rates that will be most effective in the flow of funds internationally as well as domestically.

Chairman PATMAN. My time is about up. It is 12 o'clock. I wonder if it would be all right to have a session at 2 o'clock instead of continuing on now.

(Discussion off the record.)

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. Mr. Martin, your analysis of the economic situation indicates, while the situation is mixed, that we are not operating our economy fully, we have a slackness in manpower and factory capacity.

Mr. MARTIN. Not as fully as we would like to have it, that is correct.

Senator PROXMIRE. In terms of monetary policy, it would seem to me that this would be the overwhelmingly important factor, rather than any of the other specific statistics which you present to us this morning. Because as long as we are not operating our economy fully, it would seem to me it would be sensible for us to continue to have a money supply which keeps pace with the growth of the gross national product. Isn't that sensible?

Mr. MARTIN. You and I discussed that the other day, Senator, in another hearing. It seems to me that money, when it is not being absorbed in the economy, and is redundant, does more harm than good.

Senator PROXMIRE. I think we all agree on that.

Mr. MARTIN. Congressman Reuss made a very good addition to my word picture of the stream by referring to the swamp on either side of it. I appreciate that.

Senator PROXMIRE. I understand that. Let me just go back a little bit. For example, you say in your analysis that the unemployment rate was down slightly, labor market data were encouraging, this showed a fairly large number of long-time unemployed.

You would agree that the unemployment figure of 5.3 or 5.5 percent is very high and the decline was statistically probably insignificant, as I understand, from 5.47 to 5.34.

Mr. MARTIN. I would like to see it lower. An objective of monetary policy, of course, is to try to help minimize unemployment. With the present conditions in the money and credit markets, I am inclined to think that our present policy of slightly less easy money is more likely to be helpful to it than more ease. But that is a matter of judgment.

Senator PROXMIRE. We have had the testimony of a number of outstanding officials and economists who feel very strongly that we have a real problem of monetary restraint.

Dr. Heller, Chairman of the Council of Economic Advisers, said that it has been especially vital to maintain reasonably low long-term interest rates and a plentiful supply of investment funds in order to stimulate private investment and quicken the tempo of growth and potential output.

Dr. Ritter, of New York University, said:

In my opinion we will be making a mistake if we hastily formulate our policies in terms of our impact on balance of payments and gold stock. We will be doing no favor for the many nations, if we deliberately, because of international considerations, take steps that may decrease our rate of production or retard our growth. We need on both domestic and foreign grounds exactly the opposite.

Professor Culbertson, of the University of Wisconsin, said that a policy of more drastic monetary restrictions, as already urged upon us, surely would make matters still worse and might have quite disastrous consequences. The mystical attachment to high interest rates and deflation seems, despite the clear lessons of the past periods, to have reasserted itself with a large force. The grip of this dogma and the habitual errors of Federal Reserve monetary policy are the principal impediments to the achievement of full prosperity in the U.S. economy.

There are very many more statements, and these are thoughtful men. They are not radicals. We had the vice president of the Harris Bank, who was just as emphatic. We had Dr. Bell, who made a very careful study of the impact of high interest rates or low interest rates, interest differentials on capital outflow, and concluded there was no reason for pursuing a policy of higher interest rates now. He quoted Mr. Gemmill of your own staff, who made a study indicating the same thing: interest rate differentials do not seem to be very significant in capital outflow.

The general consensus, it seemed to me, with some exceptions, was that we seemed to have been following a policy of some monetary restraint and certainly in the future, whatever the difference may have been in the past, that it would be most unfortunate if we didn't follow a policy of at least trying to keep our monetary supply increasing with our increased gross national product until we reach a level of reasonably fuller employment, until we reach a level of reasonable utilization of our industrial capacity.

Mr. MARTIN. All of the persons you cite are very competent, probably more competent in many respects than I am. But there is a phrase that you attributed to one of them, "mystical attachment to high interest rates." I insist there has been no mystical attachment to high interest rates on the part of the Federal Reserve Board during the time I have been there.

I say respectfully that a mystical attachment to low interest rates can be just as misguided and harmful as mystical attachment to high interest rates.

We want the right interest rates. We want the right interest rates to come out of a balance between the supply and demand for funds in given periods of time so that the flow of funds is as appropriately adjusted as it can be in a free market economy to the needs and requirements of the economy. That should be our goal. I hope that all of us will stop shilly-shallying about this matter of interest rates, because it is only a price attached to credit.

You can take the view that there should be no charge for interest at all. Just eliminate it entirely; but you can't do that.

Senator PROXMIRE. I have the greatest respect for your ability, and I think you are an outstanding and competent person, and everybody agrees with that, but the fact is, when you try to come down and discuss this in meaningful specific terms, it is like nailing a custard pie to the wall.

In the first place, we try to talk about free reserves, and we are in difficulty there because you say these statistics are not pertinent. We try to talk about the money supply and you tell us we have to allow for the fact that there are no time deposits included in the strict

definition of money supply, and therefore it is a concept which is very slippery.

We try to talk about these other statistics. I constantly get the feeling from you that we can't do this in terms of specifics or definite data or any kind of documentation. It has to be done in terms of generalities.

On those grounds, it is extremely hard to arrive at any agreement because we can't agree on definitions. And frankly, Mr. Martin, without specific goals, criteria guidelines, it is impossible to exercise any congressional oversight over you, and I think you know it.

Mr. MARTIN. Let me just comment that I sympathize with you completely on that. You can see my problem as Chairman of the Federal Reserve Board or the Open Market Committee in getting these 12, or 19 men as Mr. Patman likes to make it, together on this. It would be nice if this area of activity could be put in more precise terms. For a long time I have studied the money supply as hard as I can—and I don't profess to be the brightest individual—and I have come to be less and less confident of my convictions of what the right money supply level is.

Senator PROXMIRE. But you would agree that we have not reached the right level of unemployment. It is too high. We should do what we can to reduce it.

Mr. MARTIN. I certainly agree with that. I think one of the reasons we have had as much unemployment as we have had, and you may think this is silly, is because we have had too easy money. I think that you have periods where you can retard the flow of funds, particularly when you are creating money out of a vacuum, which is what printing press money is, in order to help the Government finance a deficit.

That is why I was talking the other day about loose spending and easy money frequently going together. You have to try to pull this thing together into a unit.

Senator PROXMIRE. Let us take a very definite likelihood. The President has indicated he is going to ask for a tax reduction next year. This may be, let us say, on the order of \$10 billion. This is supposed to stimulate the economy substantially. Some talk about a multiplier of \$2 or \$20 billion increase in GNP. You have indicated that you think we should sell bonds to the public to the full extent of the tax cut rather than to the banking system. I understand you to have said that.

Mr. MARTIN. That is correct.

Senator PROXMIRE. If we do this, testimony on the part of many competent economists who have come before us is that much, and some say all, of the steam of that tax cut would be taken out. We would lose it. It would not have any very substantial effect in stimulating the economy. There are times, as Mr. Lolli, of Italy, pointed out, when this is desirable. Where you have an enormous deficit equivalent to the \$35 billion deficit they had in Italy, like the huge deficits in wartime, where we had the manpower and factory capacity utilized fully. We don't have that now.

If the President's tax cut is negated by the Federal Reserve Board, it seems to me that our economic policy is just going in opposite directions. You are exercising restraint, and the President of the

United States and the Congress is trying to expand our economy. You are at war with the President and Congress. I can see why you should do that if there is any real pressure on prices. I think you would have an excellent case if unemployment should go down to  $3\frac{1}{2}$  or below 4 percent. You would have a strong case if we were at 90 percent of our industrial capacity. But we are not near that.

Mr. MARTIN. I agree with you on the pressure of prices. It is not here. We have had pressure on prices previously. The real reason for waging a battle against inflation is because it always leads to deflation. For example, in 1957 we had an increase in the dollar value of our gross national product which was running at the rate of a billion dollars a month without any additional goods and services being created; that is still part of the virus in the economy that we are having to deal with today.

If we could eliminate all of the past, our problem would be relatively easy. But we have this constant flow from past to the present. I can assure you, Senator, that our objective—certainly I can speak for all of the members of the Open Market Committee—in monetary policy at the present time is to do everything in our power to help reduce the level of unemployment.

With regard to the deficit, which you raised and about which there are many sincere differences of judgment, I think you have to realize that pressure at some point has to be brought to reduce expenditures. You can't galvanize the economy to higher rates of activity if the deficit is going to get too large. I don't believe you can say dollar for dollar that the economy would be held back in any way by trying to draw on the savings stream to finance the deficit rather than financing it by bank-created money. But I will concede to you that there is a little validity to the point.

Senator PROXMIRE. Certainly, what you are going to do is to have a drop in your payroll deductions of the equivalent of \$25 a month for some employee, at the same time sell that employee a series E savings bond of \$25, so there is no change. Instead of having the money to spend he puts it in a savings bond, and we are where we started.

Mr. MARTIN. If you isolate it at any given point then it looks like there is a mathematical relationship, but, in my judgment, this mathematical relationship does not hold at all because of the flow through time.

Senator PROXMIRE. You would concede this would slow down the expansionary effect?

Mr. MARTIN. Depending on the amount.

Senator PROXMIRE. It would certainly slow it down.

Mr. MARTIN. Don't forget that the central bank is always faced with the problem of growth in the money supply as the economy grows. It is a matter of judgment. Our judgment may not be the best. I am sure that members of the Congress will certainly let us know if they think our judgment is wrong.

Senator PROXMIRE. Let me try this once again. You would agree, even though a difference in degree, there would be a definite slow-down in the expansionary impact of a tax cut if you sold the bonds to the public to the full extent?

Mr. MARTIN. If we covered every dollar without any expansion of the money supply; yes.

Senator PROXMIRE. If you covered most of it?

Mr. MARTIN. No; I won't concede that.

Senator PROXMIRE. There would be less of an expansion if you sold it to the public.

Mr. MARTIN. This is a moving stream, a moving flow. I personally think that you would get the maximum benefit by drawing out the larger proportion in savings. This is a matter of judgment, but I personally think it would add the most to the flow.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Mr. Chairman, I too am very happy to have you here with us and as you know I admire almost everything about you except your monetary policy which is what we are to discuss this morning.

I want to review with you what that monetary policy has been under the Kennedy administration and then ask you a question about it.

When Mr. Kennedy was inaugurated, the unemployment rate in this country was around 7 percent, and the Federal Reserve System under your guidance started out, I thought, like a ball of fire in the early days of the administration. You had on the books of the Open Market Committee a splendid policy directive, "To encourage credit expansion so as to promote fuller utilization of resources."

You did, and it did so encourage fuller utilization of resources. Throughout the first half of 1961 you kept the free reserves of the banking system at a level of \$500 million or more. In fact, I was so proud of what you did that on June 1, 1961, when you appeared before the Joint Economic Committee I congratulated you on keeping that level and then I said:

I would like to express the hope that the Federal Reserve from here on out will keep its free net reserves in the banking system at something like the present level of a half a billion until we get the unemployment rate down not to 6 percent, not to 5 percent, but to some lower percentage, call it 4 percent if you like, which will enable the economy to grow and help us make a dent in unemployment.

You replied:

I appreciate your comments, Mr. Reuss. I cannot forecast what the future policy of the Open Market Committee will be, but I will certainly bear in mind your comments.

You apparently did for a while, and during the last half of 1961 you kept free reserves at a level of half a billion and you kept that policy directive.

Then on December 19, 1961, a date that will be remembered in monetary history, the Open Market Committee met, and you abandoned that resolution over the protest, I am glad to say, of Governors King and Mitchell. Instead, you put in a policy directive calling for tighter monetary conditions, for higher short-term interest rates, and for slower additions to the reserves of the banking system.

This was on Tuesday, December 19. I think it will come to be known as "Tight Money Tuesday."

Mr. MARTIN. Not Black Tuesday.

Representative REUSS. Not black—Tight Money Tuesday, when history is written.

It had an effect precisely as intended. The free reserves of the banking system promptly went down and continued down. They have been at a level of \$300-\$350 million in recent weeks.

On August 9, the most recent date for which we have figures, free reserves come to \$351 million. The interest rate on 90-day Treasury bills went up by much more than 10 percent until it hovered just below 3 percent. The interest rate on Federal funds went up some 40 percent from 1.8 percent to 3 percent, and there ensued the economic slowdown which is the despair of the administration today.

Mr. MARTIN. At the start of 1962 the slowdown started.

Representative REUSS. No, this has been a progressive thing.

Mr. MARTIN. I don't remember what our index was at the start of 1962, but we are up, just taking the index, 118.7, reported 119 for rounding, as we always do, in July.

Representative REUSS. To what index do you refer?

Mr. MARTIN. I am talking about our index of production.

Representative REUSS. We have had 2 weeks of testimony and the President's speech on the state of the economy. The consensus is that while we are not in a recession, we are stagnating and we are wasting, as Mr. Heller said, at least \$30 billion a year in goods that we could produce if we could get our unemployment rate below the 5.5 percent that it is.

I would point out that so far in 1962, during the period when you have progressively tightened credit, short-term capital movements in our balance of payments have shown a marked improvement. No short-term outflows of the kind we experienced last year ever appeared as a threat. Moreover, in this period there has been on balance no outflow of short-term capital to the major monetary centers, the United Kingdom, the Common Market and Canada.

Mr. MARTIN. Are you attributing this to our change of policy in 1961. I mean this improvement. I wouldn't claim that much for it myself.

Representative REUSS. I am glad you don't. I am suggesting there really was not much of a need for changing what was a perfectly good monetary policy of ease.

I now ask my question: At your upcoming meeting next week of the Open Market Committee, will you please pass on to them my earnest request that they consider what they did on December 19, 1961, and hopefully go back to the sensible directive which they had in effect previously, restore the free reserves of the banking system to at least the \$500 million level, and play the part which I think the monetary authorities have to play in getting this economy moving forward again.

I don't suggest that you can do it all. But I suggest you are not doing your part.

Mr. MARTIN. I will reiterate my comment that you quoted. We will certainly bear your comments in mind.

Representative REUSS. I hope you will bear them in mind longer this time. Give me 6 months of the old policy until next January, particularly since we cannot have a tax cut now. With less fiscal ease, we must have more monetary ease.

Mr. MARTIN. I can assure you that the Open Market Committee, and I am not being facetious about this, will give serious consideration to all the aspects of the problem you brought up.

But I want to put on the record, as Mr. Patman has me do periodically, that we are trying to the best of our ability to improve the employment picture, to promote growth and to help in resolving the payments problem.

Chairman PATMAN. Purchasing power is part of the Employment Act.

Mr. MARTIN. We are trying to uphold, Mr. Patman, the tenets of the Employment Act.

Representative REUSS. I realize that you are merely 1 man out of 12 on the Open Market Committee. However, if you start with Mr. King and Mr. Mitchell and make a sincere plea along these lines, I am sure you can convince one other Governor of the Federal Reserve System. With a majority of the Federal Reserve System on the Open Market Committee, I think that you will come up with a committee majority in favor of going back to the wise, sensible, and forward-looking policy which governed you during the great days of January 1961 to December 19, 1961.

I will look with intense interest in March 1963, when the minutes of the Open Market Committee are finally revealed as to what went on at that meeting next week because I think it is going to be very important.

Mr. MARTIN. Fine, fine. Mr. Young as secretary will bear this in mind.

Chairman PATMAN. Mr. Martin, would it be satisfactory with you if we recessed until 2:30?

Mr. MARTIN. It would be perfectly satisfactory.

Representative REUSS. I should like to ask unanimous consent to introduce in the record at this point a speech which I made on the floor of the House on April 9, 1962.

Chairman PATMAN. Without objection it is so ordered.

(The speech referred to follows:)

[From the Congressional Record, Apr. 9, 1962]

#### HOW TO CHOKE OFF A RECOVERY: THE FEDERAL RESERVE DOES IT AGAIN

The SPEAKER. Under previous order of the House, the gentleman from Wisconsin [Mr. Reuss] is recognized for 30 minutes.

(Mr. Reuss asked and was given permission to revise and extend his remarks.)

Mr. REUSS. Mr. Speaker, the recovery from the 1960 recession, promising until a few months ago, shows serious signs of petering out.

The administration has predicted a balanced budget for fiscal 1963, based upon revenues from a projected gross national product for the calendar year 1962 of \$570 billion. But now, according to Secretary of Commerce Luther Hodges, gross national product for the first half of 1962 is not meeting expectations. Thus, tax revenues will be below those expected, and the precariously balanced budget will be out of balance. Colin Stam, of the Joint Committee on Internal Revenue Taxation, has already estimated a fiscal 1963 budget deficit on the order of \$4 billion.

Unemployment, too, has not been reduced as fast as hoped. It now looks as if we would not be able to reach our modest goal of a 4-percent unemployment rate until the second half of 1963, if then. While the present unemployment rate of 5.5 percent is below peak recession levels, long-term unemployment has just recently begun to increase again.

The rate of nonfarm housing starts, seasonally adjusted, has steadily declined every month from October 1961.

Consumer purchasing has not expanded at the rate hoped for by Government economists.

While our international payments situation has been improving, the progress made can well be frustrated by our lagging recovery rate. Foreign central bankers are particularly sensitive to an unbalanced budget in the United States—even though they are used to looking the other way when their own budgets do not balance. If we want to keep the confidence of Europe's central bankers, we must do the best job we know how to attain the adequate growth rate which alone can bring about a balanced budget.

What is causing the trouble? What is the reason our recovery is slowing down?

The biggest single reason, Mr. Speaker, is that the Federal Reserve System is up to its old tricks.

Twice before in the last 8 years, the Federal Reserve System has applied the brakes before the economy, emerging from a recession, had a chance to get rolling again. As a result millions of man-hours were lost through unemployment; vast plant capacity went unused; and our growth rate staggered and broke, rather than turned upward.

In the 1954 recession, the Federal Reserve System, very properly, made available to the banking system net free reserves on the order of \$500 million. By 1955, with the country emerging from a recession, the Fed decided to apply the brakes. Net free reserves—the true unused lending capacity of the banking system—were lowered to around \$300 million, and later, in 1956 and 1957, the banking system was actually placed in a net borrowed position.

By 1958 we had another serious recession, and the Fed—locking the stable after the horse was stolen—then raised net free reserves again to \$500 million. But by the autumn of 1958 recovery had started. So the Federal Reserve promptly lowered its net free reserves, so that 1958 saw the banks once again in a net borrowed position.

I do not wish to seem a partisan in my criticism of the Federal Reserve System for choking off recovery from the 1958 recession. Let us take a look at what two prominent Republican economists had to say about the Fed's performance.

W. Allen Wallis, dean of the Graduate School of Business at the University of Chicago, was Vice Chairman of President Eisenhower's Cabinet Committee on Price Stability for Economic Growth. In a speech last May, Mr. Wallis said:

"The Federal Reserve Board tightened up the money supply in 1959 over-  
vigorously and overpromptly as a move against inflation. But the inflation wasn't there."

Arthur Burns was Chairman of the Council of Economic Advisers under the Eisenhower administration. Last April, Mr. Burns, taking a backward look at the Fed's monetary performance, accused the Federal Reserve of choking off business recovery in 1959 by tightening credit with excessive vigor.

On June 1-2, 1961, the Joint Economic Committee, of which I have the honor to be a member, was conducting its annual review of the Federal Reserve System; Mr. William McChesney Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System, was before the Committee. I congratulated Mr. Martin and the Federal Reserve System for helping to combat the recession of 1960 by maintaining net free reserves, as it had done for the first half of 1961, at the level of \$500 million. And then I said:

"I would like to express the hope that the Federal Reserve from here on out will keep its free net reserves in the banking system at something like the present level of half a billion until we get the unemployment rate down, not to 6 percent, not to 5 percent, but to some lower percentage, call it 4, if you like, which will enable the economy to grow, and us to make a dent in unemployment (hearings, p. 100)."

Chairman Martin replied:

"Well, I appreciate your comments, Mr. Reuss, and I want to say that the Federal Reserve deprecates the unemployment situation just as much as you do, and is just as anxious as you are to lower it.

"I cannot forecast what the future policy of the Open Market Committee will be, but I will certainly bear in mind your comments, and I am sure that all the members of the Open Market Committee will be very glad to have your observations. But I am absolutely convinced that, in the overall picture, artificially cheap money would not contribute to reducing the unemployment picture."

To which I replied :

"I am not for artificially cheap money, but just for the kind of money you are now producing, and should keep on producing until unemployment is down to a manageable level."

Much to my delight, Mr. Speaker, the Federal Reserve System then proceeded to keep free reserves at around the \$500 million level for the months following that June 1, 1961, colloquy. Free reserves, at the \$549 million level in June, were still at the \$517 million level in November. The recovery continued nicely.

Practically all through 1961, the Fed Open Market Committee, which—by buying or selling securities in the open market—controls the level of reserves of the banking system and thus the money supply, pursued this adequate-money policy. As the minutes of the Open Market Committee meeting every 3 weeks show it wisely decided to let well enough alone through June and July and August and September and October and November 1961.

But, alas, this performance was too good to be true. On December 19, 1961, the Fed returned to its old habit of choking off recovery, learned in 1955 and 1959. The Open Market Committee issued an economic policy directive for a somewhat slower rate of increase in total reserves than during recent months, and with emphasis on continuance of the 3-month Treasury bill rate at close to the top of the range recently prevailing.

To their credit, Govs. G. H. King, Jr., and George W. Mitchell voted against the directive on the grounds that the time had not yet arrived for any modification of policy in the direction of less ease.

The new tight-money policy was not long in taking effect.

The 90-day Treasury bill rate, which was at 2.4 percent in November 1961, promptly jumped up to 2.75 percent, where it has since remained.

The money supply, which had been increasing steadily throughout 1961 and had reached a peak of \$144.9 billion in December 1961, declined in January and February 1962. In the second half of February, the last date for which we have figures, money supply had dropped to \$144.2 billion, a decrease from December of \$700 million.

Free reserves likewise felt the onslaught of the new tight-money policy. By February 1962, they had dropped to \$424 million. They rebounded slightly to \$444 million by February 14, and have been lower ever since. Free reserves were \$350 million on March 8, \$353 million on March 22, and \$369 million on March 28, 1962. This low level of free reserves means that great numbers of banks, particularly city banks, are "loaned up"—without any ability to lend money, except as an old loan is paid off, or as securities from their portfolios are sold. Indeed, in February, commercial banks had to sell \$1.2 billion of U.S. securities, at least partly in order to meet even a small part of the demands of businessmen, homebuilders, consumers, and other loan applicants.

Now, it is perfectly true that in the last few weeks the interest rate on long-term U.S. bonds, and on other long-term securities, has softened slightly. This softening, however, has been in spite of, not because of, Federal Reserve monetary policy. Investors have become somewhat more pessimistic about the economy's growth rate, and are hence switching from stocks to bonds, which raises bond prices and lowers bond yields.

The Federal Reserve System, I regret to say, is at it again. Having tasted the heady wine of tight money when the economy was recovering in 1955 and 1959, it has now reached for the same old bottle again just as the economy was beginning to recover.

The remedy is clear. The Federal Reserve System ought promptly to repeal its destructive policy decision of December 16, 1961, and supply the economy with adequate credit—net free reserves at least at the \$500 million level. Two bouts with the tight-money bottle in a decade are enough.

Chairman PATMAN. The committee will stand in recess until 2:30.

(Whereupon, at 12:25 p.m., the committee recessed, to reconvene at 2:30 p.m. of the same day.)

#### AFTER RECESS

(The committee reconvened at 2:30 p.m., Representative Wright Patman, chairman of the committee, presiding.)

Chairman PATMAN. The committee will come to order, please.

We will resume the hearing with Mr. William McChesney Martin, Chairman of the Federal Reserve Board, as our witness.

I will resume questioning Mr. Martin.

**FURTHER STATEMENT OF WILLIAM McCHESNEY MARTIN, JR.,  
CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL  
RESERVE SYSTEM**

Chairman PATMAN. At the meeting of the Open Market Committee on December 17, 1961, a modification was made in the form of directive to the Federal Reserve Bank in New York. What was the real significance of the change separating a current economic policy directive from a continuing authority directive, Mr. Martin?

Mr. MARTIN. This is the point that has been discussed many times of trying to give more clarity to the instructions. That is all that was involved. As Mr. Hayes very well pointed out this morning in response to your question, this is the continuing problem of communications that the committee is always working with.

Chairman PATMAN. What was the background of the exception providing that the maturity limit of securities acquired from nonbank dealers was raised to 24 months from the previous authority of 15 months?

Mr. MARTIN. Just to lengthen the period of time that the maturity for the system could operate.

Chairman PATMAN. Of course, you had good reasons for that, I assume.

Mr. MARTIN. Under the circumstances, we were moving in that direction; yes, sir.

Chairman PATMAN. Prior to December of 1961, the rate on 90-day Treasury bills remained in the  $2\frac{1}{4}$  to  $2\frac{1}{2}$  percent range for a year. In December and January it rose rather sharply to 2.7 percent, where it remained until late June.

The upward adjustment of the bill rate last December and January suggests some further moderate tightening of short-term rates. What was the reason for the apparent change in policy, Mr. Martin?

Mr. MARTIN. Is this 1961 now, or 1962?

Chairman PATMAN. 1961.

Mr. MARTIN. In 1961 we were trying to help the economy as much as we could at that juncture without putting undue pressure on the short end of the market.

Chairman PATMAN. Since June of this year there seems to have been an upward adjustment in both the short-term and long-term rates. Are you able to tell us, first, what the reasons for this apparent further change in policy were, and also whether or not you were in agreement with the increase in rates since last June?

Mr. MARTIN. The increase in rates we didn't determine. The reserves that we supplied were supplied in accord with our feeling that slightly less reserves at that particular point of time, and this is a continuing policy, might be helpful.

Chairman PATMAN. This morning you mentioned a number of times about your objection to bank-created funds, bank-created money, and so forth. How much of our money is bank created now, Mr. Martin?

Mr. MARTIN. I couldn't give you a figure, Mr. Patman. We would be glad to work up some tables for you.

Chairman PATMAN. Isn't it practically all of it?

Mr. MARTIN. No.

Chairman PATMAN. Outside of the national currency, the Lincoln greenbacks they call them—though they are not really greenbacks—the \$346 million put in circulation in Mr. Lincoln's time. Outside of that, and the silver certificates and the minor coins, what other money do we have? There are of course the Federal Reserve notes of about \$29 billion or \$30 billion, but those are bank created.

Mr. MARTIN. We have \$16 billion of gold.

Chairman PATMAN. It is not in circulation.

Mr. MARTIN. It is in backing for the currency.

Chairman PATMAN. For foreign countries it is, yes, but for U.S. citizens it is not very good backing.

Mr. MARTIN. No, we have an international exchange standard today.

Chairman PATMAN. What other moneys do we have in circulation today that are not bank-created? I bring this up because you kept referring to it this morning, about bank-created money, saying you don't want that. What other money do we have outside of the Lincoln paper and the silver certificates?

Mr. MARTIN. The concept of bank-created money is important in relation to covering a deficit of the Government; that is why I say you have to look at it as a flow in relation to the deficit. If we are going to create additional reserves for the banking system to cover a deficit of the Government over and above what the economy requires, then we are in essence using the printing press to finance the Government.

Chairman PATMAN. I notice you referred to it as bank-created money or printing-press money in your testimony this morning.

Mr. MARTIN. I did.

Chairman PATMAN. What is that?

Mr. MARTIN. I did.

Chairman PATMAN. I would like to insist upon an answer to my question as to what money do we have in circulation today that is not created by either the Federal Reserve banks under their powers to create it, and the national banks and State banks under the fractional Reserve System? What money do we have that is not created by them except the national currency, \$346 million, the silver certificates, the silver and minor coin?

Mr. MARTIN. I have already pointed out to you, the gold that we hold.

Chairman PATMAN. That is not in circulation.

Mr. MARTIN. That is available for payment of our international transactions.

Chairman PATMAN. I know, but I am talking about what do we have here in the United States of America in circulation that we pass from hand to hand, and we use every day, outside of the money that I have mentioned?

Mr. MARTIN. The bank doesn't make it legal tender. This is the Government you are talking about now.

Chairman PATMAN. I am not restricting it. I am not disputing with you on that, Mr. Martin. I am just asking you what money do we have in circulation today that is used by the people that is not bank-created. We have about \$146 billion of money, don't we, approximately?

Mr. MARTIN. That is right.

Chairman PATMAN. How much of that is money that is not bank-created?

Mr. MARTIN. The bank deposits that we have are not all created by writing up assets on one side or the other of the ledger.

Chairman PATMAN. You say not all of it.

Mr. MARTIN. By no means. What would you say, Mr. Young? Do you have any figures on that?

Mr. YOUNG. The large part would be generated by bank lending and investing, but that doesn't mean it is bank-created to finance Government deficits.

Chairman PATMAN. I am not talking about the Government deficit now. So much was said about bank-created money, I just wanted to make the point that practically all of our money is bank-created. It is created by a flick of the pen on the books of the banks. You create it at the Federal Reserve by a bookkeeping transaction.

I wanted to make the point that practically all of our money is bank-created money.

Mr. MARTIN. A great portion of our money is bank-created money in relation to the capital and surplus the bank has when it starts out. The whole problem of credit arises when you take that credit and stretch it as a rubber band to the point where it breaks.

Chairman PATMAN. You mentioned about the capital that the bank starts out on. The amount of money that the bank creates now is not directly related to the capital?

Mr. MARTIN. No; that is correct.

Chairman PATMAN. In other words, it has no reference to the capital. It has reference to reserves.

Mr. MARTIN. We have a fractional reserve system, as you pointed out.

Chairman PATMAN. Whenever you give the banks reserves, you are letting them have something that is free to them. It doesn't cost them a penny. Upon that, they can expand from 8, 10, or 12 to 1 in creating money.

Mr. MARTIN. Within the limits set up under the Federal Reserve Act which the Congress can change at any time it wants. But within the limits set up there, we must never have Federal Reserve deposits or currency in circulation in excess of 25 percent of our holdings of gold certificates.

Chairman PATMAN. That is actual circulation?

Mr. MARTIN. No; deposits and note circulation.

Chairman PATMAN. Are you talking about the Federal Reserve banks, now, or all banks?

Mr. MARTIN. It is the same thing because we carry the reserves of the banking system.

Chairman PATMAN. That is \$18 billion now.

Mr. MARTIN. I couldn't give you the exact amount; \$16 billion-plus.

Chairman PATMAN. It used to be about \$18 billion. Does that indicate the contraction that has been going on? I wouldn't think so, because the rules have been changing on the reserves. We had the vault cash amendment and then you have changed the reserve requirements of the banks.

Mr. MARTIN. There was a reduction in the reserve requirement.

Chairman PATMAN. You can't say it has increased.

Mr. MARTIN. I am talking about the statutory reserve requirement that you have placed on us.

Chairman PATMAN. I am, too. I think I will yield to Mr. Reuss to ask questions at this point. Mr. Reuss?

Representative REUSS. Mr. Martin, during the controversy which has engulfed the Nation for the last 8 weeks on whether or not to have a tax cut, you testified on at least two occasions that you saw no need to give your view as to whether a tax cut was justified or not. If there were a tax cut, you would do your best to see that the resulting deficit was financed out of so-called real savings and not out of bank credit.

I pointed out, when you made that statement to the Banking and Currency Committee of the House a few weeks ago, that the persistence of the Federal Reserve in such a policy, would wipe out any gain from a tax cut. If you are going to require the deficit to be financed out of savings, a tax cut would result in very little stimulation.

The President, on Monday of this week, announced that there would not be a tax cut this year. I would judge that one of the elements which influenced his decision was the feeling that there is not much point in a tax cut which is then immediately countermanded by an equivalently tighter monetary policy.

Now, in this morning's presentation to us, you tell us something a little different. You say that a certain amount of money creation to meet the legitimate needs of a growing economy is a necessary and normal function of the banking system. If there were a Federal deficit, you say the banks would use some of this new money to purchase Government securities.

Specifically, you contend that additions to banks' holdings of Government securities due to normal growth in the money supply do not represent the financing of Government deficits with bank-created or printing-press money.

I am glad to hear you say this. However, I am impelled to add that your acknowledgment of an essential duty of the system, namely, to increase the money supply at a decent rate of 3 percent a year instead of the current unsatisfactory rate, comes after it has been decided to delay active consideration of a tax cut.

If you did add to the money supply at the rate of 3 percent a year, your action would have some relationship to the minimal growth needs of the national economy. The banking system, in the event of a tax cut, would be able to make some contribution to financing a deficit. No one in his right mind suggests that the banks need finance all of a large-scale deficit.

I wish you had mentioned this a little earlier.

Mr. MARTIN. I did, Mr. Reuss. I am sorry you did not understand. That was certainly my intention, to make that clear, because that has been monetary policy all the time. We wouldn't have any Federal

Reserve Act if we didn't have this problem of managing the supply of money.

Representative REUSS. But there is a little question of semantics which is important to me. I refer you again to your statement where you say—

Additions to banks' holdings of Government securities due to additional flows of savings through to this particular intermediary or to normal growth in the money supply do not represent the financing of Government deficits with bank-created or printing-press money.

What do they represent? It seems to me that any increment to the money supply represents "bank-created" money. The banks would use part of it to buy U.S. securities which were issued during a deficit period. Why doesn't that represent financing part of the deficit with bank-created or printing-press money?

Mr. MARTIN. To get back to my word picture that I like of the money stream—

Representative REUSS. Stay out of the swamp.

Mr. MARTIN. Yes, exactly. That is exactly what we are trying to do. That is the element of judgment. That is where we have to be careful when we talk about free markets. We don't have completely free markets any more in that sense. We haven't had since the Federal Reserve Act was enacted, but we have this problem of money management, to try to keep this water in the stream.

Representative REUSS. But if the banking system, with such increments to the money supply as are created by orderly additions to the money stream, purchases Government securities, why isn't that the financing of at least a part of the Government deficit with bank-created money?

Mr. MARTIN. Because they don't have to buy the Government securities with it. This is where a rate comes in.

Representative REUSS. If they do.

Mr. MARTIN. But that is not necessarily what happens. That is the process I am talking about here. We have to make the judgment on what this supply should be.

Representative REUSS. Of course you do. I think this is a distinction purely in degree, not in kind. If you create new money at the rate of 3 percent a year, a rate which I thought we both agreed was about right, and that new money is used to buy Government securities issued to meet a deficit, I think that is financing the deficit with bank-created money. If you create money at a reckless, improvident rate of say, 8 percent a year, and that money is used to finance a deficit, then that is equally used to finance the deficit with bank-created money.

The distinction is not one of financing deficits with bank-created money, on the one hand, and not doing so, on the other. The actual distinction is one of financing too much with bank-created money, as opposed to financing just the right amount with bank-created money.

What about that?

Mr. MARTIN. I have no comment on that. That is what money management is.

Representative REUSS. When you create just the right amount of new money, and this is used by the banking system in part to finance

a Government deficit, why do you say this does not represent the financing of the deficit with bank-created money?

Mr. MARTIN. To the extent that you can put in the deposits of individuals through persuading them—

Representative REUSS. I am not talking about real savings. You say, in addition to real savings, you will accept with equanimity the use by the banks of the normal growth in the money supply to finance Government deficits.

Why don't you call this the financing of Government deficits with bank-created or printing-press money? I ask you what is wrong with calling a spade a spade.

Mr. MARTIN. If it is properly related to the money supply, it is not printing-press money. That is what I tried to point out in this statement.

Representative REUSS. Then we will have to adopt a new language here. Do you mean to say that printing-press money ceases to be printing-press money if it is printed at a rate of less than 3 percent a year?

Mr. MARTIN. No. We are not talking about that. What we are talking about, covering a deficit that is being created out of thin air, if you want to put it that way, because we won't either raise taxes for the—

Representative REUSS. Nobody has suggested that.

Mr. MARTIN. That is where you end up, though. That is the point I am trying to make. The point I was trying to make to you the other day was that if you really want to get high interest rates, the best way I know to get them in the long run is to print the money indefinitely and you will end up where some of our South American friends have ended up.

Representative REUSS. That is right. I have not heard anyone suggesting that. But I do think it would contribute to public understanding if one said frankly that purchases by banks of Government securities with new money created in the orderly process of money creation is, indeed, the financing of Government deficits with bank-created or printing-press money.

Be that as it may, let me ask you this question: You said this morning that easy money causes unemployment. What is the process by which this unemployment comes about? I think you suggested that in the present circumstances of less than full employment, easing money would cause unemployment.

Mr. MARTIN. No. I was not talking about the future. I say that it does at certain times. As I pointed out, an abundance in this supply, this swamp, to get to your figure that I like, in my judgment retards the economy; it promotes unemployment.

Representative REUSS. When has an abundance of money caused unemployment in this country?

Mr. MARTIN. If there is an awful lot of money floating around and it all gets into security speculation or real estate speculation, when the bubble bursts you have unemployment on a scale that you will never have in any other way. I would say 1929 was a good example of where the bubble burst and unemployment resulted for many years

thereafter, and easy money was not able to pick it up for years and years.

Representative REUSS. You attribute the 1929 crash, and particularly the post-1929 economic depression, to easy money policies?

Mr. MARTIN. I wouldn't attribute it entirely to it, but I believe that easy money followed in the 1930's, and I was disillusioned in 1935 as to its effect.

Representative REUSS. Do you think the easy money policy of the early 1930's caused more unemployment than already existed, unemployment which I thought was in part the result of tight money policies in an earlier period? Do you think it was easy money in the 1930's that made matters worse?

Mr. MARTIN. In my judgment, yes. I am entitled to a judgment on that.

Representative REUSS. You certainly are.

Mr. MARTIN. I have no hesitation in saying so.

Representative REUSS. Do you think that period is comparable to what we have now?

Mr. MARTIN. No.

Representative REUSS. Do you think easier money than what we now have would cause unemployment today?

Mr. MARTIN. No, I didn't say that. It depends entirely on the flow of funds and whether they can be utilized. We have not had a loan demand in the last year that has come anywhere close to the expectations, in my judgment, of the banking community itself. That has been one of the interesting factors in the economy.

All of this period in my humble opinion relates to the inflation that got ahead of us years ago. I don't happen to believe, as some of you know, that high interest rates and so-called tight money caused the recession or the last few recessions.

I think there were other factors. I think by and large we have been following relatively easy monetary policies right along.

Representative REUSS. On that you do not agree with Mr. Arthur Burns, President Eisenhower's economic adviser?

Mr. MARTIN. No. I did not agree with him when he was Chairman of the Council of Economic Advisers. I have great respect for him. But I think you would expect me to follow my judgment as long as I am on this job. I should listen to everybody's advice. But you would expect me to follow my judgment and not someone else's.

Representative REUSS. You are not shaken in your judgment about whether Arthur Burns was right—as to whether or not you caused the 1959 recession by what has happened recently. You are doing about the same.

Mr. MARTIN. No, we are not doing the same.

Representative REUSS. You are doing about the same thing?

Mr. MARTIN. No, not in the slightest way the same.

Representative REUSS. In the 1959 recession you tightened money when the unemployment rate got about 1 percent better than it was at its peak?

Mr. MARTIN. We were running a deficit substantially in excess of the current deficit. I am sure there would have been some people

who would have been happier if we had not tried to draw savings out to finance that deficit.

Representative REUSS. My time is up.

Chairman PATMAN. May I make one comment here. We asked Dun & Bradstreet to speed up their regular survey of business expectations, to give us the benefit of it during these hearings. We have received a report. I will read part of it. It is titled: "Businessmen's Expectations, Fourth Quarter, 1962.

Sales by the Nation's business firms will turn down in the fourth quarter if the expectations of the executives hold true. The Dun & Bradstreet sales optimism index for the last 3 months of this year stands at 57, the lowest point since the second quarter of 1961.

For the current third quarter it registered 73. The latest survey among 1,500 of the leading manufacturers, wholesalers, retailers was conducted in July. Dampened enthusiasm for the last 3 months of the year is most pronounced among durable goods manufacturers where the index level dropped from 78 in the last survey to 58 currently, and among wholesalers where it dropped from 69 to 47.

Retailers are still fairly optimistic. The net decline in that area of the economy being only 5 percentage points.

Without objection, I will put in the whole statement with charts and other information from Dun & Bradstreet.  
(Documents to be supplied follow:)

#### BUSINESSMEN'S EXPECTATIONS FOURTH QUARTER 1962

##### BUSINESSMEN'S OPTIMISM SLIPS

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The latest survey, among 1,500 of the leading manufacturers, wholesalers, and retailers, was conducted in July. Executives were asked how anticipated sales of their products and services in the fourth quarter would compare with the same period last year. The index reflects the net difference in the percent of those expecting increases, less the percent of those anticipating decreases. Over the last two recessions there has been a remarkable parallel (see accompanying chart) between the fluctuations of this index and total business sales, as reported by the Department of Commerce, even though the index relates to expected sales levels 4 months ahead on the average, whereas Government figures are released more than a month after the fact.

This is not to say that businessmen are clairvoyant any more than the stock market is a sure-fire indication of business in the near future. And there is no question that business optimism has been seriously influenced by the poor showing in Wall Street possibly as much as by conditions in the economy itself. But it is worth noting that the index signaled the bottom of the 1960-61 recession well before most economists saw it clearly, and in February of this year, while economists were generally forecasting continued gains throughout 1962, the index for the second quarter turned down slightly, pointing to the fact that the rate of gain was already declining.

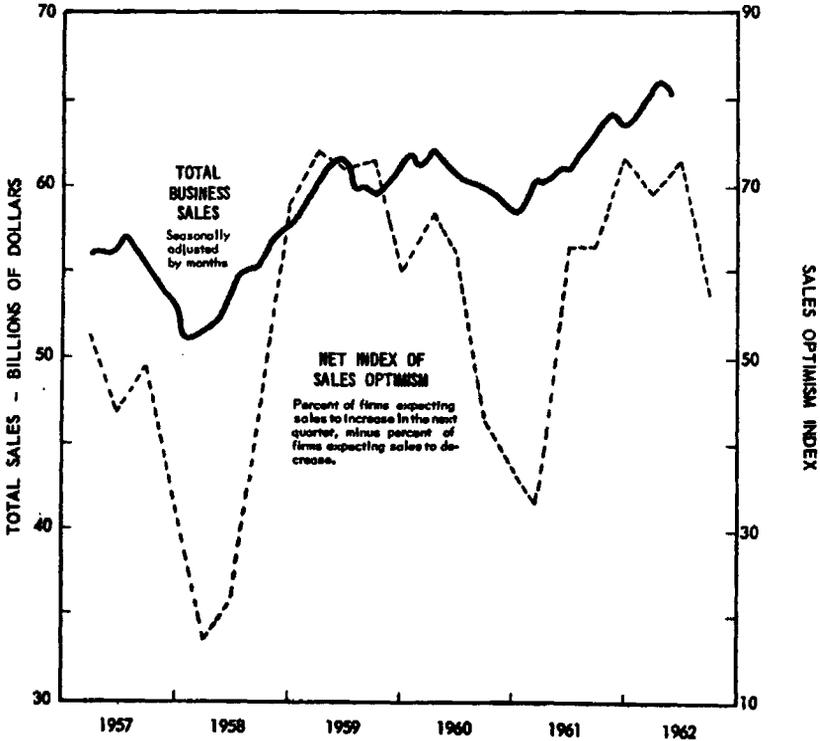
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Executives interviewed in this survey were also asked about the outlook for profits, selling prices, inventory levels, and number of employees. At no time during the current recovery has the outlook for increased profits been as favorable as the anticipated gains in sales volume, and now, with lower sales volume in prospect, the number of executives who expect year-to-year gains in earnings is even smaller.

Up until the cutback by the steel companies of their announced price increase, the survey showed strong pressure for price increases in most industries, but that even together with competitive struggles for markets has brought about a situation in which fewer companies now expect to raise prices than at any time since 1954.

Inventory accumulation is also expected to level off, and fewer businesses anticipate increases in their number of employees, so that, overall, expectations for the business sector of the economy in the fourth quarter are far from favorable.

**SALES OPTIMISM SLIPS  
WILL SALES FOLLOW?**



SOURCES: United States Department of Commerce  
Business Economics Department, Dun & Bradstreet, Inc.

## SURVEY OF BUSINESSMEN'S EXPECTATIONS, CONDUCTED BY DUN &amp; BRADSTREET, INC.

*What businessmen expect for the 4th quarter of 1962 compared with the 4th quarter of 1961*

[Interview period: July 16-27, 1962]

	All concerns	Total manufacturers	Manufacturers		Wholesalers	Retailers
			Durables	Nondurables		
Number reporting.....	1,531	811	433	378	507	213
Net sales, percent expecting—						
Increase.....	62	65	64	65	54	67
No change.....	33	30	30	31	39	27
Decrease.....	5	5	6	4	7	6
Number reporting.....	1,460	771	413	358	453	206
Net profits, percent expecting—						
Increase.....	49	53	55	51	44	49
No change.....	44	40	38	42	49	45
Decrease.....	7	7	7	7	7	6
Number reporting.....	1,507	796	426	370	502	209
Selling prices, percent expecting—						
Increase.....	10	9	10	9	10	12
No change.....	86	86	87	86	87	86
Decrease.....	4	5	3	5	3	2
Number reporting.....	1,515	803	430	373	501	211
Level of inventories, <sup>1</sup> percent expecting—						
Increase.....	24	26	26	26	19	25
No change.....	67	64	63	66	70	68
Decrease.....	9	10	11	8	11	7
Number reporting.....	1,520	804	430	374	508	213
Number of employees, <sup>1</sup> percent expecting—						
Increase.....	13	17	20	14	7	10
No change.....	83	79	76	82	89	88
Decrease.....	4	4	4	4	4	2
Number reporting.....		745	409	336		
New orders, percent expecting—						
Increase.....		53	53	53		
No change.....		43	43	43		
Decrease.....		4	4	4		

<sup>1</sup> End of quarter.

*Businessmen's expectations—All concerns*

Percent expecting—	1957				1958			
	1st quarter	2d quarter	3d quarter	4th quarter	1st quarter	2d quarter	3d quarter	4th quarter
Increase.....		63	54	58		40	41	55
No change.....		32	36	33		37	40	33
Decrease.....		6	10	9		23	19	12
Index.....		58	44	49		17	22	43
	1959				1960			
Increase.....	72	77	74	76	65	70	67	54
No change.....	24	20	24	21	30	27	28	35
Decrease.....	4	3	2	3	5	3	5	11
Index.....	68	74	72	73	60	67	62	43
	1961				1962			
Increase.....	49	46	67	67	76	72	75	62
No change.....	39	41	29	29	21	25	23	33
Decrease.....	12	13	4	4	3	3	2	5
Index.....	37	33	63	63	73	69	73	57

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. Apropos of what the chairman has been reading from Dun & Bradstreet, Governor Martin, what do you expect for the next two quarters?

Mr. MARTIN. I think you already know, Senator, that I avoid forecasting like the plague. I have indicated in this statement as far as I would care to go.

Senator PROXMIRE. Do you avoid forecasting in determining policy for the Open Market Committee? You gentlemen are concerned with the present state of the economy and simply act on the basis of what the present situation is rather than to take into account the opinions of business executives and others who might indicate what the economy might be like in the ensuing months?

Mr. MARTIN. No; we try to take those into account, and we certainly take our historical tendencies and developments into account and we take into account this element of growth in money that Congressman Reuss has been speaking about. We take all of those factors into consideration. That is why we meet so frequently—at 3-week intervals.

Senator PROXMIRE. This is an implicit forecast. You have to make some kind of assumption on the basis of the historical experience, on the basis of opinions of leading business executives, on the basis of their announced plans.

There is some basis for forecasting.

Mr. MARTIN. To that extent, yes. But it is not forecasting in the sense that we say we expect the GNP to be a certain level at such and such a time and it would therefore require such and such a level of reserves in order to get to that point. We don't make that type of forecast. We let the free market forces determine the level of activity that is achieved.

Senator PROXMIRE. There we go.

Mr. MARTIN. I think it is important. If you believe that you can make the economy——

Senator PROXMIRE. I do not at all. I do not think you should try to make the economy. But I do believe you can have influence on the economy. It would seem to me that if you expect the situation to be depressing, if you expect a contraction in the economy, if the growth is going to be inadequate, if income is going to be inadequate, then if that is the forecast, then you would follow a different policy than if you expect inflationary pressures to continue during the coming months.

In doing this you, to some extent, regulate or influence the economy.

Mr. MARTIN. We certainly do. That is why I used this phrase "leaning against the wind." We try to watch the interplay of forces and do just that. Meeting at 3-week intervals, we may change a number of times in 9 weeks because you are rolling with the dominant force. But when you talk about forecasting, you say what the next two quarters will be. We would think we were stepping out of our field to have our policy determined on the basis that the GNP was going to attain a certain level by the end of the next two quarters.

Senator PROXMIRE. Let me try to pursue the point that Congressman Reuss is raising so ably. You said that as one example, the only example I think you have given us, of easy money promoting unemployment or promoting a situation in which we had an economic contraction, 1929.

As I said this morning the Friedman-Meiselman study was introduced before this committee by Vice President Sprinkel of the Harris Trust in Chicago the other day. This careful scholarly study shows that all economic declines without exception were preceded by monetary restrictions and all recoveries by monetary ease.

For example, the largest monetary contraction is followed by the largest economic declines, 1921, 1929, 1937. The study selected 1929 on the basis of very careful analysis of the data and statistics and the facts as a year in which we had monetary contraction.

I certainly recall that in 1929 we had high interest rates. We clearly had, on the basis of the charts I had this morning, a relationship between the monetary supply and the GNP which proved that we had monetary tightness.

That was followed by serious depression. So the only example you give us of easy money is an example which other experts on the basis of data and factual analysis, not opinion, say was tight money. Can you contradict the analysis of Friedman and Meiselman as given to us by Mr. Sprinkel?

Mr. MARTIN. I think this is where you get into an endless argument. I happen to be convinced that it serves no purpose to try to say which comes first, the chicken or the egg. But I insist there are four really basic elements in the economy.

One is budgetary policy. The second is debt-management policy. The third is wage-cost policy. The fourth, and I place it in that order as a matter of my personal judgment, is monetary policy.

If you have an unsound monetary policy contributing to unsoundness in these other things, then you have a real state of chaos.

On a number of occasions, people have said to me, "Yes, Mr. Martin, we admit we have an unsound budgetary policy. Yes, we admit we are not handling our fiscal and debt-management policies as we should. Yes, we admit that the wage-cost spiral has not been handled as well as it might.

"Now don't you, Mr. Martin, come along and give us a sound monetary policy and make it more difficult for these other unsound policies to work."

This actually happened on many occasions. I don't think we ought to exaggerate the importance of monetary policy nor ought we to underestimate its importance.

Senator PROXMIRE. Yes, sir; Mr. Eccles, your predecessor as Chairman of the Federal Reserve Board, told us exactly the opposite in terms of potency of monetary policy. He said this is number one. He says this is the most powerful weapon our Government has.

He was emphatic about it. He felt particularly that it is very important that these economic weapons we do have be used in concert by the President or the Congress. These were his words, a President can be elected and have his hands tied so he has no freedom at all in connection with the problems of monetary and credit policy.

So Mr. Eccles would seem to take a different view.

Mr. MARTIN. I don't think—

Senator PROXMIRE. Or would you say these were pretty much equally potent?

Mr. MARTIN. No, I would not say they are equally potent. I think Mr. Eccles might attach more importance to monetary policy than I would or vice versa. That is a matter of judgment.

I always welcome an opportunity to say that these things ought to work in concert. That is our objective.

Senator PROXMIRE. They are not working in concert if the President of the United States feels he has to reduce taxes at a time when we already have a deficit and feels he has to do that in order to get the economy moving and the monetary managers announce if that is done they will follow the policy which every economist that testified before us says will slow down expansion.

Mr. MARTIN. I don't agree with your analysis.

Senator PROXMIRE. Can you tell us that this is working in concert if you follow a policy—

Mr. MARTIN. I have already explained that it is not a dollar-for-dollar operation. I think it is regrettable that we have to be running a deficit.

Senator PROXMIRE. I think it is, too. I would agree with Senator Douglas who argued that one of the reasons why so many people are calling for a tax cut which he disapproved, and so do I, is because we followed a policy of monetary tightness and monetary restriction.

I wrote the chairman asking for these hearings. I was the first one to write and request them for this very reason. I think it is this monetary tightness that puts us in a position where the President and Members of Congress feel we have to have a tax cut.

If we did not have that, then the tax cut would not be necessary.

Mr. MARTIN. It is my conviction, Senator—I have said this several times in colloquies up here—that generally speaking we follow a too

easy money policy. I am not taking about today or any specific time. I am talking about generally.

I have said publicly and continue to say publicly that no central bank will follow a deflationary policy in the sense of bringing about downward adjustments in order to achieve an equilibrium.

All the central bank can do is to permit interest rates to have sufficient reflection so that people see the malaise that will be caused by continuing down the path of believing you can have your cake and eat it, too.

Monetary policy has some effectiveness there. I believe that in the period preceding the last 10 years we had a pegged market for Government securities and monetary policy was of very little influence.

Senator PROXMIRE. Before 1951?

Mr. MARTIN. Before 1951. I say in the time that I have been fortunate enough to be in the Federal Reserve or privileged enough, I believe we have had some influence. I don't think the influence has been as great as some people have thought.

I think that what we are up against is that there is one school of thought that thinks if you could just push interest rates to zero there would be no problem at all. There is another school of thought that thinks if you just put interest rates up to something like 10 percent that everyone would be benefited.

Senator PROXMIRE. Neither of us belong to either one of the schools. We both agree that interest rates should vary depending on the status of the domestic economy. When we have substantial unemployment and unused capacity the interest rates ought to be encouraging people to borrow.

Mr. MARTIN. That is right. I like to return to the point you made in reading those excerpts this morning. There are some people who have a mystical faith in high interest rates. There are equally a lot of people who have a mystical faith in low interest rates.

All I am saying is that you and I are in agreement, that where we ought to be is in the middle group. We are trying to get interest rates that are neither inflationary nor deflationary and I believe we have come a long way toward it by getting a larger supply of savings in the last couple of years. We have succeeded in financing municipal and mortgage credit demands at lower levels than heretofore and the volume of such financing has been very substantial.

One of the things that worries me today, and I say this publicly here, is that if money is kept too abundant that you will undergird some weak real estate situations that would be better off if not undergirded by pressures to invest mortgage money at consistently lower rates.

We had an adjustment in the securities market and we came through very well. Let us hope we don't have to have any more adjustments of that type.

Senator PROXMIRE. What concerns me far more than the present status of monetary policy or what happened in the past few weeks, we read so much by responsible well-informed financial writers that we are going to have higher interest rates.

We hear a lot of talk about that from abroad. The Treasury offers these 30-year, nearly  $4\frac{1}{4}$  bonds and sells less than half of what they were ready to sell.

One of the arguments given is because people expect interest rates to go higher in the near future for long-term obligations.

What I am particularly concerned about is not the past. I am earnestly hoping in the future we are not going to have a policy of having the two great instruments of national economic policy, fiscal and monetary policy, going in exactly the opposite directions.

This is what we read over and over, we will have a deficit financed by a tax cut and we are going to have higher interest rates at the same time. It seems to me to be a ridiculous contradiction. I would certainly agree with you that they ought to work together.

In your statement you say you have stated quite explicitly my belief that such deficits as we may experience whether they are due to a shortfall of revenue under the existing tax structure—even if you have no tax cut, even if you have no increase in spending—or an increase in expenditures or a reduction in tax rates, all of them should be met by borrowing from the real savings of businesses and individuals and not through the creation of money through the banking system.

This means even if we have no tax cut, no increase in Government spending. But the deficit increases and it could only increase under those circumstances—if business gets worse—nevertheless the monetary policies are going to follow a policy of putting the screws on. They are going to follow the policy of soaking up what money is available.

So if John Jones getting his little wages is not going to have an increase in wages and his wife is going to be laid off, he will be persuaded to buy bonds so he buys even less.

What you say here is much more discouraging than what you told us before, that you would finance a tax cut deficit this way.

Mr. MARTIN. I have always maintained that the best way to finance a deficit is through savings—real savings—and I am sure that is the soundest way to do it. We have some leeway in our money supply figures. We have certainly not erred, in my judgment, on the side of abstaining from financing with bank-created money. We just have not erred that way. The errors have been the other way and that is what has caused us so much trouble.

Senator PROXMIRE. My time is up.

Mr. MARTIN. That is what happened during the war. This money supply that Mr. Patman was talking about this morning, I don't know what the money supply ought to be in relation to the GNP. I am convinced it has been consistently too high.

If you could have a scale by which you could precisely measure this it would be easier.

Senator PROXMIRE. You say it is too high. It is almost the lowest that it has been in history. We have to go back 30 or 40 years to find any situation comparable. But you say it is still too high?

Mr. MARTIN. In terms of present levels of economic activity I don't have any question that it is adequate.

Chairman PATMAN. Senator Javits.

Senator JAVITS. Mr. Martin, are you still a constituent of mine?

Mr. MARTIN. I am.

Senator JAVITS. I welcome you here for that and many other reasons. I have the general impression from your paper, which I did not have the opportunity to hear because we have a little business on the floor as you may have read in the papers, that you would pretty much let everything stand as it is and that you are satisfied that the policies we are pursuing, the relationship of our foreign trade balance to our gross national product and our foreign obligations—pretty much everything that you say leads to maintenance of the present posture—are the best for our country right now.

Is that a fair characterization?

Mr. MARTIN. No, I am talking only about monetary policy.

Senator JAVITS. In your field, I understand?

Mr. MARTIN. Yes.

Senator JAVITS. So you pretty much feel that way. Do you feel, however, with respect to the international balance of payments that there is reason for the disquiet expressed by many that our improved condition is temporary?

Mr. MARTIN. Yes. I think as I point out in this statement we have no reason to be complacent about it. I think we have made progress. President Kennedy has shown an awareness and an alertness of this problem that I think has been commendable.

I believe that the efforts of the Defense Department in procurement and the other efforts that have been made to get our foreign friends to share more of the burden of carrying the free world, all of it had some constructive results.

I don't think it is yet enough. I think we are making commendable progress on it and I see no reason to be discouraged.

Senator JAVITS. In all of these estimates we have seen, people always talk about an export surplus, but I see very few people that talk about the return on our foreign investments as representing any appreciable factor in our situation—both our economic situation and our international balance of payments. Yet it seems to me that this is a pretty important determinant for American policy because more and more we are investing abroad, if we are not too discouraged by the tax provisions as they ultimately come out.

It seems to me that is beginning to, or should, represent a very appreciable factor in relation to our balance with the world and therefore with what it allows us to do in domestic terms. Would you agree with that or what would be your view?

Mr. MARTIN. Yes, I would agree with that.

Senator JAVITS. Has that been taken into account as an appreciable factor? For example, you say "Up to the present time it has not been a matter of choosing between domestic and international goals."

I gather you are satisfied with the relationship of long-term to short-term interest rates in terms of dealing with the short-term capital which may leave our shores or return to them.

Mr. MARTIN. Not completely satisfied. What I am pointing out here is that up to the present time we have accepted whatever calculated risk there was in supplying the domestic economy with the requirements we think they need, even though we have not entirely equalized the possibility of an outflow of short-term funds abroad because of the higher

interest rates that can be obtained there. But we have been aware of this problem at all times and have been watching it. We would be irresponsible—that is one of my convictions at the moment—if we did not keep our eye on this differential that exists so that we would be ready at some point to realize that the domestic and international may come together.

Senator JAVITS. So as you look ahead, do you regard the short-term and long-term rates as fairly stabilized? Is that part of your overall appraisal of the situation? That we ought to go along pretty much as we are going?

Mr. MARTIN. Under present conditions we want to give the maximum of assistance to the domestic economy without endangering unduly our international balance of payments.

Senator JAVITS. Does that translate itself into the right of the domestic economy to expect that your interest rates will remain pretty much as they are unless there is some new sensational change in the situation?

Mr. MARTIN. In the absence of an important increase in demand for funds and that type of pressure, yes.

Senator JAVITS. Do you see, in terms of American foreign policy, any very special demand abroad for credit which we are not satisfying? It has been said time and again that one of the real deficiencies in the whole picture of foreign aid—and I am now talking in strategic terms in the struggle for peace—is the fact that our governmental foreign aid is not adequate to do the job that needs to be done. It is certainly more than we can expect Congress to do or as much as we can expect Congress to do, and therefore we have to look at the private economy. That will, in turn, have to draw very heavily on the credit sources of the country if we can organizationally get them into the foreign effort.

Is there any plan or forecast by the Federal Reserve System along those lines at all?

Mr. MARTIN. No, there is not, Senator.

Senator JAVITS. In other words, you would just await such demands?

Mr. MARTIN. We are watching the demand. But we don't have any forecast of what it will be.

Senator JAVITS. Do you feel our system is flexible enough so that if there were a very appreciable demand for credit for the purpose of development abroad by private business—and by appreciable I mean in the order of magnitude of billions, \$20, \$30, or \$40 billion—that our system would be able to meet it?

Mr. MARTIN. Yes.

Senator JAVITS. So we who feel strongly about the enlistment of the private enterprise system in foreign development need not have any inhibition, in terms of straining our domestic economic system, assuming that the credit is viable in terms of reasonable expectation of payment, to continue to make that effort?

Mr. MARTIN. That is my view.

Senator JAVITS. That is very interesting. Thank you very much for those reassurances, because I think they are extremely significant and important. Do you see any complications ahead, again in terms of forecast planning, for our balance of payments which are not now in evidence? Do you see any major movement of capital out of the

country? Do you see any major strains through a raid on gold or any other strain, as the Federal Reserve System looks ahead upon our international balance of payments, other than what we already have in evidence and what you are coping with?

Mr. MARTIN. I can't forecast what might happen if people lost confidence or that type of thing. I don't think anybody can make a judgment on that. We have been trying to keep on top of that as far as we can. I wouldn't want to borrow trouble.

Senator JAVITS. You see nothing sensational in the offering in that subject?

The general tenor of your paper is that we are going along pretty well, let us continue this way. I am trying to ascertain from you whether there are any calculations that you see that would upset that idea.

Mr. MARTIN. I wouldn't want to say I think we are going along in a completely satisfactory way in our balance of payments, because two swallows don't make a summer. I think we may have a critical period ahead if we don't continue to make progress because there is a certain lack of confidence in our ability to do this.

Senator JAVITS. When you say "if we don't continue to make progress," precisely what do you mean by "making progress"?

Mr. MARTIN. Exactly the sort of figures I reported here about our balance of payments.

Senator JAVITS. In other words, would you say making progress is for equilibrium?

Mr. MARTIN. Yes.

Senator JAVITS. But equilibrium, as I see it, you put not on having a greater export surplus or greater income from foreign investments, but rather on the procurement side and having our allies carry more of the burden of the world struggle for peace; is that right?

Mr. MARTIN. I think that is where we made our most notable progress. I don't believe we can expect, as I point out in this paper, to increase our trade surplus substantially above where we are now.

Senator JAVITS. Notwithstanding the new trade bill?

Mr. MARTIN. Notwithstanding the new trade bill. I would not personally be too optimistic about increasing our trade surplus beyond the \$5 to \$6 billion level we have been achieving.

Senator JAVITS. The new trade bill is more, in your view, defensive rather than in the hope of getting a greater surplus?

Mr. MARTIN. It is a move toward freer trade in the world in general and a higher standard of living for everyone.

Senator JAVITS. But not in terms of increasing our export surplus?

Mr. MARTIN. That is right.

Senator JAVITS. You don't see too much more either coming to us in terms of the income from investments or services abroad than we are getting now?

Mr. MARTIN. No.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Martin, I want to ask you about one thing that Senator Javits brought up, and that is about your ability to meet the credit needs wherever they exist insofar as the Federal Reserve is concerned.

At this time there is a ceiling on the reserve requirements of banks, but what is the legal floor?

Mr. MARTIN. You are talking about our reserve requirements?

Chairman PATMAN. That is right.

Mr. MARTIN. Yes. It is 16 percent now where the reserves are, and I think we can go down to 8 percent.

Mr. YOUNG. Ten percent for Reserve city banks. Seven percent for country banks.

Chairman PATMAN. That is your floor. If you were to reduce to that, that would create lots of credit, wouldn't it?

Mr. MARTIN. Lots of credit.

Chairman PATMAN. Tens of billions of dollars' worth?

Mr. YOUNG. Yes.

Chairman PATMAN. In addition to that, the Federal Reserve has unlimited credit facilities, in that you could, if you wanted to—nobody is advocating it—buy up the entire national debt with Federal Reserve credit.

Mr. MARTIN. There is no doubt about it. But probably nobody would want it after we got it.

Chairman PATMAN. Nobody is advocating it; I am only asking "if" you could buy up the entire national debt, \$308 million?

Mr. MARTIN. There is no limit to which we could depreciate the currency.

Chairman PATMAN. In financing deficits, Mr. Martin, you have been Chairman of the Federal Reserve Board since 1951, and during Mr. Eisenhower's administration there were several deficits, as in other administrations, and one of the biggest deficits was by reason of the 1957-58 recession, was it not?

Mr. MARTIN. It was.

Chairman PATMAN. That ran to about \$12 billion. At the end of 1957 you commenced easing credit; I believe you reduced discount rates a little.

Mr. MARTIN. We did.

Chairman PATMAN. And made credit easier?

Mr. MARTIN. That is right.

Chairman PATMAN. In 1958 you took a giant step. You reduced reserve requirements by 2 percentage points?

Mr. MARTIN. That is right.

Chairman PATMAN. I believe that was in February.

Mr. MARTIN. Whatever you say. We will check it, but I am sure that is right.

Chairman PATMAN. In the earlier part of the year?

Mr. MARTIN. Yes.

Chairman PATMAN. That meant that the banks could create, without any cost to themselves, about \$10,700 million, by making loans or investments. Isn't it a fact that the banks put every dollar of that into the purchase of Government securities, and that their Government securities increased from November 27, 1957, from \$56,910 million to November 24, 1958, about a year later, to \$67,660 million, or \$10,750 million? In other words, when you gave the banks an opportunity to make loans, they used every bit of it to buy U.S. Government securities.

Mr. MARTIN. No, not every bit of it by any means, Mr. Patman, but we certainly were doing what we could to assist in the recessionary period. I am sorry, in retrospect, that we had not had a little more

restriction earlier so that the recession might have been slightly less than it was when it came. But our entire policy in 1958 and 1959 was directed toward doing just what I am talking about here, and this caused the Treasury to put out some longer term and higher interest rate bonds in order to attract the savings of the public and to finance the \$12 billion deficit you are talking about.

In my judgment if we had not done that, we would be in a whole lot more trouble than we are today.

Chairman PATMAN. With regard to your reference here to the banks seeking other outlets for their funds, and especially their holdings of State and local securities, do you look with favor upon the banks creating money to buy tax-exempt bonds?

Mr. MARTIN. You and I discussed this before. I have never been in favor of tax-exempt securities. I suspect the Congress is not likely to change that. I think municipal finance in this country is pretty well geared to tax-exempt securities today, and it would cause a real upset to correct it. I don't like tax-exempt securities. I told you that a number of times. I don't like the idea that somebody who doesn't work can get a better return, because of a tax exemption, than somebody who does work.

Chairman PATMAN. I recall that Mr. Daniel Bell, when he was Under Secretary of the Treasury gave me an estimate of the savings in cost to a road district, school district, or a political subdivision of a State or to a State, by reason of the tax-exempt status of these bonds, and he came up with a very small figure, I believe it was one-eighth of 1 percent, and I feel that is too low now.

I have a feeling that if the Ways and Means Committee of the House will have a real hearing on this, to show the devastating effects of the tax-exempt securities, public sentiment could be brought to bear against them.

You take a person who is fortunate enough to have a million dollars. If he invests in 4-percent tax-exempt bonds, he can go any place in the world he wants, spend the rest of his life, and draw \$40,000 a year. He makes no tax return. He pays no tax of any kind. When there were a few tax-exempt bonds, this didn't mean so much; but now—when they are going into the market at the rate of \$7, \$8, \$9, and \$10 billion a year—that is about the rate, isn't it?

Mr. MARTIN. That is right.

Chairman PATMAN. Soon all the big wealth of the country is going to be in tax-exempt bonds, and the poor folks will have to pay more taxes.

Mr. MARTIN. I am enthusiastic on your point on this. I am glad we have something that we are in wholehearted agreement on. My philosophy on this has always been that the man on the street does not feel badly about a man getting a big salary from some corporation if he is doing a job. In fact, I think most of them wish they could have the job so they could get the same big salary.

I think they have every right to feel badly about Joe Palooka who is down in Florida, or some other place, and doesn't do any work at all, and just lives on a tax-exempt income.

Chairman PATMAN. He makes no report to anyone. Doesn't file any return. I have been interested in this over the years, as you know, and I know you have the same views. I have also been studying

these tax-exempt foundations, the ones that had the earmarks of not being just for charitable purposes.

I made a speech on July 23 in which I brought out a lot of information—I hope, if you didn't see that speech, you read it. I will send you one.

Mr. MARTIN. I hope you will.

Chairman PATMAN. I will make another next Monday, in which I will bring out the assets of these foundations. People not only have these tax-exempt securities as a tax haven, but they have the foundations. Of course, we are not talking about the good foundations, such as those for cancer and polio and even for education, under certain circumstances. I am talking about the foundation that looks more like a tax gimmick or tax dodge than anything else.

We seem to have an unlimited number of these in the country. I doubt Internal Revenue could even give you an estimate as to how many.

So it looks like our tax system is becoming more and more a system whereby they just pass around the hat and let the rich people pay whatever they care to pay. Such people don't have to pay too much taxes; they have ways of avoiding taxes. I think we ought to take another look at the foundations and also at the tax-exempt securities.

Mr. MARTIN. The Federal Reserve Board is not the place to look at foundations. I think you will agree.

Chairman PATMAN. That is right, or the tax-exempt securities either, because that is up to Congress.

Mr. MARTIN. That is right.

Chairman PATMAN. You have more power than Congress in many respects, but in this respect you don't.

Senator PROXMIRE. How did you finance the deficit during the past year?

Mr. MARTIN. The deficit in the past year—the increase in securities?

Senator PROXMIRE. The table I have indicates that in July of last year all commercial banks, holdings of U.S. Government securities, \$64.7 billion. June of this year, \$64.2. So it looks as if the deficit was financed during that period generally with ups and downs by sales to the public.

Mr. MARTIN. That is exactly what we tried to do. That is why I referred in my statement this morning to the fact that in the first half of 1962, give or take a little here or there, I think we have done a pretty good job.

Senator PROXMIRE. Why isn't it a fair observation to say that the economy has not performed nearly as well as we expected it to, and maybe this is one of the reasons it hasn't, because you did follow that policy of no increase in bank money at all? In fact, a slight decline. During the last part of this period the conditions are being felt and the economy is slowing down to such an extent that the President and others are proposing what I think are quite radical and extreme proposals that would increase our deficit.

Mr. MARTIN. I don't believe that monetary policy has had anything to do with this. As I tried to point out in this paper here, we have given \$1 billion of reserves and \$17 billion of credit.

Senator PROXMIRE. I was very interested in that. You say in the last 12 months alone we have added almost a billion dollars in bank

reserves. During the same period the GNP grew by 10 percent. Your increase in reserves is only 4 percent. You did not come close to keeping pace with the need for money as measured in the gross national product. This is something you should apologize for rather than be proud of. A \$2 billion increase in bank reserves would have kept pace; \$3 billion would have been expansionary; \$1 billion is contraction.

Mr. MARTIN. We are right back where we started from, because I don't think you can measure it that way. I think that any reasonable approach to the economy in the last year indicates that nobody has been suffering from lack of credit or ability to obtain money.

Senator PROXMIRE. Conventional rates, as I understand it, on 20-year mortgages are near the alltime high; 5.95 percent is the last figure I have seen for the last couple months, and it has been steady.

Mr. MARTIN. That rate has tended to decline.

Senator PROXMIRE. It is a little lower than it was a year ago, but it is still high.

Mr. MARTIN. That is right.

Senator PROXMIRE. Short-term rates are up, long-term rates are up even more, so this kind of hard statistical evidence suggests that interest rates are moving higher. The only hard evidence we have now shows money is tight now. You can say it is easy money. I can say it is tight money. The only way you can decide that is to go to the indicators we have, the money supply has not been growing, the interest rates have been going up, the money has not been keeping pace with the gross national product.

I can't come to any conclusion but that I am right and you are wrong.

Mr. MARTIN. That is right. It is your judgment that this increase in bank reserves and increase in credit was not sufficient. I wonder why we have had a decline in the securities markets, for example?

Senator PROXMIRE. I could give you lots of reasons. I think you may agree with Mr. Dillon and others who argue that the stock market was much too high. I think it is still too high. The price-earnings ratio was ridiculous. It was in the area of 23 to 1 on the average. This drop in stock prices was a healthy correction, in my judgment.

Mr. MARTIN. It was not the lack of credit that caused it to decline. That is the point I am trying to make.

Senator PROXMIRE. I think that is correct. I don't understand why you lowered margin requirements.

Mr. MARTIN. It may have been easily a case of too much credit being around.

Senator PROXMIRE. Which made it so high.

Mr. MARTIN. Yes.

Senator PROXMIRE. I feel, frankly, that the reason it was high was because of the discounting of inflation and a conviction on the part of many people that the only safe place they could put their money was in the stock market, because the value of the dollar was declining and it had declined steadily.

I think two things have corrected that: (1) The stability in the price level, especially the wholesale prices in the past 5 years and the reasonable stability in retail prices; and (2) the very tough action taken by the President, who indicated that he is going to crack down

on administered prices and see that steel and other industries do not unilaterally raise prices.

Mr. MARTIN. You don't think the profit squeeze had anything to do with it?

Senator PROXMIRE. The fact is that profits are up much more in the last year, proportionately more than wages or other indicators, and cash earnings are particularly up because of the adjustment in depreciation and so forth.

Mr. MARTIN. You see, the lack of demand for credit in part has been due to retained earnings and depreciation and lack of programs which would cause more expansion. We have had a very good demand, relatively speaking, at the consumer level. Our problem has been in the investment level.

Senator PROXMIRE. Here we had Dr. Langum, who did a superb job before this committee showing that there has been a very definite and regular decline of relationship of plant and investment to cash earnings. It is the lowest he had on his chart. He could not get any lower. It dropped from 80 percent to 61 percent.

They had ample depreciation reserves and cash earnings, but in relation to their capacity to invest in plant and equipment they are not doing it. That is why I think the investment credit is very, very hard to justify. This did not include the latest action by the administration in providing a billion and a half additional depreciation.

I can't buy the argument that we need greater capacity on the part of business to invest in plant and equipment by making cash earnings more readily available.

Mr. MARTIN. For productivity reasons. We have to compete in the world. I suspect that American productivity has tended to slip in the last several years.

Senator PROXMIRE. Once again, the statistics indicate during the past 3 or 4 years at least that labor costs have been very stable in this country. Our productivity has been quite good. It has increased quite a bit. It always does after a recession. Our strongly favorable balance of trade indicates we are doing very well.

Mr. MARTIN. I think this is all relative, and one of the things that has helped us—as we point out here, and have repeatedly—is that costs have been going up abroad.

Senator PROXMIRE. What concerns me, Mr. Chairman, very much, is this idea: We had a very distinguished economist from the University of California, Dr. Weston, who was here, and he asked for a tax cut. He said we have to get this economy moving. I asked him, "Why didn't you say anything about monetary policy?" He said, "You fellows have nothing to do with monetary policy."

I pointed out the Constitution gives us explicit responsibility for monetary policy. He said, "Yes; but you don't use it."

This is a very widely held conviction. I am afraid it is roughly true. Most of the economists who came before us took the same attitude. If Congress has no power over monetary policy and the President has virtually no power, according to Mr. Eccles and others, it seems to me the elected officials of our Government, those who are responsible to the people for the economy, are paralyzed when it comes to getting a concerted economic policy, including monetary policy.

Mr. MARTIN. Senator, I think if Mr. Weston had my job for a while he would change his views very quickly. I think you realize that you can change the Federal Reserve Act in no time at all.

Senator PROXMIRE. That is what Mr. Bryan said yesterday: We could abolish and re-create.

Mr. MARTIN. You can. It is entirely your power.

Senator PROXMIRE. I am afraid that those of us who may toy with that idea don't have a great deal of support for it. At any rate, the difficulty is that the tax must be far bigger to the extent that monetary policy doesn't go the same way as fiscal policy.

Government spending must be far higher, and the deficit much bigger, in order to achieve the same degree of economic expansion. Wherever we have substantive unemployment and idle plant capacity, it seems the argument for monetary ease and monetary supply increasing at a reasonably substantial rate are very, very strong. But you disagree with us and because we let you operate without guidelines or goals or criteria we never get on the same wavelength and you do what ever you wish.

Mr. MARTIN. You made a very good point the other day when you said, looking at this picture, that you think we might increase taxes and ease money. Here we are in a sorry, inconsistent position. We are talking about reducing taxes and tightening money.

Senator PROXMIRE. We are facing a deficit. If we follow the usual procedure that we have normally followed in this country of trying to match our revenue with our expenditures, then the logical thing to do would be to ease up on monetary policy and balance our budget.

Mr. MARTIN. If we could work things out to get a normal flow of money so that you would have relatively stable interest rates, that would be the ideal thing to do. You would get the most stability if you had a balanced budget in that period.

It is this problem of getting to equilibrium after you have got into a position of disequilibrium. That is all we are trying to do. Interest rates have to be one of the adjusting factors on this flywheel. That is really all we are trying to do, but it is not easy when you start out from disequilibrium.

Let me comment on this, because I think it is important. I think budget deficits, like easy money, reach a point where they don't have the same impact on the economy as they did at other periods. They get to be like a drug. The economy gets inured to them. I think we are now expecting to get more out of budget deficits and easy money than I believe will be achieved by it.

That is the point. I am trying to analyze it only as a problem that involves the factor of confidence and the willingness of people to save and invest money, which is what makes an economy hum.

Senator PROXMIRE. It is a matter of who takes the initiative. I feel if we could have easier money we would not have the pressure for fiscal policies that result in a bigger deficit. If we had fiscal policies that permitted a balanced budget, then perhaps we could have easy money; not easy money, but an easier monetary situation.

Mr. MARTIN. We have had easier money than in the expansion period of the last economic cycle. In the early part of 1960, we began to shift toward ease. By the end of the year we reduced our discount rate twice and we had consistently supplied reserves to the market

and had moved from a minus \$500 million—and you know my feeling that free reserves is not a good measure, but let us use it—we had moved from minus \$500 million to plus \$500 million.

In the area of \$300 million to \$500 million, \$310 million can be easier than \$510 million. Our figure on free reserves tomorrow will be \$440 million to \$446 million, or something in that area. It will be in the paper tomorrow. Actually, I think that is slightly tighter than the \$350 million we had the previous week.

Senator PROXMIRE. I think the Federal Reserve Board has been following policies of relative ease during much of this period. There is no question about it. I am saying in the past few months, a period during which many people feel there are trouble signs flying, that the interest rates have been rising and money relatively contracting.

I would agree with you that this has been a period of general expansion, and ordinarily interest rates do rise during this period. But I would also say that this is the weakest expansion we have had in a long, long time. Altogether, I think we can make some argument that we should be easing up some.

Let me ask you one other thing: I think you have not done what some people have done who came before us, argued that the interest rates should be high because of the international situation. You have not placed any stress on it.

Do you accept the analysis of Mr. Gemmill of your staff which suggests that interest rate differentials, while of some minor significance, represent a relatively small factor in the balance of payments?

Mr. MARTIN. Mr. Gemmill is a very valued member of our staff, and I am ashamed to say that I have not read that article. I read excerpts from it, Senator, and I will read the article. I think Mr. Young, who has read it, if you would permit him, might comment.

Senator PROXMIRE. I would appreciate it very much. Also, incidentally, if you have read an article yesterday by Philip Bell, of Haverford, who went further and made a thorough analysis of the effect of monetary policy on international flow, if you would comment on both of those, I would deeply appreciate it.

Mr. YOUNG. I recall the Gemmill piece, which I read at the time, but I have not read it recently. As I recall, he was speaking of this matter in rather limited context of the funds that are held here in our market by foreigners, and the relationship of movements in these funds to interest differentials. He did not find for this limited question a close empirical relationship.

I haven't studied the Bell paper closely, but I did examine it briefly. I have the impression that he set himself the rather difficult task of trying to say how much of a relationship of movement of funds could be traceable to an interest differential. He is not saying that interest differentials are not important.

A lot of things will influence capital movements. Of course, borrowers are naturally concerned about what the price is that they have to pay in this market, as compared with other markets, and they are influenced by that to some extent. It would be a factor. It would not be the only factor.

Senator PROXMIRE. It would be, I would hope, a minor factor in the determination of our basic monetary policy for this reason: If we try to maintain the differential, I don't see how we can win, because

there is every reason in the world why monetary managers in European countries should have high interest rates. They have a tight labor situation. They are short of capital facilities. They have inflationary problems that are severe.

I should think almost any money manager under these circumstances would do all he could to persuade the Government to adopt a high interest rate policy. This is true in most of these areas. In spite of it, we have a situation in which Germany, Holland, and Switzerland have lower interest rates on short-term obligations than we have.

Mr. YOUNG. It is a very special kind of situation.

Senator PROXMIRE. I understand their other obligations are higher.

Mr. YOUNG. Yes.

Senator PROXMIRE. Nevertheless, I think this point is significant, because I think for some time we will have that situation. We are getting into a problem here where in Germany the international trade situation would suggest that they should have low interest rates, discourage capital inflow, which is embarrassing them because it is too abundant, and the domestic situation would suggest higher interest rates. We are in almost the opposite situation.

I wonder whether we will persist in a situation where there is an obvious conflict between our domestic and international situation. I would hope it would be reconciled by relying primarily on domestic considerations because (a) they are important to our well-being; (b) because there are other ways to cope with the international situation; and (c) the only studies that I have seen indicate that this is not a highly significant factor in our adverse balance of payments.

Mr. YOUNG. Recorded net outflows of U.S. capital in 1960 and 1961 came to \$4 billion.

Senator PROXMIRE. The short-term capital movement in the first half of 1962 was only \$300 million, short-term capital, on an annual rate.

Mr. YOUNG. On the annual rate basis, the outflow of U.S. short-term capital is less than \$1 billion at an annual rate for the first half. This is down considerably.

Senator PROXMIRE. The figures I have seen were \$300 million in the first half of 1962, adjusted to an annual basis. A drop from something like \$1.6 billion in the preceding year of 1961.

Mr. YOUNG. The outflow of short-term U.S. capital might not be as low as \$300 million. Not all of the figures are in yet. Then there is a question of the unrecorded capital balance.

Senator PROXMIRE. This is adjusting for errors and omissions.

Mr. YOUNG. That is the short-term. When you throw in the unrecorded items, as is usually done, then you raise the figure somewhat, possibly to as much as \$1 billion, but we do not know yet. That would be at an annual rate.

Senator PROXMIRE. Mr. Martin, would you care to comment whether you think that is correct, that under these circumstances that we can give primary weight to domestic considerations?

Mr. MARTIN. I think we have given primary weight to domestic considerations right along. We have also had to give consideration to the danger of—I will use the words “decline of confidence.”

Senator PROXMIRE. In the absence?

Mr. MARTIN. Of a decline of confidence in our management, that could cause quite a flow of capital quite apart from the interest rate itself. Lack of confidence in our ability to manage our own affairs is one of the things that we have to deal with during this period.

Senator PROXMIRE. Thank you very much.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Martin, I know we have taken a lot of your time and we appreciate very much your patience and consideration.

Senator PROXMIRE. I want to join you, Mr. Chairman, in saying I deeply appreciate it. I have taken more time than any other member of the committee.

Chairman PATMAN. I want to ask you about margin requirements and I will be through.

The margin requirements went to 70 percent, but you reduced them.

Mr. MARTIN. We reduced them to 50 percent.

Chairman PATMAN. From 70 to 50.

Mr. MARTIN. That is right.

Chairman PATMAN. I wanted to ask you about policing these regulations. This requirement was made by the Federal Reserve Board.

Mr. MARTIN. That is right.

Chairman PATMAN. An investor has to put up at least 50 percent of his own money in order to buy securities. He can't borrow over 50 percent. Does that apply to any securities outside of the New York Stock Exchange? Does it apply to the American Exchange?

Mr. MARTIN. Yes. The American Exchange.

Chairman PATMAN. Does it apply to the over-the-counter market?

Mr. MARTIN. No, sir.

Chairman PATMAN. Does it apply to the Government bond market?

Mr. MARTIN. No; it does not apply to the Government bond market.

Chairman PATMAN. That is over the counter?

Mr. MARTIN. That is right.

Chairman PATMAN. It only applies to the American and New York Stock Exchanges?

Mr. MARTIN. The Midwest Stock Exchange, San Francisco Stock Exchange.

Chairman PATMAN. They are part of the system.

Mr. MARTIN. They are separate exchanges. It only applies to securities listed on a registered exchange.

Chairman PATMAN. When a person goes into a bank to borrow money, he must certify that he is not going to use that money in violation of that regulation.

Mr. MARTIN. A nonpurpose loan is made with the understanding that he is not using any securities that are pledged as collateral for the purpose of carrying those securities.

Chairman PATMAN. The banks require of him a statement to that effect?

Mr. MARTIN. That is right.

Chairman PATMAN. Which banks require that? Just the members of the Federal Reserve System, or all banks belonging to FDIC, or which banks are required to do that?

Mr. MARTIN. I think all banks are required to do that.

Chairman PATMAN. Does the FDIC have a similar ruling?

Mr. MARTIN. No; but all banks are subject to regulation W.

Chairman PATMAN. You could not enforce your ruling against anyone except the members of the Federal Reserve System, could you?

Mr. MARTIN. The regulation applies to all banks and brokers.

Chairman PATMAN. Who polices the regulation? We have heard all kinds of statements about gross evasions and no one paying any attention to it. We hear about people going into a bank and borrowing \$10,000 and signing the statement and going out and changing their mind in 3 minutes and putting it in the stock market.

Who do you have supervising this regulation, and who do you have policing it?

Mr. MARTIN. The bank examiners, of course, check these agreements. At one of our examiners' conferences several years ago I asked one of the examiners whether they went back, finding out whether an agreement had been compiled with or not. It is a very difficult thing because this is a subjective thing in an individual's mind.

Chairman PATMAN. That is why it seems impossible to enforce.

Mr. MARTIN. It is a very difficult thing to enforce. The answer of this examiner to my question when I raised this was that it would not do him any good to ask a customer who signed such an agreement whether he told a fib or not.

Chairman PATMAN. How long has the law been in effect that permits you to make margin requirements—since 1935?

Mr. MARTIN. Since the Securities Exchange Act of 1934.

Chairman PATMAN. What punishment can be meted out to a person who violates it?

Mr. MARTIN. I believe it is a criminal penalty.

Chairman PATMAN. Have you ever heard of any one being prosecuted?

Mr. MARTIN. I have not heard of any one.

Chairman PATMAN. They are falling down on the enforcement of the act? There must be some violations, but you haven't caught one.

Mr. MARTIN. I would not say that. I think it is something that we constantly have to check on. We are working on it now. I think the matter of violations is being exaggerated at the present time. Several years ago we tried to tighten up on regulation U and we had quite a number of discussions with bankers on the subject, and we finally decided that any real tightening that we could undertake would be penalizing the honest and not help us catch the dishonest.

We are going to try to get our examiners to check more carefully on this and we are going to explore this in the light of what has happened here to see if there is anything we can do to improve on enforcement.

Chairman PATMAN. Under date of April 17 you addressed a letter to me in which you stated that during your appearance before the Joint Economic Committee on January 30, Senator Douglas raised with you the following question:

Instead of fixed exchange rates, why would it not be a good thing for the Western World to adopt a fluctuating exchange rate? Then you wouldn't have to worry about your balance of payments or gold reserves. You would have exchange rates fluctuate according to relative balance of imports and exports, claims and debits, and you would get an automatic adjustment.

Do you know any reason why we should not insert your reply in the appendix of our hearings, along with your accompanying statement?

Mr. MARTIN. Mr. Young says it has been revised. Can we give him the revision?

Mr. YOUNG. If it is going to be published, it should be the revised memorandum.

Chairman PATMAN. You can hardly revise a letter of April 17.

Mr. YOUNG. No; not the letter, but the memorandum accompanying the letter.

Chairman PATMAN. With that understanding, without objection, the revised memorandum will be inserted in the record of this hearing.

Thank you again, Mr. Martin. You have been very kind to us. We appreciate it.

(The following was later received for the record:)

AUGUST 23, 1962.

#### A SYSTEM OF FLUCTUATING EXCHANGE RATES: PRO AND CON

At a hearing of the Joint Economic Committee on January 30, 1962, Senator Douglas requested that the staff of the Board of Governors prepare a memorandum on the following question for the benefit of the committee:

"Instead of having fixed exchange rates, why would it not be a good thing for the Western World to adopt a fluctuating exchange rate? Then we wouldn't have to worry about the balance of payments or gold reserves. Exchange rates would fluctuate according to the relative balance of imports and exports, claims and debts, and there would be an automatic adjustment."

In response to that request, the present article was prepared in the Division of International Finance under the general direction of Ralph A. Young, adviser to the Board and Director, Division of International Finance, who is also responsible for the article's summary and appraisal. Robert L. Sammons, adviser in that Division, had responsibility for sifting the professional literature that advances a case for an international payments system based on fluctuating exchange rates for the currencies of the principal trading nations. J. Herbert Furth, together with A. B. Hersey, both also advisers in the Division of International Finance, carried main responsibility for presenting the arguments against variable exchange rates.

#### SUMMARY AND APPRAISAL

Reconstruction of the international payments mechanism following World War II was based, and continues to be based, on a system of exchange rates for major currencies anchored to fixed par values, with rate movements limited to 1 percent above and below the parity. The International Monetary Fund, established under the Bretton Woods Agreements of 1944 "to promote international monetary cooperation," was founded on this principle. Accordingly, any move away from this system of interconvertible currencies, with established parities and limited market deviations from them, would necessarily have profound effects on the existing pattern of international economic relations as well as on the domestic economies of the free world.

Nevertheless, there have been recurrent questions and discussions regarding the economic advantages of this payments system as compared with one in which currency values of major countries would be free to fluctuate without definite limits in relation to one another. Against the background of this discussion, the present article undertakes to bring together the main arguments advanced by supporters of such an alternative payments system and to subject these arguments to critical examination.

The article proceeds by stating the case for a system of fluctuating exchange rates free of any official intervention and with no limits as to the possible range of rate fluctuations. Then the case is argued for a modified system of variable rates in which governments or central banks would intervene to temper or limit exchange rate fluctuations. A final section examines critically the major premises and arguments of the case for any system of floating

exchange rates, with special attention to the consequences such a system would have if applied to the dollar. While this section is formulated in terms of arguments against flexible exchange rates for currencies of the major industrial countries, it argues in substance for an international payments system based on fixed exchange rates.

#### *Review of arguments pro*

The issue of an international payments mechanism with fluctuating exchange rates versus one with fixed exchange values has many ramifications, and any summary of arguments risks criticism as doing less than justice to the case made by those who advocate a generalized system of fluctuating exchange rates applicable to the currencies of both less developed and highly developed nations. At the risk of such criticism, the following points endeavor to summarize the principal contentions by advocates of such a system.

1. The exchange rate is the price for a foreign currency in terms of the domestic currency. In equating short-run supply and demand and in inducing equilibrating adaptations in basic supply and demand conditions over the longer run, the prices of foreign currencies should be as free as other prices to vary with shifting supply and demand forces.

2. Under modern systems of managed convertible currencies, governmental policies directed to the attainment of stable economic growth domestically may obstruct and frustrate the processes for bringing about balance in international payments that are postulated in gold standard theory. A system of floating exchange rates, however, could provide a mechanism of adjustment through market processes and would be less constraining on public policies designed to maximize orderly growth in industrial economies than a system of fixed exchange rates.

3. Fluctuating exchange rates would be particularly advantageous when a country is simultaneously undergoing domestic recession and balance-of-payments deficit. The depreciation in its exchange rate resulting from the balance-of-payments situation would tend to have favorable countercyclical effects on domestic economic activity.

4. Truly variable exchange rates would tend to diminish speculative movements of short-term capital by introducing more risk of loss, since the cost of the currency into which funds were moving would immediately be driven upward beyond the range permitted by fixed exchange rate margins.

5. While the principal industrial countries may not be prepared to accept a system of freely fluctuating rates, they might find feasible a modified system providing for official intervention to dampen short-run variations in the rates, and to prevent cumulative depreciation or appreciation not warranted by underlying balance-of-payments developments. Such a modified system would admittedly have two difficult but, according to its protagonists, solvable problems—one relating to the form in which monetary reserves are held and the other relating to a norm of internationally acceptable behavior as to official intervention.

6. Under a system of fixed exchange rates, currency devaluation and revaluation tend to be regarded as measures of last resort and are frequently postponed until long after their necessity has become evident. Variable rates would avoid the adverse effects on domestic and international trade and finance of prolonged periods of overvaluation or undervaluation of currencies.

7. Floating exchange rates would enable a country to avoid large changes in its momentary reserve position and the undesirable effects that such changes may have on the domestic credit base and on domestic financial conditions in general.

8. Some countries would find it possible to operate with smaller monetary reserves than at present, and thus could economize on the national resources that, under a fixed exchange rate system, have to be devoted to maintaining the monetary reserve position.

#### *Review of arguments con*

Opponents of a system of fluctuating exchange rates for the free world's principal currencies maintain that such a system would have serious disadvantages and that these would outweigh alleged advantages. Their main arguments are briefly stated below:

1. The arguments presented by advocates of variable exchange rates are not applicable to an international reserve currency such as the dollar.

2. An international payments system with fluctuating exchange rates for major industrial countries, and especially for countries whose currencies serve as international means of payments and as monetary reserves, would make foreign trade and investment transactions more uncertain and hence more speculative and costly. Every transaction would involve the risk of adverse exchange movements, the burden of which at least one of the parties would have to bear.

3. By thus impeding the international division of labor, a fluctuating rate system would both interfere with the organization and level of current economic activity and retard economic growth throughout the free world.

4. Exchange rates have a function different from that of other prices. They are the basis of international commerce, making possible comparison of trade and production advantages and disadvantages for individual commodities and services. Any change in rates affects not merely the domestic production and consumption of particular commodities and services but as well the entire system of production, distribution, and consumption of all other countries participating in world trade. In view of these far-reaching effects, changes in exchange rates need to be kept to a minimum.

5. Costs and prices under present economic conditions are not so rigid as to prevent the economies of countries with a system of fixed exchange rates from adjusting through market processes to a disequilibrium in international payments within a reasonable period.

6. A system of fluctuating exchange rates for major countries would involve serious risk that rate fluctuations would exceed in magnitude the range of movement assumed as tolerable and likely by advocates of floating rates. Speculative movements of funds would thereby be enhanced rather than limited. Destabilizing forces generated by large rate fluctuations might become cumulative, especially for a country suffering from persistent payments deficits internationally.

7. A system of variable exchange rates would not free the participating countries from having to consider their individual balance of payments in formulating domestic policies. Because of possible repercussions of exchange rate fluctuations and instabilities on domestic developments, these countries, for domestic policy purposes, would probably have to pay more attention to their international position than under a system of fixed exchange rates.

8. The paucity of the world's gold supply and the risks of keeping monetary reserves in foreign currencies of fluctuating value would hamper the intervention needed to make a "modified" system of fluctuating exchange rates workable. An international understanding, tacit or formal, as to the "rules of the game" for reconciling exchange rate policies of individual countries with each other would be essential, but neither a theoretical nor an empirical approach to the formulation of such ground rules has yet been suggested.

#### *Staff appraisal of arguments*

Choice between a fluctuating exchange rate or a fixed exchange rate is one of the most basic any country can make in providing its economy with an effective monetary mechanism, for the choice affects both the domestic and the international operation of that mechanism. A weighing of the arguments bearing on this choice for major trading countries supports, it is believed, the following judgment.

For a major industrial country, an automatically variable foreign exchange rate would not long be tolerable because of the adverse effects that such a rate would have on its international relations and also on its domestic economy. Sooner or later, the Government would find the country's foreign trade and investment activities hampered by increased risks and costs; and unless it followed domestic policies that would effectively preserve strict financial equilibrium, it would experience rather sharp fluctuations in the external value of its currency, which would further impede planning for high resource utilization and sustainable growth.

Accordingly, the Government would feel obliged to combat these adverse effects. A first response might be to abandon a system under which the exchange rate was left free to vary with market forces of supply and demand. This would involve resort to intervention in the exchange market, although still without fixed limits on the rate. But successful intervention would be difficult in the absence of willingness of the central bank to hold significant amounts of foreign currency assets and without a fixed par value as a policy guideline. These difficulties could not be overcome without reestablishing a fixed exchange rate.

Such a sequence of developments would prove illusory the central advantages alleged for a fluctuating exchange rate—the advantage of automatic adjustment to changes in the balance of payments, and of making domestic stabilization policies independent of balance-of-payments considerations.

The difficulties of a fluctuating rate for an individual industrial country would be aggravated if all other major countries were also having fluctuating rates. Experience would show that an international payments system based on fixed exchange rates would be in the ultimate national interest of all of them.

#### THE CASE FOR FLUCTUATING EXCHANGE RATES

The arguments for a generalized system of fluctuating exchange rates rest on two assumptions. A first assumption is that the participating countries, in the absence of the discipline imposed by maintaining fixed value exchange rates, will be willing and able to pursue domestic fiscal and monetary policies that sustain high levels of domestic economic activity and balanced economic growth, without endangering reasonable stability of domestic cost and price levels.

The second assumption is that each country in the system will permit others to adjust their balances of payments by letting exchange rates move without itself resorting to defensive exchange controls, special protective trade measures, or competitive exchange rate depreciation.

#### *The foreign exchange rate as a price*

The theoretical case for freely fluctuating rates as against fixed rates starts with the proposition that the foreign exchange rate is a price that should be permitted to perform the functions of a price; namely, to balance supply and demand in the foreign currency market. If permitted to fluctuate without governmental interference, it would help to establish a relation between domestic and foreign prices and costs that would induce changes in the production and consumption of goods moving in international trade, as well as capital flows, of a sort that would foster and maintain balance in external payments.

In any market, there is some price that will clear the market. It is true that in markets where supply or demand is unresponsive to price change in the short run, price fluctuations may sometimes be more violent than is necessary to restore or maintain long-run equilibrium. Price changes may also be destabilizing if demand and supply are strongly sensitive to expectations about future influences on the market, so that a price decline may reduce demand (and increase supply) if a further decline is anticipated.

But the price of foreign exchange differs from the price of a single commodity in that it represents to both buyers and sellers command over a whole basket of goods, services, real capital assets, and claims payable in a foreign or the domestic currency. Thus, the demand or supply of a foreign currency is derived from many specific needs or motivations. Such composite demand or supply will tend to be responsive to small changes in price, although these responses may be frustrated or accentuated at times by expectational influences.

Consequently, unless expectational influences are adverse or unusual, changes in foreign currency values under a floating exchange rate system should produce relatively prompt adjustment in the supply of and demand for foreign exchange and thus in the balance of payments. If balance-of-payments adjustment could be achieved under a fluctuating rate system without interfering with domestic stabilization policies or unduly burdening other trading countries, such a system would have advantages greater than the disadvantages attributable to the rate changes themselves.

#### *The mechanism of adjustment*

According to gold standard theory, an effective mechanism of adjusting international payments imbalance was provided through the tie between the amount of a country's gold holdings and its supply of bank credit and money. A country with a balance-of-payments surplus would receive gold and its monetary policy would respond by permitting bank credit and money to expand and interest rates to fall relative to the gold-losing deficit countries. In the process, the surplus country's money incomes and prices would rise and after a time also its imports, while exports would fall. Reverse developments would take place in deficit countries. During the adjustment period, deficit countries might benefit from an equilibrating movement of short-term capital, because their interest rates would rise, attracting funds from the surplus countries. Thus, balance in international payments would be achieved.

Under modern systems of managed convertible currencies, so runs the argument of advocates of a fluctuating rate system, this mechanism of adjustment does not have its former effectiveness because policies of governments, business, and labor in deficit countries are geared to resist a downward adjustment in prices and wages; while in surplus countries, governmental policies may be directed at resisting an upward adjustment of prices and wages. In the modern setting, in other words, public policies in major industrial countries are especially directed at domestic price and cost stability as a means of facilitating high-level employment and maximum economic growth. Hence, the tendency is to temper or offset the domestic impact of balance-of-payments developments that might otherwise frustrate achievement of domestic policy objectives.

This line of reasoning leads to the view that present-day governmental policies, together with prevailing attitudes of business and labor, no longer facilitate, but in fact hamper the interplay of monetary, price, and interest rate forces working to bring about balance in international payments. Imbalance in payments, if taken into account in domestic programs, tends to be regarded mainly as a condition limiting governmental discretion—a condition to be met for the purpose of maintaining a stable value for a currency internationally. In this context, it is asserted that a system of fluctuating exchange rates offers an alternative mechanism of adjustment, with greater promptness in converting imbalance in payments into balance and more freedom to pursue domestic goals of economic policy.

Under a system in which exchange rates would be permitted to respond freely to changes in market supply and demand forces, without Government limitation or intervention, the mechanism of adjustment would involve both major types of international transactions—the movement of goods and services (mainly merchandise) and the movement of capital (especially short term). For simplicity, the adjustment appropriate to a deficit country will be used as an illustration.

A deficit country would find the demand for its currency low relative to the supply of it in exchange markets, so that its currency would become less valuable in relation to other currencies. The changes in commodity prices that would result would be influenced by the price and income elasticities of supply and demand, and by the importance of the deficit country as a world supplier or purchaser of specific commodities. But in general, price movements along the following lines might be expected.

*Effects on imports.*—The prices of the deficit country's imports, in terms of its own currency, would tend to rise. This rise would reduce its purchases of imported goods. How great the reduction would be would depend on the price elasticities of demand for such goods and the elasticities of domestic supply of competitive goods.

Insofar as domestic goods were substitutable for imports, the higher prices for imports would encourage the expansion of domestic production of competitive goods, and thus would reduce imports, even if total demand for these goods were not reduced by the increase in prices. The rapidity and extent of the response would depend, among other factors, on the presence or absence of unutilized capacity in the import-competing industries and on the length and complexity of the production process.

If some foreign exporters were able and willing to reduce their prices in terms of foreign currencies (i.e., to maintain their prices in terms of the depreciating currency) in order to keep their import markets, adjustments in the deficit country would be less. But there would still be some reduction in foreign exchange expenditures even if the quantity of imports were maintained as a result of price responses of foreign exporters.

*Effects on exports.*—Effects on the exports of the deficit country would depend on the organization and structure of its industrial and agricultural production and the competitive position of its export products in world markets. For one-product material or food producing countries facing relatively inelastic demand schedules for the particular commodity, exchange depreciation might leave the export volume unchanged but reduce the foreign exchange proceeds of exports. For industrialized countries with diversified exports competitive with similar products of other industrialized countries, however, the result would probably be some increase in the volume of exports and in foreign exchange receipts. The increase would be the larger, the greater the previous underutilization of existing capacity.

The effect on prices of export goods in terms of domestic currency would vary from commodity to commodity. Probably export prices in terms of domestic currency would rise on average, but not by so much as the depreciation in the external value of the currency.

For export commodities of the primary materials or food staples category (the world prices of which are set by international supply and demand forces and are probably not much affected by changes in the value of a single currency), the domestic price rise would tend to be inversely proportional, or nearly so, to the reduction in the external value of the currency. For other export commodities, the price rise would depend more on the relative importance of domestic demand for exportable goods.

In the case of those export goods whose domestic prices tend to rise in proportion to the depreciation in the value of the currency, the effects would be twofold. First, assuming domestic demand for such goods to have some price responsiveness, the amount sold at home would fall, freeing some scarce resources for other production, including production for exports. Second, profits in the industries producing these goods would rise as a result of their higher prices and these industries would bid more actively for resources for export production.

In the case of those exports whose domestic prices do not rise commensurately with the depreciation in value of the currency, foreign buyers would enjoy a lower price in terms of their currencies, and domestic producers would thus enjoy an increase in foreign orders. How large the increase would be would depend on whether competitive foreign producers would accept the situation without lowering their own prices. If prices declined all around in international markets, and if world demand was price elastic, the total market would expand and the exports of the depreciating country would presumably rise along with a general rise in international trade.

The speed of adjustment on the export side would thus depend on (1) the extent of the rise in domestic prices of export goods, (2) the rapidity with which domestic production could be expanded (clearly greater in a recession than in a boom), (3) the elasticity of foreign and domestic demand for export goods, and (4) the response of foreign competitors to any reduction of prices in terms of foreign currencies. Proponents of a fluctuating rate system contend that significant marginal adjustments would occur with reasonable promptness in response to small changes in exchange rates. Such adjustments might also include the exportation of products not previously exported.

The increase in prices of imports and exports in terms of domestic currency would exert upward pressure, however, on domestic costs and prices in general. As a rule, the balance-of-payments adjustment would be the more prompt and the less painful, the more successfully the domestic cost and price pressures were resisted. For this reason, in case of a chronic external deficit, domestic restrictive policies would usually remain as important under conditions of freely variable exchange rates as under fixed rates. But if the domestic situation were such that a moderate rise in costs and prices might be welcomed as a stimulus for more rapid domestic economic expansion, there would be no need to counteract the pressure by restrictive domestic policies.

An adverse effect of a currency depreciation in the short run would be a deterioration in the terms of the deficit country's foreign trade—it would have to give up more of its own output in exchange for a given quantity of imports. But given time, an expansion in domestic output of import competing and of exportable goods, induced by the currency depreciation, would work to reduce or eliminate adverse effects of this development on domestic living standards.

*Countercyclical effects.*—Under a system of flexible exchange rates, a country that experienced moderate domestic recession and simultaneously a balance of payments deficit—say, as a result of capital outflows rather than a shift in the current balance—could gain special advantages from depreciation of its currency internationally. In such a situation, the price and income effects of depreciation on both exports and imports would tend to stimulate total effective demand at home. Domestic production of import-competing and export goods would be directly stimulated, and purely domestic output would receive a secondary stimulus.

A serious domestic recession, however, would tend to result in a decline in imports relative to exports and thus in an improvement in the country's current international balance. If foreign economic conditions were unfavorable to at least a compensating capital outflow, a system of flexible exchange rates in this

case would tend to make the depressed country's currency appreciate, and the effects of appreciation could work to aggravate the domestic recession.

Nevertheless, if a government were to embark on fiscal and monetary policies of an expansionary character, a capital outflow might be induced strong enough to overcome the effects of an improved balance of payments on current account. In this situation, the currency would depreciate and this would reinforce such upward cost and demand pressures on prices as were being generated by the anti-recession domestic policies.

In case of a worldwide recession from which all countries suffer, exports and imports, as well as foreign lending and borrowing activity, of all countries would be expected to drop. Any resulting effects upon exchange rate relationships in these adverse circumstances would largely reflect the uneven incidence of the recession.

*Effects on capital movements.*—Even if it be assumed that with fluctuating exchange rates compensating adjustments would tend to occur in the trade account, there would remain the problem of volatile capital movements. Would not the currency depreciation generate expectations of further depreciation and thus set in motion capital movements that would in themselves produce such further depreciation? Would not this, in turn, lead to unwarranted, unneeded fluctuations in exchange rates and to a loss of confidence in future exchange values with a consequent disruption of the processes of international trade and investment? The proponents of a flexible exchange rate system argue that these consequences would not follow.

Volatile capital movements are greatly influenced by psychological and expectational factors. The only experience the world has had with fluctuating rates has been under an international currency system where floating rates were the exception rather than the rule. There has always been at least one currency, the dollar, convertible into gold at a fixed rate, except for a brief period in 1933-34. For this reason, it is impossible to know what might have happened in a world of flexible rates.

If the principal countries promoted a reasonable degree of stability in economic activity and domestic prices,<sup>1</sup> a theoretical expectation would be that wide fluctuations in exchange rates would not occur. So long as a flexible currency was freely convertible into goods and property claims for export, at relatively stable prices, it could not depreciate far before it would begin to appear a bargain both to commodity traders and speculators in property values. At this point, some stabilizing speculative trade and capital flows could be expected to set in. If these developments failed to occur, it would be because traders and speculators distrusted the fiscal and monetary policies of the government or the basic economic forces shaping the internal structure of the economy.

Large flows of volatile speculative capital occur even under the present fixed-rate system, notably when a large part of the market believes that a specific currency is so overvalued or undervalued that existing rates cannot be or may not be long maintained. If determination of the exchange rate were left to the market, speculators would have to analyze all the factors entering into the demand for and supply of exchange. There is no reason to expect that the market opinion derived from this analysis would be dominantly bullish or bearish, though in particular circumstances either market attitude might well predominate.

Any speculative movement into a currency, however, would begin immediately to increase the cost of that currency, thus raising the possibility of loss as well as gain in the minds of the speculators. Obviously, the possibility of loss would be much greater than under a system of fixed exchange rates with its narrow spreads. The existence of this speculative risk would tend to dampen, and eventually reverse, any speculative movement of funds between international money and capital markets not warranted by relative price changes.

*Effects on domestic financial stability.*—Even if it be assumed that fluctuating rates would work to balance international accounts, the problem remains whether they would lead to violent fluctuations in domestic prices. A frequent argument in support of fixed exchange rates is that such a system makes it easier to receive support for stabilizing monetary and fiscal policies. Under such a system, any deviation from sound policies will lead to depletion of the country's reserves of gold and foreign exchange, and declines in such reserves will show the need of, and bring public support for, appropriate fiscal and monetary policies.

<sup>1</sup> In the absence of such policies, any system of exchange rates—fixed or flexible—would tend to break down.

Proponents of variable exchange rates argue that governments would actually be better able to follow stabilizing fiscal and monetary policies under a system of floating rates than under a system of fixed rates.

They contend that the rate of exchange of a currency is much more widely known and understood than the amount of, and changes in, a country's international reserves. Thus, exchange rate depreciation is more apt to show the need for, and bring timely public support for, appropriate fiscal and monetary action than a decline in a country's international monetary reserves.

#### A MODIFIED SYSTEM OF FLUCTUATING RATES

Up to this point a system of freely fluctuating exchange rates applicable to major industrial countries has been contemplated. It has been assumed that there would be no intervention in the exchange markets by the authorities, and hence no need for official reserves of gold or foreign currencies. Such a system is hardly realistic, however. Proponents of fluctuating rates usually acknowledge that some official intervention would be desirable to smooth out short-run fluctuations or to provide for some stability in the flow of import payments and other payments to foreigners in the event of unpredictable or unavoidable short-run fluctuations in foreign exchange receipts. Such a modified system of variable exchange rates would, however, be faced with two problems.

The first relates to the assets that would be used as monetary reserves. The key trading countries might seek to rely mainly on gold as a monetary reserve asset, for the reason that gold would be more likely than any currency to retain its value in relation to the domestic currency and to the currencies of other industrial countries. That is to say, their willingness to hold reserves in other important currencies would depend heavily on whether these currencies had, in fact, proved stable enough to inspire confidence that this stability would continue. But if central banks would not hold reserves in foreign currencies as a regular matter, they might still from time to time, as a matter of central bank cooperation, engage in temporary reciprocal currency transactions to enable the participating central banks to intervene in the foreign exchange market in behalf of their currencies.

The second problem has to do with the internationally accepted rules that would govern official intervention in exchange markets to affect the international value of a currency, especially as to intervention that would appear to have the purpose of competitive depreciation. To be sure, such rules do not exist at present, but they might be developed over a period of time through a process of international discussion and cooperation.

If these problems could be solved—and they are indeed problems of inherent complexity—then advocates of a modified variable rate system would argue that such a system might offer advantages besides those already discussed.

#### *Speed and amount of adjustment*

Under a modified system of fluctuating exchange rates, the monetary authorities of an industrial country would not be so tempted to delay a rate adjustment when conditions seemed to make such an adjustment unavoidable as they are under a fixed exchange rate system. Such delays may slow the adaptation of a country's economy to its needs for external balance, with a resulting erosion of its monetary reserve position.

Under a fixed exchange rate system, the exchange rate is both a focus of diverse business and labor interests and a symbol of financial prestige. Consequently, a devaluation or revaluation, if taken, risks criticism as harmful to these interests and also as evidence of some failure of the Government's economic policy and as a breach of faith with the public. Devaluing or revaluing a currency in terms of gold and other currencies thus becomes an action to be resisted as long as possible—an action of last resort. At times, countries have imposed, or reimposed, or tightened exchange and trade controls rather than adjusting their currency value internationally.

When devaluations or revaluations become unavoidable for major countries, moreover, they tend to be a disruptive factor in international trade and finance, and since they are arbitrary actions to resolve a complicated problem, they risk being either too large or too small. Under a fluctuating exchange rate system, if a currency were overvalued or undervalued, any necessary depreciation or appreciation of the rate would have a chance both of achieving an equilibrating level and of coming soon enough to avoid an extended period of disequilibrium.

*Changes in rates versus changes in reserves*

Under a modified system of variable rates, a country could decide whether and to what extent changes in its balance-of-payments position—particularly large and sudden changes—would be permitted to affect its international reserves and to what extent they would be permitted to affect the rate of exchange for its currency. Changes in international reserves, unless counteracted, are reflected in equivalent changes in the reserve base of the country's banking system. The resulting changes in the credit base, if considered undesirable from the point of view of domestic policy needs, may be offset by open market operations or other appropriate actions of the monetary authorities.

The effects of the offsetting policies on interest rates and domestic security markets, however, may not always be welcome. In particular, a country undergoing a substantial balance-of-payments surplus may find it politically difficult to follow policies that would fully offset the inflationary impact on the domestic credit base of the resulting increase in international reserves. For a surplus country, therefore, large increases in its monetary reserves impart an inflationary bias to a fixed exchange rate system. For this reason, advocates of a system of fluctuating exchange rates argue that changes in exchange rates within moderate limits would be preferable to large changes in monetary reserve positions.

*Management of reserves*

Under a modified system of variable exchange rates, the monetary authorities of a country might regulate its reserve holdings more effectively according to the economy's monetary needs. They would be in a position to buy or sell gold or foreign exchange (if they continued to hold foreign currency reserves despite exchange risks) whenever they thought it appropriate and advantageous without being constrained by the need to maintain the exchange rate. One limitation on their freedom of policy action in this regard would be the interpretation of the actions by other countries: if such operations were interpreted as official efforts deliberately to depreciate a country's currency, other countries participating in the floating currency system might take retaliatory action.

*Size of reserves*

If a modified system of fluctuating exchange rates were universally adopted, many countries might find it feasible to operate with smaller international monetary reserves than they presently hold, because their monetary systems would not have to be protected against persistent or substantial reductions in reserves. Hence, more of their resources could be invested in domestic production rather than in holdings of short-term claims on foreign countries.

## THE CASE AGAINST A SYSTEM OF FLUCTUATING EXCHANGE RATES

The arguments for a system of fluctuating exchange rates embracing the principal industrial countries need critical evaluation, particularly from the standpoint of the interests of the United States. Also, such arguments need to be set against the positive advantages of an international payments system based on fixed exchange rates.

In the following discussion, attention is first drawn to the problem of applying a system of flexible rates to international reserve currencies such as the dollar and the effects of such a system on current economic activity and economic growth. Then, the main arguments of the advocates of flexible rates are considered in order, namely, the price function of exchange rates; the alleged inability of the present world economy to adjust to international payments deficits and surpluses under fixed rates; the constraints on domestic policies allegedly caused by fixed rates; the alleged probability that rate fluctuations would remain within tolerable limits; and the assumption that official intervention in exchange markets could be regulated by some internationally accepted rules of behavior under a "modified" system of flexible rates.

*Fluctuating rates for reserve currencies*

The present system of international payments with fixed exchange rates for major industrial countries relies on widely accepted reserve currencies, along with gold, in meeting monetary reserve needs for international and national purposes. The reserve currencies of this system (the U.S. dollar and, within limits, the pound sterling) are used by businessmen and other transactors as final means of payment and settlement for international transactions and debts and as standards for economic calculus for trade and investment, especially

in transactions with countries having currencies of unstable foreign exchange value.

A general system of variable exchange rates presupposes that it could be applied to the reserve currencies as well as the currencies of other industrial countries without endangering the continued expansion of world trade and finance. But even if floating exchange rates were harmless or advantageous if applied to currencies little used or held by foreigners, a general system of such rates would be undesirable if its application to reserve currencies rendered the international payments mechanism inefficient and unstable.

Worldwide economic activity need not be seriously affected if a currency little used or held by foreign traders and investors is permitted to fluctuate. The country having such currency and its trading partners will probably carry on most of the necessary international trade and finance in a reserve currency, if such a currency is available.

But if a reserve currency were permitted to fluctuate freely against all other major currencies and also in relation to gold, the reserve currency could no longer find general acceptability. It would no longer be widely used or held by foreigners, and, because of the interrelations of domestic and international economic activities, its usefulness as standard of value and store of value for domestic transactions would also be impaired.

#### *Burden on international trade and investment*

Primarily, the effects of a change from an exchange rate system anchored to fixed parities for industrial countries to a general system of rates varying with changes in the supply of and demand for their currencies would be felt in international trade and investment.

Instead of being able to conclude international transactions on the basis of a stable reserve currency, everyone engaging in a trade or investment transaction would need to speculate on a possible change in the international value of his own currency and that of some other country between the time of making a commitment and the time of concluding it. Compared with a fixed parity system with narrow fluctuations (1½ to 2 percent around par), the transactions risk of such a flexible rate system would be very much greater.

For transactions scheduled to be consummated quickly, exchange risks in many cases could be avoided by arranging for forward cover; but the forward cover would not be costless, for the exchange risks would not be carried by other parties except at a price.<sup>2</sup> Numerous international trade and credit transactions, moreover, would have to be on an uncovered basis, if undertaken at all, since there are well-developed and efficient forward markets in only a few currencies. Finally, forward cover would not be available for long-term loan transactions, and such transactions would be severely handicapped by the uncertain risk of fluctuating currency values.

Thus, a generalized system of freely variable exchange rates would directly increase the risks and costs of international commerce and finance. The effects of these greater risks and higher costs would be a contraction and reduction of international trade and, in consequence, a reduction of economic activity in the countries currently benefiting from a larger volume of commerce among them.

If the foreign exchange values of currencies of all industrial countries fluctuated, private and public transactors, especially in the international sphere, might turn to gold as the standard for economic calculation and for storing value. The huge amounts of dollars and sterling that foreign monetary authorities now hold as reserves and as working balances as well as the dollars and sterling held by banks and other private interests would become subject to unpredictable exchange risk. Even if private transactors were willing to retain their dollar and sterling holdings, it is unlikely that foreign monetary authorities would be willing to do so. The result would be great demand and price pressure on the limited market supply of gold. The supply not only is small in relation to the demands that might be generated; it also cannot be as readily adjusted over time to the needs of international commerce and investment as can the supply of dollars and sterling.

<sup>2</sup> Forward exchange rates would no longer correlate closely with short-term interest rate differentials between markets, but would more heavily reflect expectations as to future fluctuations in spot rates. These expectations, as between major markets, might contrast sharply at a given time.

*Handicaps to economic growth*

More basically, the generally accepted free world objective of advancing prosperity at home and abroad through international trade based on the best geographic division of labor and other resources would indeed be seriously handicapped.

Under a system of freely fluctuating exchange rates, international price relationships would tend to vary more widely and unpredictably. It would become impractical to rely on international price comparisons in making long-range investment plans for allocating resources between production for the domestic markets and for exports. Even relatively small changes in exchange rates would upset any estimate of relative cost and price advantages in different countries.

Insofar as extreme fluctuations in industrial output and employment caused by sudden reversals of international competitive positions could be overcome by protectionism, pressures for such protectionism would develop and appear compelling. Any resumed multiplication of trade barriers could only result in slowing economic development and growth internationally.

*Price function of an exchange rate*

The function of an exchange rate is more similar to that of a country's overall price level than it is to the price of an individual commodity or service. Stability of the level or average of prices, in contrast to stability of individual prices, has been generally recognized as a prerequisite of sustained high levels of economic activity and rapid economic growth, because it facilitates long-range planning by entrepreneurs and investors. The same reasoning applies to the stability of exchange rates.

The advocates of fluctuating rates implicitly recognize the validity of this argument when they insist that a system of flexible rates would not actually lead to large or violent rate fluctuations. In doing so, they admit that they are not prepared to rely on the price function of exchange rates to bring equilibrium to the international economy but that they advocate the pursuit of policies that would bring about equilibrium without any need for the exchange rates to change much. There is no economic advantage in formally permitting a price that is central to the organization of activity domestically and internationally to fluctuate when it is recognized that such fluctuations would be generally harmful to specific business and labor interests as well as to the public interest.

*Cost and price rigidity*

Advocates of flexible exchange rates contend that domestic costs and prices have become so rigid under present economic policies that exchange-rate fluctuations, in spite of any disadvantages, must be permitted to take over the adjustment function previously performed by changes in domestic costs and prices.

This contention, however, cannot be pressed very hard or far. Present-day Government policies are indeed designed to avoid a general decline of prices and incomes. But neither Government policies nor the resistance of business and labor to price and income declines can or do prevent individual prices in particular industries from declining. Similarly, Government policies designed to avoid a general increase in prices do not prevent individual prices from rising.

International trade arises in the first instance from cost and price differentials in particular export and import industries; and adjustments in these differentials are continually taking place. And if these industries are sufficiently important in the cost and price structures of individual countries, relative movements in the respective cost and price averages of these countries can and will occur.\*

In the recent period, the impact of increased imports on U.S. costs and prices has been important in helping to restore competitiveness in various branches of U.S. industry, in curbing inflationary tendencies generally, and thus eventually in strengthening the U.S. balance of trade. Meanwhile, in surplus countries the inflow of foreign exchange and the bank credit and monetary expansion as well as increases in overall liquidity stemming from it has helped to raise aggregate

\* Between the average of 1957-59 (the base period of the wholesale price index of the Bureau of Labor Statistics) and March 1962, prices of the following categories declined by the percentages indicated: Man-made textile products 6.4, organic chemicals 6.7, plastic materials 8.3, automobile tires 12.9, warm-air furnaces 12, metal doors 5.1, electrical motors and generators 9.1, transformers and power regulators 12.4, household appliances 5, television sets, radios, and phonographs 8.7, glass containers 8.1, plate glass 10.8. For individual products, declines were often far larger (e.g., household and commercial refrigerators, 13.8).

domestic demand with a demand-pull effect on domestic costs and prices—and also on imports—more rapidly than in deficit countries.<sup>4</sup> While these movements have not yet occurred on a scale sufficient to establish balance-of-payments equilibrium among the countries concerned, they have clearly accorded with the postulates of gold standard theory.

Finally, under contemporary conditions of continuous advances in productivity, deficit countries do not need to follow policies that would keep wage rates and other cost elements from rising at all, nor do surplus countries need to pursue policies designed to foster increases in these costs. Provided that surplus countries permit costs to rise as much on average as productivity, international trade and payments adjustment can still take place through relative cost and price changes, provided costs rise less in deficit countries.<sup>5</sup> The essential trade and capital adjustments necessarily occur at the margin—in regard to products or services, including financial services, that are just on the verge of being competitive or noncompetitive internationally.

These considerations make clear that there continues to be a mechanism of marginal international payments adjustment through market processes under postwar conditions of managed currencies with fixed exchange rates. It needs to be emphasized that the mechanism of adjustment contemplated by gold standard theory also was activated by relative changes in costs and prices, as between deficit and surplus countries—and not by absolute increases and decreases in these elements. Thus, the postwar mechanism of adjustment does not differ in principle from the gold or gold exchange standard mechanism as conceived by theory and as relied upon in the past by leading industrial countries.

#### *Destabilizing forces*

Advocates of floating exchange rates underrate the risks to the international trade and financial position of a principal country from permitting rate fluctuations without clearly defined limitations. What, for example, would happen under present conditions if the United States adopted a flexible rate system?

The United States has been suffering for some time from a persistent international payments deficit. Unless the dollar exchange rate were fixed, this deficit would cause dollar depreciation in exchange markets. The resulting increase in the dollar price of imported and import-competing goods and services as well as of exports would put upward pressure on domestic costs and prices. This pressure would tend to frustrate current efforts to keep costs and prices under restraint.

If this happened, the market would sooner or later give up the expectation that the dollar rate might return to its previous level, and would count on further depreciation. Once market behavior became geared to such expectations, it could easily give rise to cumulative destabilizing movements of exchange rates, costs and prices.

The situation would be acutely aggravated by the large volume of liquid dollar assets—securities, money market paper, and time and demand deposits—held by foreigners. Foreign holders would try to liquidate the many billions of dollars of these assets before the depreciation of the dollar in terms of foreign currencies progressed. As a group, they would seek to sell or transfer marketable assets to others for cash which they would then offer against foreign currencies. This process would simultaneously generate upward pressures on interest rates (by depressing the price of securities and money market paper), disorderly markets for securities, strain on domestic bank reserve positions and a difficult problem for monetary policy, and a strong downward pressure on the dollar exchange rate.

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<sup>4</sup> Between 1958 and 1961, the trade surplus of the United States (as defined by the staff of the International Monetary Fund) rose by \$1.5 billion while the combined trade deficit of the major industrial continental European countries (Austria, Belgium, Denmark, Germany, Italy, Netherlands, Norway, Sweden, and Switzerland—excluding France, which devalued its currency in 1958 and thereby turned a trade deficit into a surplus) increased by \$1.4 billion (International Financial Statistics, August 1962, pp. 38–39).

<sup>5</sup> Between 1958 and 1961, wage rates (as defined by the staff of the International Monetary Fund) rose 10 percent in the United States. Of the continental European countries mentioned above, only three (Belgium, Italy, Switzerland) showed a similarly modest rise; in the others, the increases ranged from 16 to 30 percent (International Financial Statistics, August 1962, pp. 52, 56, 100, 120, 124, 168, 190, 202, 238, 242, and 270). While international comparisons of wage rates are subject to a wide margin of error, such large differences would appear to be significant.

These developments would sharply reinforce expectations of a continued and perhaps accelerating decline in the external value of the dollar, and would accentuate expectations of rapid decline in the internal purchasing power of the dollar, originating in the rise in domestic prices of imports, import-competing, and exportable goods. Such expectations in turn would easily lead to hoarding of foreign currencies by domestic traders and speculators, which would further depress the dollar exchange rate and at the same time aggravate domestic financial disturbances. Abroad, these developments would also stimulate hoarding of gold and thus result in further drains on international reserves.

Two further special elements of the U.S. balance of international payments would add to the harmful effects of a depreciation of the dollar. First, those payments abroad for military expenditures and foreign aid that have to be converted into foreign exchange would have to be increased in terms of dollars, thus burdening the Federal budget. Second, expectation of continuous (whether fast or slow) depreciation of the dollar would make it ever more attractive for foreigners to borrow in the United States. Thus, the net outflow of investment capital and bank credit, at present already a major factor in unbalancing our international payments, would be further stimulated.

Risks of cumulative disturbances resulting from a variable exchange rate are greater for the United States than for most or all other countries, but to a lesser degree they would exist in any important trading country adopting a fluctuating rate. Seasonal and other short-run fluctuations in trade and capital movements could always produce larger fluctuations in exchange rates than would be appropriate for maintaining equilibrium in the long run.

The threat of cumulative exchange rate movements would be aggravated by the inflationary bias inherent in a system of variable exchange rates. If costs and prices were in fact generally characterized by resistance to downward rigidity, they would be expected to rise in countries with depreciating currencies but not to fall in countries with appreciating currencies. Since most countries would be expected to experience some measure of depreciation at one time or another, the forward expectation as to price and cost trends would everywhere be in the direction of rise. This expectation would produce an inflationary climate that might well be much more pronounced and pervasive than the alleged inflationary bias resulting from such fluctuations of monetary reserves as are likely to be experienced under a system of fixed exchange rates.

These considerations lead to the conclusion that some of the assumptions made by the advocates of fluctuating exchange rates are quite unrealistic. The "normal" responses to change in the price of a currency will often be not merely frustrated but actually perverted by the influence of expectations. And in order to protect themselves against the threat of cumulative effects of exchange rate fluctuations, countries would continue to feel compelled to hold sizable reserves (probably in gold); there is no reason to assume that these reserves would be smaller than they have to be under the present system of fixed exchange rates.

#### *International constraints on domestic policy*

International relations impose constraints on domestic economic policies regardless of the form of the international payments system. A country cannot achieve the goal of sustainable orderly growth if it continually pursues policies that tend to produce chronic deficits in its international payments. Under a system of fixed exchange rates, persistent deficits mean continued drains on the country's international monetary reserves. Under a system of fluctuating exchange rates, the disequilibrium instead means continual depreciation in the exchange value of the country's currency.

In either case, persistent tendency to external deficits will undermine a country's ability to maintain the volume of its imports of goods and services and its foreign lending, and thus retard its rate of growth. In either case, moreover, the process, unless checked by a change in domestic policies, is bound eventually to end in economic and financial crisis. Under fixed exchange rates, a country will run out of actual and potential reserves and be forced to devalue its currency, with disruptive effects on domestic and international commerce. Under freely variable exchange rates, depreciation of a country's currency will tend to progress continually, with domestic inflation propelled by the declining value of its monetary unit in international markets. It is an illusion, therefore, to suppose that reliance on the working of fluctuating exchange rates for adjust-

ment of international payments would reduce the constraints on domestic financial policies that exist under a system of fixed rates of exchange.

To clarify this matter, one needs to consider the nature of the constraints that are referred to in this connection. Under boom conditions, major goals of public policy are to prevent inflation in order to foster the sustainability of the economic growth process. For this kind of economic situation, fiscal and monetary restraints are clearly called for. If the balance of payments at such a time tends toward deficit, these policies are precisely the ones required to defend a fixed rate of exchange. Similarly, if a country is in recession while experiencing a tendency toward surplus in its balance of payments, no constraint exists on policies correctly designed to hasten recovery.

The constraints on domestic policies stemming from a fixed exchange rate system relate only to the case in which domestic activity is below desired levels, but the balance of payments is in deficit, indicating either that the country's competitive position needs to be strengthened or that for one reason or another capital investment at long term and short term inside the country needs to be made more attractive relative to capital investment elsewhere. In such a situation, undue emphasis on easy fiscal and monetary policies, without proper use of other measures available to a government, would not only worsen the balance-of-payments deficit, but, by weakening the country's competitive position for both exports and imports, would react unfavorably upon aggregate demand for the country's potential production.

It is asserted by advocates of floating rates that this constraint on policies designed to stimulate domestic demand would be significantly reduced under a system of variable exchange rates, because depreciation of the rate would counteract the worsening of the competitive position. But a country hoping to avoid constraints by means of continuing depreciation under a flexible rate system to counteract deterioration of its competitive position would soon find that the depreciation itself would tend further to weaken its competitive position: domestic costs and prices would continually move upward so as to offset the decline in the currency's external value. The result would be an interacting spiral of depreciation and domestic inflation, which would aggravate rather than relieve the country's international and domestic economic position. Finally, the country would feel obliged to adopt the constraining policies it had hoped to avoid. In fact, it would have to do so through a stabilization program, which would force abrupt adjustments that otherwise might have been accomplished in a more orderly and gradual fashion.

#### *Official intervention*

Some advocates of a system of fluctuating exchange rates concede the desirability of some official intervention to influence the abruptness and degree of fluctuation in international currency values. But intervention presupposes the availability of monetary reserves in foreign currencies. These reserves would be depleted if central banks, because of the uncertain exchange risk, did not retain the large amounts of dollars they now hold as reserves and working balances. As previously discussed, such a change, apart from contributing to dollar depreciation, would put great demand pressure on the limited supply of gold and its price. With limited annual accretions to the world's gold supply, and without the machinery for economizing gold provided by the present system of international reserve currencies, a floating rate system would lack adequate facilities to moderate exchange rate fluctuations in response to volatile and speculative flows of payments.

There are no established or conventional patterns of central bank behavior under variable rate conditions to provide a basis for any rules of the game for official intervention as envisioned by the advocates of a modified system of fluctuating rates. Without accepted ground rules, there would be a constant danger of countries using competitive exchange depreciation against other currencies to gain export advantages for domestic industry, and of engaging in other forms of conflicting exchange operations. As long as there is no agreement on the question of what these rules should be and how they should be established and enforced, there is little likelihood that official intervention could make a multiplicity of fluctuating rates, applying to developed as well as less developed countries, into an orderly system.

Chairman PATMAN. Tomorrow we have, in the morning at 10 o'clock, in the District of Columbia Committee room, New Senate Office Building, room 6226, the Secretary of the Treasury, Mr. Douglas Dillon, as our witness.

In the afternoon, at 2 o'clock, we have Mr. Ewan Clague, Commissioner of Labor Statistics, as our witness.

Without objection, the committee will stand in recess until 10 o'clock tomorrow.

(Whereupon, at 4:05 p.m., the committee recessed, to reconvene at 10 a.m., Friday, August 17, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

FRIDAY, AUGUST 17, 1962

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

The Committee met at 10 a.m., pursuant to recess, in room 6226, New Senate Office Building, Hon. Wright Patman (chairman) presiding. Present: Representative Patman; Senators Proxmire, Pell, and Javits; and Representatives Reuss and Curtis.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; and Hamilton D. Gewehr, research assistant.

Chairman Patman. The committee will please come to order.

This is a continuation of our hearings on the state of the economy, and policies for full employment. We have as our witness this morning the Honorable C. Douglas Dillon, Secretary of the Treasury.

Mr. Dillon, I notice you have a prepared statement. You may proceed in your own way.

## STATEMENT OF HON. C. DOUGLAS DILLON, SECRETARY OF THE TREASURY

Secretary DILLON. Thank you, Mr. Chairman.

The performance of the economy has already been reviewed by previous witnesses. As you know, there have been substantial gains in domestic employment and production over the past 18 months, plus clear progress toward restoring balance in our international accounts.

You are also aware that the margin between our productive potential and the current rate of business activity is still far too wide to permit complacency. Unemployment at 5.3 percent, although much improved, is still at an unacceptably high level. And, if we are to maintain a secure foundation for the dollar and for vigorously expanding trade among nations, the deficit in our balance of payments must be eliminated.

Thus, the major task of economic policy is to facilitate a step-up in the pace of domestic expansion at the same time that we reinforce our program for achieving equilibrium in our international payments.

There is no basic conflict between these twin goals of rapid growth at home and balance in our foreign payments. The key to both is the fuller and more effective use of our unmatched human and physical resources. We must produce more and better goods and services, with greater efficiency, and we must have markets—domestic and foreign—to adequately absorb our output.

This requires that our productive plant and machinery be modernized and expanded. The skills and initiative of our workers must be better channeled into constructive effort. Domestic demand must also grow to provide markets for increased productive capacity. And foreign markets must not be closed to us, either by insurmountable tariff barriers or by increases in our own price level.

The financial policy of the Federal Government will be one of the vital factors in shaping our progress toward these ends over the years ahead. Within our overall financial policy, tax policy can play a particularly important role.

Federal income taxes today absorb fully 15 percent of our total national income. The sheer size of these taxes and the way they are levied—the tax rate schedules, their application to different sources of income, the maze of special provisions—all exert a pervasive influence on economic activity.

It is the joint responsibility of Congress and the Executive, while raising needed Government revenues, to use the taxing power constructively to facilitate progress toward our goals of full employment, rapid growth, and stable prices. It has become apparent in recent years that some elements of our tax structure are impediments in our path to those goals, impediments that in many cases can and should be removed.

Four distinct problems have urgently called for reform:

(1) Our tax structure has placed a heavy burden on the productive investment so vital to the growth process.

(2) The current rate structure siphons off so large a fraction of the increased income generated by business recovery that forward momentum is dissipated before full employment and full utilization of industrial capacity can be reached.

(3) Overly high rates of individual income tax interfere with the economic process. Energies and resources are diverted from the business at hand and concentrated on minimizing tax burdens through the use of a patchwork of special deductions and exclusions, built up over the years to lighten the burden of our onerous rate structure.

(4) Our tax system today lacks provision for flexible and timely adjustments to meet swiftly developing changes in the overall level of economic activity.

One of the major objectives of this administration has been a tax environment more conducive to business investment in new equipment. As a first step toward this objective, the Treasury has overhauled depreciation guidelines within the framework of existing law.

This reform—the first thoroughgoing review in a generation—recognizes fully the impact of swiftly changing technology of the economic life of equipment, and permits individual businesses to establish schedules in keeping with objective measures of their own replacement practices.

Depreciation deductions permitted for manufacturing machinery and equipment will be increased by an estimated 17 percent from existing practice; the current tax load will be lightened by an estimated \$1.5 million the first year; and administrative procedures will be greatly simplified.

Although the result, in terms of stimulating new investment, cannot be gaged precisely, the reaction of the business community to this long-needed reform has been extremely favorable.

These realistic depreciation schedules must be supplemented and reinforced by other measures, however, if we are to provide incentives for investment within our tax structure comparable to those available in the other leading industrialized countries. These further incentives—and the increased investment they will generate—are necessary both to spur growth at home and to maintain and improve our competitive position in world markets.

The proposed 7 percent investment tax credit, incorporated in the Revenue Act of 1962 already passed by the House of Representatives and approved by the Finance Committee of the Senate, represents the minimum we must do to keep up with our competition from abroad.

All of our foreign competitors provide special tax inducements of one sort or another over and above realistic depreciation in order to promote the modernization and expansion of business investment. We must do as much if we are to compete on equal terms.

This is clearly indicated by a table I am submitting for the record. The table is at the back of my statement. You will note, in looking at the table that, even with the 7-percent credit as reported by the Senate Finance Committee, our treatment of new investment will be less generous than many of our foreign competitors.

And without the investment credit, merely with the new depreciation guidelines, our treatment of investment will be less favorable than any of our foreign competitors. Its early enactment is essential to narrow the gap and is also of great importance in sustaining and accelerating the current economic expansion.

The President has announced that a comprehensive program of tax reform—including a general reduction of both individual and corporate rates, effective January 1, 1963—will go to the Congress for action early next year. In developing this reform program within the administration, we are particularly conscious of the need to achieve a tax structure that will both increase consumer demand and provide new incentives—both to individuals and to business—while also providing for an appropriate surplus of revenues over expenditures when the economy is operating at acceptable levels of employment and plant utilization.

The economy over the past 5 years has been marked by two recessions, as well as a persistently excessive level of unemployment. That record provides ample evidence of the drag on growth inherent in our current tax structure.

Today, many of the special expansionary forces that marked the private economy during the first decade of the postwar period are no longer with us. The tax system that was appropriate during the inflationary postwar epoch is now too onerous. Too much potential purchasing power is diverted from the spending stream as a business recovery develops, dampening economic activity long before full employment is approached. The end result is that recovery bogs down at some level of output well below potential—and instead of the theo-

retical large surplus that would be generated at full employment, we find ourselves with further deficits.

Part of the solution to this problem can be found in reducing the total tax load on the economy. Another part can be found on developing a tax structure that will increase private initiative and productive investment. The structure of taxes—as well as their level—affects incentives to work, to invest, to cut costs, and to produce efficiently.

Thus tax reform is just as important as tax reduction. Such a program necessarily involves a loss of revenue in its first year of application, but this initial loss of revenue should be soon recouped as our economy moves ahead. It should be looked upon as a necessary downpayment on economic growth, more jobs, and higher standards of living and greater opportunity for all Americans. More rapid growth will hold and attract funds here, that might otherwise be invested abroad, and rising investment will make our producers more competitive in world markets. Both of these effects will serve to improve our balance of payments.

Fear of deficits is deeply rooted in our thinking—and that fear has its basis in the fact that deficits have sometimes led to excess demand and inflation. But in today's economic environment—far from being a source of dangerous inflationary pressures—our deficit reflects our idle plant capacity and our overly large unemployment rolls. A temporarily larger deficit under these circumstances is a reasonable price to pay for a program of basic tax reform and tax reduction designed to spur output and promote full utilization of our human and physical resources, a program that promises over the years to generate increased Government revenues as a result of increased output.

Finally, even with the enactment of such a program, we will also need a measure of tax flexibility, in order to strengthen our arsenal of tools to combat cyclical downturns. Legislation providing this flexibility, patterned on a recommendation of the Commission on Money and Credit, has been submitted to the Congress by the President. Its enactment would strengthen our ability to handle future downturns.

Monetary and debt management policy, which affects the cost and availability of credit, is another area in which the Federal Government can exert a powerful influence on economic developments. The main responsibility for monetary policy lies, of course, with the Federal Reserve. But the Treasury—largely through its management of the public debt—can also significantly influence the cost and availability of funds.

Difficult and new problems have arisen in this area over the past 18 months. On the one hand, the Federal Reserve and the Treasury together—and I want to emphasize the continuous cooperation and close working relationships that have developed between these agencies—have had a common interest in assuring the availability of an ample supply of funds to finance domestic investment. But we are also alert to the potential danger of investors shifting their funds abroad in search of higher returns—thereby increasing our balance-of-payments deficit.

Fortunately, rates for top-grade short-term securities—the part of the rate structure which is the most important in international capital flows—also have the least significance from the standpoint of domestic business conditions. Therefore, within the limitations imposed by a free and fluid domestic market for credit, we have sought to encourage an active flow of funds into productive long-term investment, while maintaining a competitive equilibrium with foreign markets in the short-term area. For this reason a large portion of the funds injected into the market by the Federal Reserve since February 1961 have taken the form of purchases of approximately \$3.4 billion of securities maturing in more than 1 year, rather than short-term bills, as had been their usual practice in the past. At the same time, the Treasury increased the volume of its own debt outstanding in the under 1-year maturity area by nearly \$14 billion.

With the short-term rate structure supported in this manner, the Federal Reserve has been able to supply the banks liberally with reserves throughout the recovery period, and thereby to maintain an atmosphere of credit ease and ample availability. At the same time, the Treasury, through flexible use of advance refundings and other sales of intermediate and longer term securities during propitious market periods, has been able to improve its overall debt structure without impeding the flow of funds into productive long-term investment.

The results have been gratifying. Rates for Treasury bills, which never fell below  $2\frac{1}{8}$  percent during the recession months of 1961, have risen to the  $2\frac{7}{8}$ - to 3-percent area. This has been necessary in order to keep out rates roughly competitive with the rate structure in foreign markets—after allowing for the fluctuating cost of forward exchange cover.

At the same time, the interest rates of key importance to domestic growth and investment—for mortgages, bank loans, corporate bonds, and State and local government securities—have generally remained close to, or even dropped below, their recession lows. Mortgage rates, in particular, have declined, slowly but almost steadily, for more than a year, and market rates for Government-insured mortgage loans now average more than one-fourth of 1 percent below the levels prevailing at the trough of the recession a year and a half ago. Local government borrowing costs in recent months have been at the lowest levels since mid-1958. Moreover, funds are freely available at these rate levels in all sectors of the market. Far from drawing back on new commitments, banks and other lenders have continued to offer liberal credit terms and to actively seek out potential borrowers.

The contrast with other recent periods of expansion is striking. Rates in all sectors of the market are well below the postwar peaks reached in 1959; 18 months after the recovery began, banks are still liberally supplied with funds for new loans; and there is no lack of credit availability.

As we move ahead in financing our current deficit, we will naturally be concerned to maintain a balanced structure of Federal debt. That means we must be able to continue to tap a cross section of the funds becoming available in the market, from individuals and long-term investment institutions as well as from banks. But it is not part

of our policy to press ahead with long-term financing to the extent of jeopardizing the flow of funds necessary to support an expansion of business investment. Any changes, during the coming year, in the level of long-term interest rate will reflect a natural response to changing levels of business activity, and not any rigid preconceptions regarding the appropriate method of financing our current deficit. Nor will it represent a blunt effort—which I believe would be quite futile—to crowd out of the long-term market some marginal amount of foreign borrowing—borrowing that in any event is attracted more by our unrivaled market facilities than by relatively small differences in the total cost of the credit to the borrower.

The balance of payments: Over the longer run, as I have said, our ability to maintain equilibrium in our international balance of payments will reflect our success in achieving more rapid increases in productivity, a favorable climate for new investment, faster growth, and stable prices in our domestic economy—precisely the objectives we are seeking in our tax reform program and in credit policies. But, for the present, after more than a decade of deficits, we cannot wait idly by until these longer run solutions take hold. Instead, we must intensify our efforts through other means to restore balance as promptly as possible.

Our balance-of-payments accounts are beginning to show some of the fruits of the measures we have taken. The overall deficit, which averaged \$3.7 billion between 1958 and 1960, was reduced to \$2.5 billion in 1961 and during the first half of this year fell further, to an annual rate of \$1.5 billion. Part of this recent improvement resulted from the temporary Canadian difficulties, but more basic factors have also contributed.

For instance, the net drain from our mutual defense program is being significantly narrowed, reflecting additional military procurement in the United States by our allies, as well as our own economies in oversea spending. Current outlays for economic aid also reflect our efforts to furnish this assistance in the form of American goods and services. Perhaps most significant for the longer run, our exports have climbed to a new record level—thanks in large part to the virtual stability of the prices of our manufactured goods since 1958. Although imports have also risen—an expected response to higher levels of business activity—our trade surplus has improved over the second half of 1961.

Efforts to lessen the balance-of-payments impact of our oversea expenditures and to stimulate our exports are being stepped up. One evidence of our determination to reduce Government spending overseas to the minimum necessary is the recent development under the aegis of the Bureau of the Budget of a Government-wide control system for international transactions. This requires the quarterly submission by all agencies, whose transactions affect the balance of payments, of a detailed report of past results, as well as of detailed estimates running 1 year into the future. This system provides for the first time a regular and orderly procedure for the special review and control of these outlays. Each item is being subjected to close scrutiny, and, unless adequately justified in terms of overall priorities,

is promptly eliminated. The institution of this close control over the spending which affects our balance of payments should lead to substantial savings in the future.

Secretary McNamara has established as a target the reduction of net military spending abroad to \$1.6 billion for fiscal 1963, and to \$1 billion by fiscal 1966. This compares with a previous total of \$2.6 billion or more. With the full cooperation of our allies, these targets can be reached without in any way impairing our defense position.

Our export program should soon receive additional impetus as the result of a number of measures—including the recent appointment of an overall Export Coordinator in the Department of Commerce. This official is charged with the responsibility of reviewing and expediting our total export drive, working with both industry and Government to assure the best use of our recently improved facilities and assistance programs for exporters.

Meanwhile, our defenses against the potential shocks and strains that can come from sudden and large-scale shifts of liquid funds—whether arising from speculative or other pressures—have been greatly strengthened.

The agreement reached last December by the industrialized countries to supplement the regular resources of the International Monetary Fund with additional credit facilities of \$6 billion has now been ratified by seven countries and will become effective as soon as the United States itself completes the necessary legislative action. Apart from that agreement, the Treasury and the Federal Reserve, acting in close cooperation with each other and with responsible foreign officials, have made steady progress in arranging facilities for acquiring convertible foreign currencies. These currencies, in turn, may be flexibly employed to absorb dollars passing into foreign hands as a result of our payments deficit. While still in a "pilot" stage, enough has already been learned from this experience to suggest that these facilities can potentially provide an entirely new dimension to our defenses against disturbances in the international monetary system.

Taken together, the financial program and policies I have outlined here today will make a major contribution to our economic goals. But I should also emphasize that these policies cannot, however wisely considered and implemented, do the job alone. They are no substitute for responsible wage bargaining and pricing practices, for measures to maintain active competition among producers, for better educational and research facilities, or for all the other ingredients of dynamic growth with stable prices. But, it is equally true that without well-considered tax reform, monetary, and debt management policies flexibly attuned to the facts of our internal and external position, and intense efforts to restore balance-of-payments equilibrium, the prospects for substantial progress toward a better life for all our citizens in the years ahead would be seriously impaired.

(The table previously referred to follows:)

*Comparison of depreciation deductions, initial and investment allowances<sup>1</sup> for industrial equipment in leading industrial countries with similar deductions and allowances in the United States*

	Representative tax lives	Depreciation deductions, initial and investment allowances (percentage of cost of asset)		
		1st year	1st 2 years	1st 5 years
	<i>Years</i>			
Belgium.....	8	22.5	45.0	92.5
Canada.....	10	30.0	44.0	71.4
France.....	10	25.0	42.8	75.3
West Germany.....	10	30.0	36.0	67.2
Italy.....	10	25.0	50.0	100.0
Japan.....	16	43.4	51.0	68.2
Netherlands.....	10	26.2	49.6	85.6
Sweden.....	5	30.0	51.0	100.0
United Kingdom.....	27	39.0	46.3	64.0
Average, 9 foreign countries.....		29.0	46.3	80.6
United States:				
Practice prior to July 11, 1962.....	15	13.3	24.9	51.1
With new depreciation guidelines.....	12	16.7	30.6	59.8
With new depreciation guidelines and investment credit <sup>2</sup> .....	12	29.5	42.5	69.6

<sup>1</sup> The deductions and allowances for each of the foreign countries have been computed on the assumption that the investment qualifies fully for any special allowances or deductions permitted. The deductions in the United States have been determined under the double-declining balance depreciation method, without regard to the limited 1st-year allowances for small business.

<sup>2</sup> For purposes of this table, the 7-percent investment credit has been considered as equivalent to a 14-percent investment allowance. For corporation subject only to the 30-percent normal tax, for instance, it is equivalent to an investment allowance of 23 percent. Allowance has been made in these calculations for the adjustment to basis in the amount of the credit as provided in the bill as reported by the Senate Finance Committee.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Secretary.

And without objection the table will also be inserted in connection with your remarks.

Some of us, Mr. Secretary, are really very much disturbed about the kinds of tax cuts the Treasury has been recommending.

Let me be sure, when you refer to an across-the-board tax cut, that it means you would reduce each income tax bracket by the same number of percentage points?

Secretary DILLON. It is not necessarily limited to that. No, Mr. Chairman. We might go beyond that. We have not yet reached any conclusion as to what the best form of tax reduction would be, but we have not closed the door to coming near an equal percentage reduction across the board.

Chairman PATMAN. But it is contemplated that you will reduce each bracket some?

Secretary DILLON. Oh, most certainly; and substantially.

Chairman PATMAN. Have you closed the door on concentrating the reduction in the lower income groups; for example, increasing the \$600 exemption to \$800 or \$1,000. You have closed the door on that?

Secretary DILLON. We have not reached final conclusions on anything, but I think that our basic idea is to have a reduction that would affect our whole economy, and would add to inducements for initiative and to incentives as well as merely increasing demand, which would be the result of merely increasing the exemptions.

Chairman PATMAN. What concerns us is this: many of us have long believed, particularly the Democrats, that when the economy is in the kind of situation it is in today, with several million workers underemployed and large amounts of idle productive capacity, what is needed is something to stimulate consumption, rather than something to stimulate savings.

Many of us believe that what we need today is a stimulant for consumption to allow about two-fifths of the American families who are now really living in poverty to participate more in the benefits of our great productive potential and have more than just enough to keep the children in school.

We are persuaded to this view not merely because it is traditional Democratic doctrine, but because we think it is good economics.

Now, of course, all of us want to see an increase in the level of investment, an increase in the level of savings, increased incomes, and increases in all the measures of economic well-being, but the basic question is how to do it. The basic question, as I see it, is whether the rate of savings is too high or too low.

I asked Dr. Walter Heller about this, and he did not give me an answer. Rather, he answered in terms of the level of savings. And of course we all agree that the level of savings should be raised, though the question still remains as to how to do it, and increase employment, too.

Does the Treasury Department, Mr. Secretary, have any factual studies on this question of whether, considering the state of our economy, the rate of savings shows up too high or too low as compared to past periods?

Secretary DILLON. I do not think we have any detailed studies on that, but we do follow it, along with the Council of Economic Advisers, and I think that we have not seen anything substantially out of the ordinary or substantially wrong with the current percentages.

We do feel that it is necessary to have faster growth, and we do agree with you that one of the needs is to stimulate demand and thereby make for increased consumption. That was the basic point I made in my statement, when we said that the pressure of the tax system is too onerous, now that we are no longer in an inflationary postwar epoch; and certainly the reductions that would be made—the great percentage of the funds released—would go to the lower income brackets and would be helpful in stimulating demand.

We also feel that, for the long run, rates that are too high in the higher brackets act to restrict initiative and in that way do not result in a favorable climate for economic growth, which will be good for all. So we feel there should be reductions there, too, which would not be important from the point of view of stimulating demand, because most people in that area probably are well enough taken care of, but which would be important in stimulating initiative, and to an extent business investment.

But we think the two are not in conflict with each other, and that both of these important things should be taken care of in the new tax bill.

Chairman PATMAN. Thank you, sir.

Some of us have been in sympathy with the idea that the President should have discretion to make temporary tax cuts in periods of recession. The Commission on Money and Credit made this recommendation last year in its report; the Commission's report is very emphatic recommendation that such tax cuts be made in the first income bracket only.

All income classes would benefit, of course, but relatively speaking, the lowest income families would receive most relief under this proposal. Therefore it was a little surprising when the President's recommendation came up for an across-the-board cut.

Let me call your attention to the chart on the easel, which shows how the different income classes would be affected by a \$6 billion tax cut made under different methods. It is the one on the far right over there, that I am referring to now.

Looking down at the second box, you will note that if the personal income tax exemption was increased by \$200, disposable incomes of those families receiving less than \$5,000 would be increased by 2.8 percent. At the other end of the scale, those families receiving over \$50,000 would have their aggregate incomes increased by six-tenths of 1 percent.

Looking at the next box down, if the reduction were made in the first income tax bracket, families with less than \$5,000 of income would have their incomes increased by 2.3 percent, whereas the over \$50,000 a year families would have their disposable incomes increased by one-half of 1 percent.

By either of those two methods, you would increase the disposable income of the low income families relatively more than the high-income families, and presumably get an increase in consumption expenditures.

In contrast, if you make an across-the-board cut, in this case of 3 percentage points, the lowest income families would have their aggregate incomes increased by 1½ percent, whereas the top income families would have their aggregate income increased by more than twice that much, 3.3 percent.

Under this method of reducing taxes, you would, of course, have an increase in the rate of savings, although not necessarily in the level of savings, and conceivably, you would have more unemployment than we have today. (See p. 223.)

I asked Mr. Leon Keyserling the question of whether, if we had an across-the-board tax cut, we would have a better or worse fiscal structure, and his answer was that we might have a stimulus to the economy as long as we had a large deficit, but that when the period of the deficit was over, we would have a worse fiscal structure and more unemployment than we have now.

Mr. Secretary, if the Treasury has any factual studies or estimates which indicate the percentages of family incomes that is saved in each of the different income classes, I would appreciate it if you would supply those studies or estimates for our record.

Secretary DILLON. We will be glad to do that, Mr. Chairman.  
(Information referred to follows:)

The average levels of personal savings characteristic of different income classes in 1950 have been estimated in two major studies, one by the Federal Reserve

Board-Michigan Survey Research Center and the other by the Bureau of Labor Statistics—Wharton School of the University of Pennsylvania.<sup>1</sup> In 1959, Profs. Irwin Friend and Stanley Schor of the Wharton School tested the reliability of these two estimates (information for both studies was obtained from sample surveys of individual consumer units) by comparing them with external statistics measuring total values of the components of saving. The testing revealed a major deficiency; serious underestimation, in both studies, of saving in the form of cash and deposits. Professors Friend and Schor corrected this deficiency by using proportions based on external banking statistics to allocate the additional amount of saving among the income categories.

Annual household income before taxes:	Average consumption of goods and services
Under \$2,000.....	\$1, 933
\$2,000 to \$2,999.....	2, 924
\$3,000 to \$3,999.....	3, 839
\$4,000 to \$4,999.....	4, 363
\$5,000 to \$6,999.....	5, 016
\$7,000 to \$9,999.....	6, 063
\$10,000 or more.....	7, 946

Figures on the level of saving for 1960 and 1961 are now being prepared by the Survey Research Center of the University of Michigan, and should prove a much more useful guide to recent saving patterns.

Saving-income ratios for nine income classes as estimated by each of the three sources are shown in table I. The Friend-Schor computations, which build on the two earlier works and have the advantage of the subsequent availability of external checks, probably should be accepted as the most reliable set of statistics.<sup>2</sup>

It should be noted that many components of savings as defined in these studies (for instance, purchases of dwellings) might be considered consumption in another framework. Another limitation to the use of these data is the absence of a predictable relationship between average and marginal rates of saving; the average rate of saving for a particular income level, as shown in table I, is not necessarily indicative of the proportion which would be saved out of a net addition to after-tax income.

TABLE I.—Estimates of saving-income ratios, by income class, 1950

	Saving-income ratios (percent)			
	Federal Reserve—Michigan (total United States)	Federal Reserve—Michigan (urban)	BLS—Wharton (urban)	Friend—Schor (urban)
Income after taxes:				
Under \$1,000.....	-55.2	-48.9	-105.5	-81.7
\$1,000 to \$1,999.....	-2	.9	-13.5	-6.2
\$2,000 to \$2,999.....	.1	-7	-5.0	-1.7
\$3,000 to \$3,999.....	5.6	4.9	-7	2.4
\$4,000 to \$4,999.....	9.1	7.7	1.7	4.5
\$5,000 to \$5,999.....	12.7	12.9	5.2	6.5
\$6,000 to \$7,499.....	28.4	30.1	12.3	10.0
\$7,500 to \$9,999.....	33.1	29.6	26.4	16.3
\$10,000 and over.....				30.7
All.....	8.6	9.2	4.3	8.2

<sup>1</sup> A study by Life-Time, Inc., gives data on 1955 consumption expenditures by level of income, but unfortunately the form in which the material is presented does not make it possible to derive the related level of saving. Expenditures for taxes, gifts, and contributions, education and vacations away from home are not deducted from income. Since average income by bracket is not given, it is not possible to compute a consumption-income ratio, however defined, based on this data. Some interest, however, may attach to the following table, reproduced from the Life report.

<sup>2</sup> The differences in the three estimates are explained primarily by sampling variations and differences in the treatment of components of saving (such as the exclusion of, say, equity in corporate pension funds or social insurance for one set of estimates and inclusion for another).

Chairman PATMAN. There is also a serious question in my mind concerning your proposals for cutting the corporate income tax. The question in my mind is whether such cuts would do more harm to the economy by stimulating increased savings than they would do good by stimulating investment.

Before these hearings started, we heard a great deal about the so-called profit squeeze, but the facts presented at the hearings show that there is really no profit squeeze, except one which results from the corporations counting relatively more of their cash income as depreciation and relatively less as profit.

Let me ask this, Mr. Secretary: The new depreciation guidelines which the Treasury issued last month will, of course, increase profitability of the corporations. That is what they are intended to do. But as far as profits are concerned, they will have a tendency to make the profit rates even lower, will they not?

Secretary DILLON. That might be the first and immediate result. Naturally, if you increase depreciation charges, you reduce not only taxes but profits. So business would tend, to the extent they use this, to report lower profits immediately.

Over a period of time, extending over the use of the equipment, this would balance out, and I do not think that there would be that sort of effect overall. The reform allows companies to depreciate equipment at the rate at which they wish to use and replace the equipment. By facilitating replacement at the most effective and most efficient rate, the new guidelines should tend to lower costs and increase profits over the long run.

Chairman PATMAN. I want to ask you about one statement in your prepared testimony. You mentioned about the level of interest rates on municipals, that it has been very satisfactory. Do you not think some of that is due to the fact that the commercial banks have gone into the market for municipals in a rather big way?

Secretary DILLON. Well, I think that that is very true. The commercial banks have done two things which are somewhat different this year than they have done in the past. They have gone into the market for municipals in a larger way than they have before, and also the larger commercial banks, the banks in the big cities, which in the past were not very much interested in the mortgage business, have gone into the mortgage market and have bought mortgages, which has had an effect on the mortgage market.

Chairman PATMAN. It was brought to our attention by Mr. Eccles, former Chairman of the Federal Reserve Board, who testified the day before yesterday, that the banks are going in for these tax-exempt bonds, and they are really buying them. You know, the volume has increased about 15 percent just during the past year.

Secretary DILLON. Since the first of the year it has increased very, very much.

Chairman PATMAN. Yes, sir. Mr. Eccles made the observation that a 3½-percent return on a tax-exempt bond is equal to a 7-percent return, in fact a little bit more, because with only a 52-percent tax rate, it would amount to a little more than 7 percent, as compared to a taxable bond. And that makes these bonds very attractive.

I just wonder if the banks are getting into a position where they will soon be just Government bond brokers and commercial bookkeepers, and not be doing much business for the people in the way of making loans to local folks. I just wonder if there is not a danger there.

Secretary DILLON. I think that certainly the larger banks have been trying very much to put their money out on business loans. Up until possibly very recently, there has not been the demand they would like to see. And I think that that is one of the reasons that they have gone so heavily into municipals, because the loan demand in volume was not there.

I think the small banks probably have not changed so much, and they probably are still making the same local loans they always have.

Chairman PATMAN. Thank you, sir.

Mr. Curtis?

Representative CURTIS. I am glad to see the Secretary.

I have two lines of questioning, one on debt management, and the other on the tax setup. I think I will start on debt management and then on my second round get into tax matters.

I was very happy to have you discuss at some length the problems of debt management, because most of the witnesses, both before the Ways and Means Committee, in the past few weeks, in this matter, as well as the witnesses before this committee, had in my judgment largely ignored the problems that would be put on the shoulders of the debt managers if we enlarged the deficit. If we do enlarge the deficit, it simply means we have that much additional bonds that we have to market, and the economic consequences of grappling with those debt management problems ought to be considered in any study of this matter.

Now, what I was disturbed about in your presentation was your not mentioning—and I want to be sure I am right on this—one problem that I think confronts us right now, which is the continuing cashing in of E bonds. Is that balance still going down? And what about it? Is the Treasury policy to diminish the amount of bonds that are held by what I might say are our consumers? Because that is what the E bond market largely is.

Secretary DILLON. That is correct. Actually, what has happened is that our E bond sales have done very well. The amount that we have been selling recently of E bonds has been larger than in the same time of the year for some time. But it is true that we have had a larger number of cash-ins this year at the same time as we were selling more than ever before.

The net result has been that our overall totals of E bonds outstanding, the total obligation of the Government, which naturally includes the interest that has been earned on these bonds, is continuing to rise.

And just recently, with the combination of E and H bonds, we did cross the \$45 billion mark for the first time. We have watched this rise carefully, and we are hopeful that it will continue.

Now, we have had an experience with the H bonds that has not been quite as satisfactory so far this year as with the E; the reason being, I suppose, that H bonds are generally bought by people who have more money to invest and who are more interested in immediate return.

They see that they can go down to the bank pretty generally and get 4 percent on their money if they leave it on deposit over a year, and get even more than that at many savings and loan institutions.

The competition with the 3¾-percent rate of the Government is having some effect in this H-bond area. In the E-bond area it has not had as much effect as many feared, because apparently the other advantages of E bonds—the fact that you can deduct them from the payroll, that they are cashable at any time, and the various other advantages that they have—have offset the fact that their current rate is a little lower than the going rate on many savings accounts.

But I must say that we do watch this steadily. We are still watching it. And it is part of our basic policy to sell as many E bonds, in particular, as we can, to keep the general public interested in having a share of the debt.

Representative CURTIS. And then it becomes important to know what the policy is, as to what percentage you would like to have of the debt in E bonds. And it also becomes a very serious question, if we were to give one of these tax “quickie” cuts that were advocated, of—how would you do it if you wanted to increase the amount of the Federal debt in E-bond holdings? But here the balance has been going against you.

Secretary DILLON. Oh, our balance is continuing to go up.

Representative CURTIS. I thought that cash-ins were greater than the resales.

Secretary DILLON. The cash-ins at times exceeded sales, but the total volume outstanding, which includes the interest that is continually accruing on these bonds, has continued to go up.

Representative CURTIS. Is what you are saying that the percentage of our Federal debt which is in E and G bonds has increased over the past, say, 2 or 3 years? or has it decreased?

Secretary DILLON. I think that it probably has varied only slightly, and I think you are probably correct that there may have been a slight decrease. The E and H volume has gone from, I think, about \$44 billion to \$45 billion in the last year, which is about 2½ percent increase, and our total debt has increased a little more than that, about 3¼ percent.

So there is some very minor difference there. The proportion in E and H bonds has perhaps shaded down slightly.

Representative CURTIS. As I understood, Treasury at one stage was advocating—or was Treasury advocating?—a tax cut, to stimulate the economy.

Secretary DILLON. To stimulate it at this time, you mean? No such statement was ever made by anyone connected with the Treasury.

Representative CURTIS. If that had become policy, though, because it certainly was under consideration, what was Treasury's idea? Would selling of bonds have been largely in the E and G sector, or not?

Secretary DILLON. Largely in which sector?

Representative CURTIS. The E and G bonds.

Secretary DILLON. Well, there are no more G bonds.

Representative CURTIS. What I am trying to get at is whether the bonds would have been bought by individuals rather than businesses and institutions.

Secretary DILLON. We think that the E bond sector is very important. It is not subject to sudden surges and changes in volume, the way other areas of the market are, because it is primarily based on long-term buying programs.

Representative CURTIS. But you do not have a strong policy on that?

Secretary DILLON. We have a very strong policy, a very strong effort to continually expand our E bond sales through thick and thin. And it is going on all the time.

Representative CURTIS. Do you have a target? Is there a percentage?

Secretary DILLON. Yes, we have targets each year of what we hope to sell.

Representative CURTIS. No; I mean as a matter of general policy, would you like to see, if you had your "druthers," E bonds as  $x$  percent of the national debt? Is there such a policy?

Secretary DILLON. Oh, I would like to see, if I had my own way, 50 percent more E bonds outstanding. But that is not a practical policy at the moment. So you try and get as far as you can.

Representative CURTIS. Exactly. Because of the problems in selling bonds. And now let me get on with this next one.

The Treasury just recently had an experience with  $4\frac{1}{4}$ . What was the offering? Around \$900 million? And we ended up with \$360 or \$370 million?

Secretary DILLON. No; the offering was up to \$750 million. We did not know how many would be taken. And I think the public took \$315 million.

Representative CURTIS. The point is that again here was the market; and again, there are people who talk of a \$10 billion additional deficit, with a "quickie" tax cut, and just pass over the problem of marketing. When I ask them: How are you going to market these things and handle this problem of debt management, in the light of the experience in the E area, and this experience in the long-term area of  $4\frac{1}{4}$ , which is your highest rate permissible by law—

Secretary DILLON. These bonds were offered at a premium of 101, which was a 4.19 yield basis.

Representative CURTIS. You still have little margin—I agree with you—on that. In fact, you could do the other, too, I understand, offer them at 98.

Secretary DILLON. Sometimes, yes.

Representative CURTIS. I see my time is expiring. I will have to come back later on debt management.

But what is the policy of Treasury in regard to the balance in the debt in respect to maturity? A few years ago our policy was to try to lengthen it. And we were quite disturbed that the debt was shortening in maturity. What is the policy today in the Treasury?

Secretary DILLON. We have had greater success than the Treasury has had, I would say, in some years in lengthening the debt. We have been able to halt the continual shortening up of the average debt, which had been going on almost steadily during the post-war period, during the period I have had responsibility for debt management.

Since then, we have been able to lengthen out the debt slightly. It is not a great thing, but the average debt now is 4 years and 11 months. I think the last time it was that long was sometime in 1958.

Representative CURTIS. Again, is it your policy to continue to lengthen the debt in maturity?

Secretary DILLON. I am not sure, with a debt of the size we have in our country, and the problems we have, whether we would want the average to go very far beyond, say, 5 years. We certainly do not want it to shorten up much below that.

The country does need a very substantial amount of short-term debt, which is really part of the money supply of the country. And we certainly would not want to diminish that now, because it is needed, and the country operates on that.

Representative CURTIS. We are not in any danger of running short in that area, are we?

Secretary DILLON. We would be in real danger today if we did. If we did run short we would probably drive the short-term rates down, and it would be very difficult as to market scarcity and very difficult for our balance-of-payments problem.

But, within the area in which we can operate in large volume, we would rather have not all the debt coming due in 3 years or 4 years. The more that we could have in 6, 7, 8, or 10 years, the better we would feel.

And we do feel that a certain amount, a relatively small amount, of the total, should be stretched out over the whole maturity range. We do not think you should try to put the whole debt out in 25 years or 20 years, because then you would compete in the area which has been largely reserved, and I think wisely so, for municipal debt for mortgages and for private corporate debt that is generally originally issued at long term, probably 20 to 30 years.

Representative CURTIS. My time has expired.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. I want to congratulate you, Mr. Secretary, for your usual comprehensive and elegant statement.

Earlier this week we had a number of visitors from overseas who put out the idea that this country ought to issue gold guarantees or exchange guarantees on its foreign short-term holdings in this country. What do you think of that idea?

Secretary DILLON. I think it is a very poor idea. I do not think it should be seriously considered, for a number of reasons.

In the first place, the dollar is and has been for many years the equivalent of gold. That is what makes the gold exchange standard. The President has stated that the value of the dollar will be maintained, and its value will be maintained in a fixed relationship to gold.

To talk seriously of a gold guarantee, in the first place, would be to question his word, and the faith of the United States, in a way which I do not think is necessary.

In the second place, I do not think this thing would work at all, because it is generally put forward as a guarantee for certain specific types of deposits, usually deposits of foreign banks and official institutions and not of American citizens. And I think that is totally unjust, unfair, and would not work, because if that happened,

American citizens would immediately try, many of them, to shift their funds abroad, and in that way get the same sort of guarantee.

So, actually, the way our system works, I do not think it is practical, and I think it would be a very dangerous experiment to get into.

Representative REUSS. In addition to the reasons you have given, isn't there another disadvantage? Suppose we did give a guarantee. Would this not, if nothing else were done, tend to jeopardize other foreign currencies, like sterling, for example?

And if the British felt forced to give a gold guarantee on sterling, this would then jeopardize the lira, the deutsche mark, and whatever was left, in sort of an international game of old maid?

Secretary DILLON. I think that is right; and that is one reason, I think, why the British Treasury also opposes any suggestion of gold guarantees for sterling, and always has, because they realize it will not work.

Representative REUSS. This may, then, be the simplest answer to the gold guarantee suggestion, that it would be unacceptable to almost all of our financial and trading partners.

Secretary DILLON. Oh, most certainly.

Representative REUSS. Let us turn to debt management.

I am not one of those who criticize the recent effort of the Treasury to put out some 4¼ long-term bonds. I was not enchanted by the relatively high coupon you put upon it, but I cannot criticize you very well, since you were only able to get rid of less than half of the offering at that coupon. The action was taken in accordance with the maxim that we should lengthen the debt, a maxim to which I have sometimes subscribed.

I would like to discuss with you, however, the reasons behind that. The only reason I can see why we lengthen the debt, and I think it is a pretty good reason, is that to the extent that the debt is longer, rather than shorter, it relieves the Treasury of repeated and recurrent financing.

That is, as far as I can understand, the only reason for lengthening the debt that amounts to anything.

Secretary DILLON. I think that is a major reason. At the time we made this current offering, we thought that it would have a side effect which would be helpful—that no matter what the result of it in terms of volume of subscriptions, it would tend to stabilize the long-term market, which had been weak.

Representative REUSS. You mean interest rates had been low?

Secretary DILLON. Interest rates had risen and the market had been weak for the 3 or 4 weeks prior to our offering.

Representative REUSS. Excuse me. Interest rates had risen? And you were trying to bring them down?

Secretary DILLON. Yes. We thought that showing that there was a rate at which trading could be done in big volume would have this effect.

Maybe a month or two prior to our offering, first class double A securities, new issues, had been sold successfully in the area of 4¼ percent, and just before we made this offer, these rates had moved up to about 4.40 or 4.42. Two issues had been sold in that range.

We are very gratified that our offering helped stabilize sentiment, and as a result the private market has strengthened substantially. Just yesterday a new issue of top-grade utility bonds, the Duke Power bonds, were sold successfully and marketed at just over 4 $\frac{1}{4}$  percent, 4.27. So it shows that the market has stabilized and come back in the way we had hoped it would.

Representative REUSS. In the marketing of these long-term bonds, you receive no help from the Federal Reserve, do you?

Secretary DILLON. Oh, no. None whatsoever. We had expected, and I think the market generally had expected, that subscriptions would be about half a billion dollars. Instead, they were \$315 million, which was less than most of us had thought.

I think the major reason we did not receive more subscriptions was that these bonds are primarily bought by pension funds, some State funds, and organizations of that nature. And many of these organizations have committees that must function, and they are not used to operating the way we do in the Government bond market, with 1 day's notice and then 1 day's sale.

They are used to buying corporate bonds, which are announced for sale quite a time ahead, and they have plenty of time to submit subscriptions. For our offering they had 1 day. I think experience has shown that if in the future we want to sell such a bond, we probably ought to give the public 2 or 3 days to make up their mind. I think we would have sold the amount we expected if we had done that.

Representative REUSS. Bearing in mind what you and I have agreed is the main reason for lengthening the debt, or preventing the shortening of the debt; namely to prevent undue bedevilment of the Treasury by the necessity of frequent refundings, why would it not be a good idea for the Federal Reserve, which after all has a \$28 billion portfolio of Federal securities, to have a few more long-term Federal obligations in the cigarbox, another half a billion of long-term debt? Why would that not be an excellent thing? Not to be purchased in one fell swoop, but as they add to the money supply in the months and years to come.

Secretary DILLON. They did last year purchase some bonds of over 10 years, and I think that was helpful to the extent that they did it.

I do think that it is probably more important to be of what help they can be in the area in which there is a greater volume of securities, which is the 5- to 10-year area. They have bought more in that area, but still not very much, and I would think if they were going to buy longer issues, that would be a place it would be particularly important for them to start.

Representative REUSS. Yes; but do you not think there is a lot of evidence over recent years—I certainly would claim to have found some—that institutionally there does not seem to be the number of buyers for long-term Federal debt, 20-year bonds, and so on, that there once was, or at least proportionately, and hence why is this not an area where the Fed could come to the rescue in a modest way and do some good and no harm?

Secretary DILLON. I do not think there are fewer buyers than there used to be of Federal long-term bonds. I think what has happened is that we have deliberately not tried to offer long-term Government bonds in large volume.

And when I say "we," I am talking about the Treasury over the past 10 years or more, since long-term bonds were last sold in large volume during the war. I have not tried to offer long-term bonds in any volume at competitive rates, and by that I mean rates that are competitive with private issues of corporate bonds.

We have felt that the market prices that are quoted for outstanding long-term Treasuries are not an indication where they could really be sold. They are more an indication of the fact that there are very few of these issues outstanding.

And I think that was shown by the offer of this new issue, with a 4.19 rate, which was only a quarter of 1 percent below the then current going rate for corporate bonds. The public, even though the short period of time was a factor, certainly did not show great avidity for these bonds that were quoted a quarter of 1 percent below the rate they could have gotten on a corporate bond.

Now, as soon as they were sold, these bonds have risen to a premium of three-quarters of a point or more; three-quarters of a point to a point of premium above the original offering price. They are quoted at 101¾, and offered at 102.

So when you say there is not a demand—I think we could sell all we wanted, if we wanted to sell them at a price that was close to the going rate on utilities—but then we would just do great damage to our economy by knocking out this area, which should, I think, be left available largely for corporate and other financing.

Representative REUSS. The analysis you have just made suggests to me that it would be profitable for the Fed to sit down and see if it cannot give a little more help than the very middling help it has given in the long-term market.

Would you not agree?

Secretary DILLON. As I have said, it would certainly do no harm. And all I was trying to say was that if they are going to move into the longer area, they can be more effective and can do more good by moving in somewhat greater volume into the 5- and 10-year area rather than skipping that and going all the way out.

Representative REUSS. Yes. And they have not moved into the 5- and 10-year area to great degree, either, have they?

Secretary DILLON. No.

Chairman PATMAN. Senator Javits?

Senator JAVITS. I join with my colleagues, Mr. Secretary, in welcoming you in your appearance before the committee.

Mr. Secretary, the Chairman of the Federal Reserve Board, as well as a good many economists, who have appeared before us, seem to differ on where the economy is going. The economists think we need a tax cut now—a great many of them do—and that the economy is moving in such a way that we may be imminently in or near a recession. Mr. Martin says he thinks things are rolling along pretty well, that you do not have to do too much differently about it than you are doing now, but just go on this way.

What is your own appraisal of the economic situation as you see it for the last quarter of this year and the first quarter of next year—the near term, as it were?

Secretary DILLON. Well, I do not wish to put myself in the position of an economist who can prognosticate accurately about what is going to happen in the future.

I would say simply this: that I have been among those who were not as disturbed as some others by some of the figures which came out regarding the economy in June, in particular, because I felt there were a great many special factors at work there, which tended to make those figures exaggerated on the downside and more or less a special circumstance.

That seems to be borne out by the figures which are coming out for July, all of which show a resumption of the upturn. The newest figure, which came out yesterday, and was particularly significant, showed that new orders for durable goods for July increased very sharply over the June level, and indeed increased over the level of May and April, and I think even March. It went back to practically the February level.

I think the sharpness of that rebound was partly because the June figures were unduly depressed by some special circumstances, including primarily the slowdown, which was merely temporary, in defense orders.

But that just shows one incident of that nature. The Defense Department, for reasons which are not clear, was just a little slower than usual in placing orders toward the end of the fiscal year. That turned down the new orders indicator in June, and everybody felt we were going to have a recession in September. Well, the Defense Department got back on the beam in July, and new orders are up.

Now, I do not think that means that we are going to have a boom in September, but I do think that the best description of the economy is that we are moving ahead, that this recovery is not exhausted, that we will continue to move ahead, but that we are not moving as satisfactorily or as rapidly as we would like. Every indication is that we will not reach the full capacity and full employment level that we all hope to get to unless some other action is taken.

And that is why I think permanent action in the tax field is necessary.

Senator JAVITS. Do you consider that to be the most important single thing that Government can do in order to come abreast of the three major economic problems which are referred to in the first paragraph of your statement, to wit, the difference between our productive potential and the current rate of business activity, endemic unemployment at an unacceptably high level, to use your words, and the deficit in our balance of payments?

Secretary DILLON. Well, I do not like to say that any one thing is the most important, but I think it is an essential thing.

As you will note in the concluding paragraph of my statement, there are other things in other areas, but this is certainly the most important thing in the financial area. It is the one thing we can do in that area, and I think if it is not done, the things that might be done in other areas might not be effective. So I think it is an essential element.

Senator JAVITS. Well, as the Treasury sees it, are we making a satisfactory recovery from the recession of early 1960?

Secretary DILLON. No; I do not think so. As I said, I do not think we will reach the full-employment and full-capacity level which we all want unless further action is taken.

Senator JAVITS. Now, Mr. Secretary, in view of the problems the administration has run into with its tax bill, which is nothing near like what it thought it ought to be or wanted, as it now looks, what would you think about the proposition of giving to the Congress, before we go home, your next year's tax package, so that we can study it and, in a sense, submit it to a plebiscite of the people in this fall's congressional elections, and therefore come back fortified with a mandate—or the lack of it—to put through your tax package in some certain way, instead of again taking it apart, as happened in this particular situation?

Secretary DILLON. Well, I have two comments on that.

First, as regards the present tax bill: the withholding item, which was a very important item, has been removed from the bill in the report of the Senate Finance Committee. Aside from that I think the bill is pretty much the bill which we requested, and certainly there have been no further changes, with that exception, in the Senate that are of a drastic or a serious nature. I think that the tax bill as finally enacted, after conference with the House, will be a good bill.

As I understand it, the Senate committee report was to be filed late last night and ought to be available today or over the weekend, and, in studying it, I think you will agree that most of the objectives are still maintained.

As to a new bill, it was our original concept and hope that we could have at least the broad outlines of a program ready to send to the Congress before the close of this session. However, the fact of the matter is that at that time we expected the tax bill to be enacted sometime in the summer, in June or July, and the extra time it has taken has kept our people working on that.

Depreciation reform took longer than we expected, and far more work than we realized. And the fact of the matter is that we have just not had any opportunity to concentrate on any of the details of the new program, and it is in no form to be submitted to the Congress.

And we have not got a program, except that we do know that there should be net tax reduction, and we do feel that there should be cuts across the board, and we do feel that there are areas where we should recoup some income.

So we are not ready and have no program that is in form to be submitted, and I do not expect there will be one until Congress comes back next January.

Senator JAVITS. So that notwithstanding the fact that you put down in your statement four distinct problems of urgently called for reform, nonetheless, the administration does not yet have its tax program?

Secretary DILLON. Not in detail.

Senator JAVITS. And so it will not be submitted to the Congress before we go home?

Secretary DILLON. No.

Senator JAVITS. Mr. Secretary, I do not agree with you about what has been done to the administration's tax program, and I do not think the country does. I think that the country's general opinion is that it has been very much changed and dismembered.

Your tax on foreign operations has been very radically changed, and entertainment expenses very radically changed. There is even grave doubt that you are going to get the tax credit of 7 percent. I am for it, but you have got a pretty tough opponent in Senator Harry F. Byrd.

And I was against the withholding, and, of course, that was one of the principal props of the bill, and it is out.

So I appreciate your desire to feel that you have got a good deal left; but I do not think the world thinks so.

Secretary DILLON. May I answer that?

Senator JAVITS. Please.

Secretary DILLON. I think you are quite correct that that is the general understanding of the press; but in the foreign area, which you say has been dismembered, the bill has been rewritten. It has been rewritten after a great deal of care and a great deal of work by the Finance Committee of the Senate, by ourselves, and by the staff.

The end result is a bill that attacks the tax haven problem, and our own estimates, and the estimates of the joint committee staff, are that it will bring in just about the same amount of revenue as the bill that has been passed by the House.

So I do not think it has been dismembered. It has been somewhat changed in form, but I think improved, because that particular area of the House bill was not subject to the same amount of detailed hearing and the same amount of work in the Ways and Means Committee as the rest of the bill was.

Senator JAVITS. I might say to the Secretary that I think that foreign investment is critically important. I thought your original bill materially harmed it, and I am happy to see it changed. But I am only giving the general appraisal of the tax bill.

I would say finally, and my time is up, that I wish the administration would put the pressure on, even now, to give the Congress its tax package. I think it would be a very fine thing for the country in making up to some extent for the fact that there was no incentive tax cut this fall. I think we are running an unnecessary risk, that this indicator that you think changed everything may next month prove that it was not at all determinative, either, and that the views of other people and these many economists are entitled to great weight.

And I would hope that we will probably be here a month from now, and I would hope that the administration would give us its tax package, and in that way give some assurance to the country that when we come back action will be prompt, because I deeply feel that if you do give us a constructive package, the people will back up legislators who say they will back it up.

Thank you, Mr. Chairman.

I thank the Secretary.

Chairman PATMAN. Mr. Proxmire?

Senator PROXMIRE. Mr. Secretary, is it not true that you have given a billion and a half tax cut? It is my understanding that the

distinguished Senator from New York, certainly one of the ablest Members of the Senate, included that in his own tax package—the billion and a half tax cut, which you were the leader in providing, plus the investment credit which he approves and which you also champion, so that certainly this year we already have a billion and a half depreciation tax cut.

We also have a billion-plus investment tax cut as it comes out of the Finance Committee, so that we cannot say that to date there has been no tax cut. It seems there has been.

Is that right?

Secretary DILLON. I think there has been action in the field of incentives to invest.

Senator PROXMIRE. I mean incentive tax cut.

Secretary DILLON. Yes. That is right.

Senator PROXMIRE. I would like to ask you, Mr. Secretary: I think that you state your case very well when you say that you have been cooperative with the Fed. Frankly, I am not so happy about that cooperation.

But I notice that under your administration, in the brief period since the futile trial of Operation Nudge in early 1961, the Kennedy administration has refunded to the extent of \$7½ billion in long-term obligations, and this compares with \$20 billion of long-term refunding since the end of the war. So more than a third of all long-term refunding in the past 17 years has been during this administration, in only 19 months. While this is an accomplishment in terms of lengthening the debt, in my judgment it is a very definite contribution to high long-term interest rates and a very definite contribution to limiting economic expansion.

And this is one of the reasons why some of the economists who have come before us have been very deeply concerned by monetary contraction and about this adverse effect as one of the things that did slow down the economy in the past few months.

Secretary DILLON. Well, I have to respectfully differ. I do not think that the fact of issuing 3½ percent bonds of 1990 or 1998 in exchange to holders who had 2½ percent bonds of 1972, has had any effect whatsoever on long-term interest rates. And long-term interest rates actually declined during the time we were doing this, so it certainly cannot be said to increase it.

All one can say, if one wants—and that is a hypothetical argument that nobody can answer—is that long-term interest rates would have declined even more if this had not been done.

Senator PROXMIRE. There is just no question that when you sell another \$7½ billion worth of long-terms, the effect is to drive down the price of long-terms, and push up interest rates.

Secretary DILLON. I do not agree. Where I do not agree is the word "sell." I think if you sold, offered for sale, at current market, \$7½ billion, or any billions of dollars, of long-term Governments, you would have an effect on the long-term interest rate, but that is not what we did.

We offered an exchange of long-term bonds, 30-year bonds, for 10-year bonds, or 9-year bonds. And all that happened was that the individual who had the 9-year bond now has the 30-year bond.

He was not going to buy another 30-year bond. He merely exchanged one piece of paper for another. And I do not think it has any effect on taking new money available for investment in the long-term area out of the market.

Senator PROXMIRE. Certainly this last action, of selling a 30-year bond, and hoping to sell, or at least being willing to sell, as I understand it, \$750 million, expecting to sell \$500 million and ending up with \$315 million, indicates a number of things.

No. 1, that by this sale you do tend to depress, to a very moderate extent, perhaps, but to some extent to depress the price, and raise the interest rate on long-term obligations.

No. 2, the general expectation is that interest rates are going to rise higher. This is certainly the most logical explanation for the fact that there was not a very enthusiastic reception for this offering with an attractive coupon.

And, No. 3, the Fed is not cooperating to the extent of stepping in and providing the kind of support for this sale to assure its success.

Secretary DILLON. Well, we were very careful to price it in such a way that it would not affect the market. Maybe we were too careful. And that is the reason that only about \$300 million was subscribed.

I do not think that there is anything in some statements that it was because people thought interest rates are going up in the future. I think that is obviously ridiculous, because in the market, within a week of our sale, the rate on long-term corporate securities rose, interest dropped, and people bought the bonds avidly. So I do not think it was a question of that.

I think the real question was that these new bonds were priced at a level that did not give enough advantage to the purchaser over what they could get in utility bonds. They preferred the market for regular corporates and utilities and just took a moderate amount of these Government issues, because we priced them at what the market considered to be a high price. We did that on purpose, because we did not want to affect the market.

If people were ready to take a little more at the high price, we were ready to sell them. But we agree with you, that large sales at lower prices would tend to raise long-term rates and we keep that constantly in mind, so that we would not affect the basic long-term market, because if we did so, we think that would be doing a disservice to economic expansion.

Senator PROXMIRE. Mr. Chairman, I want to reserve the balance of my time. I am sorry we have to run in and out to vote on the floor. It is the price of cloture.

Chairman PATMAN. There are some questions that I wanted to ask the Secretary. I would like to return to the issue of the profit squeeze for just a minute.

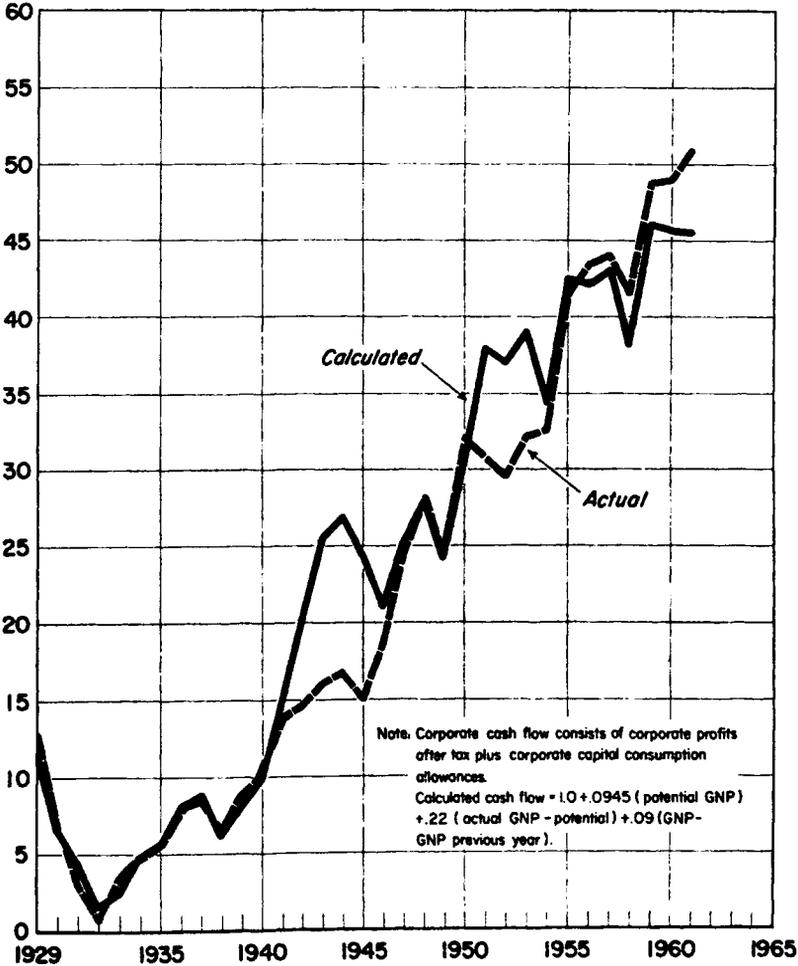
We have had several studies presented during these hearings, which show that total return of capital, that is, both profits and depreciation allowances, is very closely correlated with utilization of capital.

In other words, with high rates of capacity utilization, the return to capital is very high; and at low rates of capital utilization, such as we have now, the rate is low.

The studies also show, I think, that considering changes in capacity utilization, return on capital has not been going down in recent years. On the contrary, it has been going up. It is now at levels higher than in previous periods, when we were having an investment boom. This is illustrated on a chart, which was prepared by our staff.

## CORPORATE CASH FLOW Actual and Calculated, 1929-1961

Billions of Dollars



Source: Department of Commerce and Staff, JEC

What the chart shows is this: Our staff has found the average relationship between capacity utilization and corporate income after taxes for the 20-year period, 1929 through 1949, but omitting the war years, 1942-46. The heavy black line represents the computed cash income.

The broken line, on the other hand, is actual corporate cash income.

You will notice that beginning in 1946 for the first time, actual corporate cash income has been higher than what it would have been on the basis of past relationships; and indeed, in 1959, 1960, and 1961, the excesses have been widening very rapidly.

Now, Mr. Secretary, my question is this: whether or not the Treasury has any studies which throw light on these propositions: First, that recent cash flow to the corporations is adequate to support a much higher rate of expansion and modernization; and, second, that corporations have in the past expanded and modernized at a rapid rate when they were operating at a rate considerably below existing capacity?

If so, may we have them for our record?

(The material referred to follows:)

Treasury analyses indicate that, in general, corporate expansion and modernization of productive facilities have not been restricted by any inadequacy in the availability of funds. For most individual businesses and industries there has been a steady growth of funds available from internal sources, particularly from rising depreciation allowances. As a result of the rise in economic activity, moreover, undistributed profits in the first half of 1962 were substantially greater than in the first half of 1961. Long-term external funds for corporate expansion and modernization have also continued to be readily available. This is evidenced by the moderate downward trend in yields on new corporate bonds since about the middle of 1961. Yields are now lower than in 1959, 1960, or 1961. The ready availability of short-term bank credit is also evidenced by the continued high level of free reserves in the banking system.

On the whole, therefore, it appears that fluctuations in the level of investment in plant and equipment and the relatively unsatisfactory rate of investment at the present time mainly result from deficient investment incentives. These have been reflected in the relatively low level of profits and retained earnings during the past several years. The program of tax reform, including the investment credit, the revision of depreciable lives, and the major reform and tax reduction proposals to be forthcoming next year, are part of an effort to provide necessary incentives to stimulate the expansion and modernization of productive facilities.

The Department of Commerce is the main source of data on corporate sources and uses of funds. The table below showing corporate sources and uses from 1956 to 1961 was reproduced from the July 1962 Survey of Current Business.

*Sources and uses of corporate funds*

[Billions of dollars]

	1956	1957	1958	1959	1960	1961
Sources, total.....	47.9	42.5	39.4	57.1	44.1	51.8
Internal sources, total.....	27.8	28.0	28.0	31.1	30.4	32.0
Retained profits.....	10.5	8.9	5.7	9.5	7.3	7.3
Depreciation.....	17.3	19.1	20.3	21.6	23.1	24.8
External long-term sources, total.....	11.1	11.9	10.9	9.5	9.8	11.1
Stocks.....	3.2	3.5	3.6	3.7	3.0	4.5
Bonds.....	4.7	7.0	5.9	4.1	5.0	5.1
Other debt.....	3.2	1.4	1.4	1.8	1.7	1.4
Short-term sources, total.....	9.0	2.6	2.6	16.5	3.9	8.7
Bank loans.....	2.2	.3	-.4	5.4	1.3	.4
Trade payables.....	5.5	2.4	3.8	5.3	2.6	6.0
Federal income tax liabilities.....	-1.7	-2.2	-2.5	2.1	-1.5	.6
Other.....	3.0	2.1	1.7	3.7	1.6	1.7
Uses, total.....	45.0	40.3	35.3	52.1	41.1	48.3
Increase in physical assets, total.....	37.5	34.8	24.0	34.2	33.4	31.3
Plant and equipment.....	29.9	32.7	26.4	27.7	30.8	29.6
Inventories (book value).....	7.6	2.1	-2.4	6.6	2.6	1.8
Increase in financial assets, total.....	7.5	5.5	11.3	17.9	7.7	17.0
Receivables.....	8.8	4.5	6.7	10.9	7.6	9.6
Consumer.....	1.4	.9	-.3	2.4	1.6	.1
Other.....	7.4	3.6	6.9	8.4	6.0	9.5
Cash and U.S. Government securities.....	-4.3	-.3	2.7	2.9	-3.1	2.5
Cash (including deposits).....	.2	.1	2.5	-1.1	-.2	2.9
U.S. Government securities.....	-4.5	-.4	.2	4.0	-2.9	-.4
Other assets.....	3.0	1.3	1.9	4.1	3.1	4.9
Discrepancy (uses less sources).....	-2.9	-2.2	-4.2	-5.0	-3.0	-3.4

The measurement of industrial capacity is an extremely complex and complicated problem, and the Treasury Department has not itself carried out any detailed studies in this area. The Subcommittee on Economic Statistics of this committee, however, on May 22, 1962, heard a study paper on "Measures of Capacity" prepared by Frank de Leeuw, Economist, Division of Research and Statistics, Federal Reserve System. This paper discusses the measurement problem and presents some suggestions regarding the relationship between capacity utilization and business investment. The general relationship between capacity utilization and new investment is indicated by a chart appearing on page 130 of Mr. De Leeuw's testimony in hearings of the Joint Economic Committee on Inventories of Production Capacity, May 1962.

Secretary DILLON. I would like to make a couple of remarks on that, if I may, Mr. Chairman.

Chairman PATMAN. Certainly. You may proceed.

Secretary DILLON. I think from the point of view of cash flow, it is probably quite correct to say that business as a whole has not been suffering. Certainly there have been some businesses which feel that their cash flow has been inadequate, because they have very great needs for modernization. The steel industry is one I have in mind. But industry in general, because of increasing flows from depreciation, I think has had a relatively adequate cash flow.

I think that the general feeling among all, or certainly a great majority of businessmen is that even with an adequate cash flow, their profits as a percent of invested capital—one way to measure it—has been declining and is inadequate to stimulate or stir new investment.

And it certainly is clear that the item which has lagged the most in our recent recovery, and in the last 4 or 5 years, has been the volume of new investment in modern equipment.

Now, it certainly is entirely true, as you say, Mr. Chairman, that as business operates nearer capacity, profits go up. That has happened in the last year. Profits are much higher than they were a year ago as a result of that. So by an extension of that, if capacity utilization could be moved up still further, I think there is no doubt that profits would move up very rapidly.

That is one of the reasons why we feel that one of the necessities of tax reform is to provide increased demand, because that should make for increased capacity and capacity utilization, and should help the earnings of corporations.

But I think it is a perfectly fair statement to say that there is a very real belief among business executives that there is a profit squeeze, and that they have not had adequate profits on sales. And that does affect investment decisions.

Now, this belief may not be entirely accurate, but whether it is accurate or not, it is there, and it is affecting corporate action.

We feel that the best way to attack that problem is to give corporations, give businesses, the same kind of incentives for new investment and modernization that are given to businesses in other industrial countries. That has been the reason why we moved particularly, first, in that area, both with the administrative reform of depreciation and with the proposal for an investment credit.

Beyond that, if there is a question of corporate rate reduction, I would quite agree, I think, with you, Mr. Chairman, that it is probably not as important as individual tax reductions. And I would certainly think that in any tax reform, a much greater proportion of the reduction, dollarwise, would be reserved for individual tax reform than for corporate tax reduction.

Chairman PATMAN. Mr. Secretary, when Dr. Walter Heller testified, he indicated that he was puzzled by the recent increase in long-term interest rates. And I judge he felt the long-term rate should be brought down somewhat.

On the other hand, if I understood Mr. Martin's testimony correctly yesterday, he feels that some further increase in long-term rates may be wholesome.

I wonder what your position is on the question of whether the Federal Reserve should put upward or downward pressures on the long-term rate.

Secretary DILLON. Well, I think that what is going to happen is that the long-term rate would only move depending on business. I think I said that in my statement, that it would not move artificially.

I think that what Dr. Heller was talking about has turned out to be a more or less temporary phase of the market. When short-term rates rose, about 6 weeks or so ago, long-term rates rose part of the way with them. There was no particular reason for this, and I think that the reaction of the public market since then has indicated that. Certainly new corporate issues, as I stated earlier, that have been sold in the last few days have been sold at steadily declining rates of interest, and most of that increase in corporate interest rates, not all of it, that Dr. Heller was talking about has now vanished and is not there any more.

I think what Mr. Martin may have been saying is that if there is an increase in business, and if our economy moves ahead, so that there is a substantially greater demand for long-term credit, then the long-term interest rate might increase somewhat.

I think that I am one who would believe that there is no great reason for long-term corporate interest rates to vary very much from their present level one way or another.

They might go up a quarter of 1 percent, or even a half of 1 percent, if there is a great demand, and even come down again as demand lessened.

But I think they have found a level which, if one looks at the level of long-term interest rates historically, seems to be reasonable. And I know that the International Monetary Fund staff feels that this is about the case, and they feel the most likely occurrence is that as the industrial development continues in Europe, long-term rates in Europe may gradually come down somewhat and approximate our own at a level of  $4\frac{1}{2}$  percent plus or minus a little bit, for corporate securities.

Chairman PATMAN. Thank you, sir.

On June 30, 1914, when the Federal Reserve System was established, demand deposits amounted to \$10.1 billion and currency outside banks to \$1.5 billion, giving us a money supply in the form of demand deposits and currency amounting to \$11.6 billion.

That was in 1914, June 30, at the end of that fiscal year. The figures today are \$115.1 billion and \$30.1 billion, respectively, making a total money supply of \$145.2 billion.

How has this increase in money supply been brought about?

Now, Mr. Martin testified yesterday, and in his testimony yesterday he seemed to be opposed to money creation. So I wonder where this money actually came from.

What would be your answer to that, Mr. Dillon?

Secretary DILLON. Well, I did not know that he was against money creation, because I think that the Federal Reserve has always had a policy of supplying the funds that were needed for a growing economy. Therefore they would have to supply the reserves that would enable the banks to create deposits that were needed to sustain the economy.

So I think most of the increase in the money supply has come through bank-created deposits.

Chairman PATMAN. I want to call your attention to this. In 1914 the money supply amounted to about 35.8 percent of the gross national product. In 1953, it was about the same, 36 percent of the gross national product. Today, the money supply amounts to about 26 percent of the gross national product.

Do you know of any time in history when the percentage of the money supply to the gross national product was lower than it is today, Mr. Dillon?

Secretary DILLON. I am not prepared to answer that historically.

I would like to make just one comment, and that is that I think there has been, particularly very recently—over the last 5 or 6 years, or 7 or 8 years—a very substantial increase in the use by the public of savings accounts and time deposits of one sort or another, which, while not counted, by definition, in our money supply, are very close to it. So I think it is very difficult to judge by comparison of percentages in 1962 and 1914 exactly what the effect on the economy was.

But I would suspect from what you say that probably this is historically a very low ratio for money supply.

Chairman PATMAN. Thank you, sir.

Senator PROXMIRE, you may resume your questioning at this time.

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Secretary, you have made a very strong appeal here for an investment credit, and you indicate you feel this is quite important in stimulating the economy and moving it ahead.

We had testimony from Dr. Langum, who is a distinguished economist, who also was for the investment credit. But all the facts he had seemed to argue against it.

One of the things he did was to give us the kind of facts shown on this first chart, here; although he added to them the business investment in plant and equipment, and showed that whereas cash earnings, that is, earnings after profits plus depreciation reserves, have increased, the ratio of actual investment of the amount available from cash earnings in plant and equipment has decreased very greatly.

The ratio of plant and equipment investment, to these cash earnings, has dropped steadily and sharply, until now they are at the all-time low shown on Langum's statistics, which go back about 20 years.

Now, we see on this chart that leaving out of account this new \$1.5 billion increase in depreciation reserves you have provided, we have the perfectly enormous availability of corporate cash. It goes up to between \$45 and \$50 billion. And with this new amount, it will be even higher.

Now, part of the argument that you have made to us this morning is based on a chart. The only source you give for this chart is the Office of Tax Analysis, Office of the Secretary of the Treasury. This chart compares depreciation in this country with depreciation provisions in various countries abroad.

I have talked with the staff members of this committee, and they question the source of these statistics. It is a very serious position they have taken, but I have great confidence in them. I think they are extremely able men.

And they feel they have a real basis for conceding that these figures were taken right out of thin air, and they just cannot get the source for them. They have tried terribly hard to duplicate tables like this, at the request of several members of this committee, who were interested in the same kind of thing. They cannot get them.

I wonder if you could give us the sources and how the individual statistics were derived because we are deeply concerned with this, and we think we should have the actual sources made available to us. In particular, could you indicate how the representative lines were selected both in the United States and the foreign countries.

Secretary DILLON. We would be delighted. The sources, of course, were given in full to the competent tax committees, to the Ways and Means Committee and the Finance Committee.

We made a very detailed study of the tax systems in all these various countries. It is a document that is probably 40 or 50 pages long, and was submitted to those committees. They have it in their files, and we can certainly furnish it to this committee and could finish this information that the staff of this committee would like.

I would like to point out that these figures were first furnished to the Joint Committee on Internal Revenue Taxation in January. They have been under study by that committee and those other committees for some 7 months. And today is the first day to my knowledge that anyone has ever questioned the validity of these figures. Certainly no one from the Joint Economic Committee has ever, to my knowledge, asked the Treasury to substantiate these figures before.

So I do not accept any accusation or any intimation that these figures are not entirely accurate, but I would be glad certainly to have any members of the committee come to the Treasury, and would be glad to show them, or the staff of the committee, exactly how these were figured.

(In response to Senator Proxmire's request, the following memorandums and materials are submitted by the Treasury. They describe in detail the sources of information and methods used in compiling the data on foreign capital recovery and investment incentive provisions presented in the table entitled "Comparison of depreciation deductions, initial and investment allowances for industrial equipment in leading industrial countries with similar deductions and allowances in the United States." This table appears following Secretary Dillon's statement at page 670 above and also in an earlier form in Revenue Act of 1962, hearings before the Committee on Finance, U.S. Senate, 87th Cong., 2d sess., on H.R. 10650, Apr. 2, 1962, pt. 1, p. 82.)

#### *Sources of information*

The data on percentage of cost recovered through tax allowances shown in the table are based on information assembled from reliable sources and outlined in a memorandum entitled "Depreciation Practices in Certain Foreign Countries," which is submitted herewith as a supporting exhibit. This memorandum and the table were previously submitted to the Joint Committee on Internal Revenue Taxation on January 18, 1962. The memorandum is also reproduced in the Senate Finance Committee hearing, April 2, 1962, part 1, cited above, at pages 396-416.

As indicated in the introductory paragraph of the memorandum, a main source of data was the response to a questionnaire sent by the Treasury Department to the U.S. embassies in the various countries for which information

was obtained. In April 1961, a cable was sent to the embassies in the selected countries requesting detailed information on their depreciation and investment incentive practices, as well as related pertinent information on tax rates and the business tax structure. The embassies obtained the requested information directly from the finance ministries, other tax authorities of the particular countries, and official documents. Their responses and related documents are available in the Treasury for examination by congressional staff members.

Additional references consulted were published and unpublished material from the "World Tax Series," prepared by the Harvard Law School International Program in Taxation; "Taxation in Western Europe," published by the Federal of British Industries; "Common Market Fiscal Systems," by E. B. Nortcliffe; "Canadian Tax Reporter," published by CCH Canadian Ltd.; and "Information Guide for Those Doing Business Outside the United States of America," published by Price Waterhouse & Co.

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**EXPLANATION OF ALLOWANCES SHOWN IN SUMMARY COMPARISON OF DEPRECIATION DEDUCTIONS AND INCENTIVE ALLOWANCES ON INDUSTRIAL EQUIPMENT IN LEADING INDUSTRIAL COUNTRIES AND THE UNITED STATES**

**BELGIUM**

The 22.5-percent deduction shown for the first year under the Belgian provisions includes ordinary depreciation of 12.5 percent, based on an 8-year representative life, plus a 10-percent incentive allowance.

As indicated in the description of the Belgian provisions in the memorandum entitled "Depreciation Practices in Certain Foreign Countries," the average Belgian straight-line depreciation rate on industrial equipment is between 10 and 20 percent. The 8-year life or 12.5-percent rate used in the table is a conservative estimate in relation to this range of average negotiated depreciation rates.

The 22.5-percent figure also includes a 10-percent incentive allowance. As is also indicated in the descriptive memorandum, Belgium allows a 30-percent special deduction on the excess of investment in industrial property over depreciation on such property and sale proceeds of certain business and investment assets. This 30-percent deduction is normally spread over a 3-year period.

The 45-percent deduction for the first 2 years shown is the sum of the 22.5 percent allowance in the first year plus an equal allowance in the second year.

The 5-year total of 92.5 percent of cost is arrived at by adding the combined depreciation and incentive allowances of 67.5 percent for the first 3 years (3 times 22.5 percent) and regular depreciation at 12.5 percent a year for the ensuing 2 years.

**CANADA**

The 30-percent capital recovery in the first year shown for Canada is the sum of the regular declining balance depreciation at the 20-percent rate applicable to most machinery and equipment and an incentive allowance in the form of a 50-percent increase in the normal depreciation in the first year. This incentive allowance, designed to encourage reequipment and modernization, applies only to those capital expenditures in excess of normal or ordinary capital expenditures, as indicated in the description of the Canadian provision in the memorandum "Depreciation Practices in Certain Foreign Countries." The depreciation in the second year is 14 percent of the investment, computed at 20 percent of the unrecovered cost of 70 percent. Thus, depreciation totals 44 percent at the end of 2 years. The remaining 56 percent of unrecovered cost is depreciated at 20 percent per year by the declining balance method. These calculations yield the sum of 71.4 percent as the depreciation for the first 5 years, as shown in the table.

**FRANCE**

The 25-percent recovery shown for the first year is based on the accelerated declining balance method allowed at a rate equal to the straight-line rate of 10 percent typical for industrial machinery multiplied by a coefficient of 2.5 applicable to assets with a life longer than 6 years, as explained in the description of the French provisions contained in the memorandum "Depreciation Practices in Certain Foreign Countries."

The 43.8 percent for the first 2 years is the sum of 25 percent for the first year and 18.75 the second year, computed in accordance with the declining balance formula (25 percent of the 75 percent unrecovered cost at the end of the first year).

The 76.3-percent cost recovery for the first 5 years is the sum of the 43.8 percent recovery for the first 2 years plus declining balance depreciation computed at a 25-percent rate on the remaining 56.2 percent which would aggregate 32.5 percent of the original cost over the next 3 years.

#### WEST GERMANY

The depreciation shown for West Germany is based on a 20-percent rate under the declining balance method. Depreciation in the second year is 20 percent of 80 percent or 16 percent. The sum for the first 2 years is thus 36 percent. A straightforward continuation of these calculations for 3-5 results in a total depreciation of 67.2 percent for the first 5 years.

#### ITALY

The 25-percent cost recovery to the first year shown for Italy in the summary table consists of 10 percent straight-line depreciation, which is representative for industrial machinery and equipment, plus the additional 15 percent permitted in the initial period and each of the 3 succeeding years, as indicated in the memorandum "Depreciation Practices in Certain Foreign Countries."

The 50-percent cost recovery shown for the first 2 years consists of the sum of the 25 percent for the first year and an equal percentage allowance for the second year.

The 100-percent cost recovery over the first 5 years is the sum of the additional depreciation of 15 percent of cost in each of the first 4 years (a total of 60 percent of cost) plus 10-percent annual straight-line depreciation for 4 years (a total of 40 percent). This combination of allowances will thus effect complete recovery of the investment over 4 years.

#### JAPAN

The 43.4-percent first-year recovery of cost shown for Japanese industrial equipment in the summary table is the sum of (1) regular depreciation computed at approximately a 13.4-percent declining balance rate consistent with the representative life of 16 years (in accordance with the formula explained and illustrated in the section on Japan contained in "Depreciation Practices in Certain Foreign Countries") and (2) accelerated depreciation in the form of a 33½-percent first-year allowance based on original cost less 10 percent salvage value, equivalent to 30 percent of cost, also explained in the section referred to above.

The 51-percent cost recovery for the first 2 years is the sum of the 43.4 percent recovered in the first year and regular declining balance depreciation, computed at 13.4 percent of the remaining 56.6 percent of the original cost, equal to 7.6 percent of the original investment.

The 68.2-percent recovery of cost over the first 5 years is the sum of the 51 percent recovered in the first 2 years plus cumulative allowances at a 13.4-percent declining balance rate applied to the remaining 49 percent of cost over the next 3 years. These allowances in years 3-5 amount to 17.2 percent of the original investment.

#### THE NETHERLANDS

The cost recovery aggregating about 26 percent of the investment in the first year shown for The Netherlands is the sum of (1) accelerated depreciation permitting the spread of 33½ percent of the cost over the first 4 years (or 8½ percent in each of the first 4 years), (2) normal depreciation on the remaining 66½ percent of cost at a declining balance rate of 19 percent consistent with a representative 10-year life (compared in accordance with the formula shown in the memorandum "Depreciation Practices in Certain Foreign Countries" on the assumption that the salvage value is about 8 percent of the entire cost or about 12 percent of the portion of the cost subject to normal depreciation), and (3) a special investment incentive allowance of 5 percent permitted in each of the first 2 years in addition to accelerated and regular depreciation.

The computations of the annual accelerated depreciation, normal depreciation, and investment allowances and the cumulative total allowances year by year for the first 5 years are shown in detail in the table below.

Percent of capital cost]

	Accelerated depreciation	Normal depreciation	Investment allowance	Total	
				Annual	Cumulative
1 year.....	8.3	12.7	5	26.0	26.0
2 years.....	8.3	10.3	5	23.6	49.6
3 years.....	8.3	8.3	-----	18.6	66.2
4 years.....	18.4	6.7	-----	15.1	81.3
5 years.....	-----	5.5	-----	5.5	86.8
Total.....	33.3	43.5	10	86.8	-----

<sup>1</sup>Adjusted to compensate for rounding in prior years.

Owing to differences in rounding procedures and a minor clerical error in the original computation, the percentage of cost recovery shown in this detailed calculation is a fraction of a percentage point lower for year 1 and 1.2 percentage points higher for the first five years as a whole, compared with the previously published table.

## SWEDEN

The figure of 30 percent for the first-year cost-recovery in Sweden is based on a 30-percent declining balance method. Depreciation in the second year under this method is 21 percent (30 percent of the unrecovered balance of 70 percent). Total depreciation at the end of 2 years thus comes to 51 percent.

Taxpayers in Sweden are free to choose the amount of depreciation provided that it does not exceed the limits established by either of two methods, as indicated in "Depreciation Practices in Certain Foreign Countries." The limitation under the first alternative is obtained by applying the declining balance method with a 30-percent rate as described above. The second alternative ceiling is based on 20 percent per annum straight-line depreciation. The limit for any year is the amount necessary to reduce book value (unrecovered cost) to a figure equal to acquisition cost reduced by straight-line depreciation at the rate of 20 percent since acquisition. This latter alternative permits taxpayers to write off the entire cost of machinery and equipment in 5 years.

The taxpayer has an option at the end of each year to choose whichever alternative will permit the largest depreciation allowance for that year. He is not required to follow the same alternative each year.

To continue the computation of the depreciation limits, the third-year allowance under the declining balance method is 14.7 percent (30 percent of the unrecovered cost of 49 percent). Under the straight-line method, the limit is 9 percent, the amount required to reduce book value to original cost less straight-line depreciation at 20 percent per annum for 3 years.

The limit in the fourth year is larger when the straight-line rule is followed. The declining balance method for the first 3 years leaves the unrecovered balance at 34.3 percent of cost. The declining balance method would provide depreciation at 10.3 percent in the fourth year (30 percent of 34.3 percent). The straight-line rule, however, permits depreciation of 14.3 percent (the difference between the 80 percent straight-line ceiling and the 65.7 percent unrecovered cost after 3 years under the declining balance method) which reduces the unrecovered balance to the 20 percent that would have existed with the 20 percent straight-line depreciation during the 4 years. The final 20 percent is written off in the 5th year under the limit set by the straight-line rule. The asset is thus completely depreciated at the end of 5 years, as shown in the table.

## UNITED KINGDOM

The cost recovery amounting to 39 percent of the investment in the first year shown for the United Kingdom is the sum of an initial allowance of 10 percent, an investment incentive allowance of 20 percent, and regular depreciation at a 9 percent declining balance rate applicable to most manufacturing machinery, as shown in the memorandum "Depreciation Practices in Certain Foreign Countries."

The second year cost recovery amounting to about 7.3 percent of the investment (computed at 9 percent of the original cost reduced by the 10 percent initial allowance and the 9 percent regular depreciation of the first year) brings the 2-year total recovery to 46.3 percent. (The 20 percent investment allowance does not reduce the depreciable basis.)

The additional depreciation in years 3-5 consists of 9 percent declining balance depreciation on the 73.7 percent remaining depreciable basis after the second year. This amounts to roughly 18 percent of cost for these 3 years, which in combination with the 46 percent for the first 2 years brings the total recovery to about 64 percent of cost for the first 5 years.

#### AVERAGE, NINE FOREIGN COUNTRIES

The average figures shown for the 9 foreign countries represent unweighted arithmetic averages. Sufficient data were not readily available to permit the computation of a weighted average which would be more reliable or meaningful than the unweighted figures.

#### COUNTRIES PERMITTING DEPRECIATION AND RELATED DEDUCTIONS OF MORE THAN THE TOTAL COST OF ASSETS

Australia, Belgium, the Netherlands, and the United Kingdom have incentive allowances that permit total deductions, including depreciation, to exceed the cost of assets. Under certain conditions, total allowances in Sweden may exceed cost. These provisions for tax-free capital recovery in excess of 100 percent of cost are summarized below.

##### AUSTRALIA

The Australian income tax and social services contribution assessment bill of 1962 provides a 20-percent investment allowance to encourage investment in manufacturing "plant." Buildings and structural improvements are not included in eligible "plant" for this purpose. This incentive provision permits a deduction from taxable income equal to 20 percent of the capital cost of new manufacturing machinery and equipment, in addition to normal depreciation allowances.

To qualify for the allowance, equipment must be used primarily and directly in the manufacture of goods, exclusive of buildings, roads, and structures. The equipment must be new and owned by the manufacturer. Certain types of equipment are ineligible, including automobiles and trucks, hotel and restaurant equipment, tooling for particular models as well as other short-lived tools, and equipment used in developing electric, steam, or other power for use by the manufacturer rather than for sale.

The Australian 20 percent investment allowance is applicable to eligible machinery and equipment delivered to manufacturers' premises on or after February 7, 1962, and to construction of eligible assets under contracts let on or after this date.

##### BELGIUM

Belgium provides a special deduction of 30 percent of the excess investment in industrial property over the sum of (1) depreciation for the year on property held at the end of the previous tax year and (2) the proceeds of land, buildings, machinery, and certain securities sold during the year. This deduction (for purposes of the undistributed profits tax, as indicated in "Depreciation Practices in Certain Foreign Countries") is normally distributed in the equal amounts of 10 percent over a 3-year period. This special deduction is in addition to the normal depreciation otherwise allowable on the property. The total of the special deduction and normal depreciation will thus equal 130 percent of the cost of the property.

##### THE NETHERLANDS

As a special investment allowance, taxpayers in the Netherlands are permitted to deduct a percentage of new investments from taxable profits. This allowance has no connection with regular depreciation; it is simply an additional deduction. The special allowance is 5 percent of cost in each of the first 2 years. Investors are thus permitted to recover 110 percent of cost. Eligible investments are new

or used business assets, including improvement of presently owned assets. Land and residential property are not eligible. If the assets are sold within 10 years, the special allowance must be added back to income.

#### THE UNITED KINGDOM

The United Kingdom has a special investment allowance in addition to regular depreciation and an initial allowance. As indicated in "Depreciation Practices in Certain Foreign Countries," the rates of the investment allowance currently range from 10 percent on industrial buildings and structures and agricultural works to 40 percent on ships. The special allowance is 20 percent for most industrial equipment. Taxpayers are thus able to deduct 120 percent of cost over the period of depreciation for industrial equipment, and amounts varying from 110 percent to 140 percent for other types of assets.

#### SWEDEN

Swedish law may permit tax deductions equivalent to more than 100 percent of the cost of assets through the operation of the investment reserve for economic stabilization, as described in "Depreciation Practices in Certain Foreign Countries." Investment funds placed in the reserve are deductible from income. Amounts withdrawn from the reserve for investment when the economic situation warrants are not restored to taxable income but the basis of the assets so acquired is correspondingly reduced. However, an investment deduction of 10 percent is allowed with respect to such outlays, so that the aggregate tax-free allowance with respect to an investment so financed is in effect 110 percent of its cost.

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#### DEPRECIATION PRACTICES IN CERTAIN FOREIGN COUNTRIES

The following outline is designed to provide information on depreciation practices in leading foreign industrial nations. Countries surveyed are Belgium, Canada, France, West Germany, Italy, Japan, Netherlands, Sweden, and United Kingdom. Replies to a questionnaire sent by the Treasury Department to the United States Embassies in the various countries were the main source of data. Among the additional references consulted were published and unpublished material from the World Tax Series prepared by the Harvard Law School International Program in Taxation. Taxation in Western Europe published by the Federation of British Industries, Common Market Fiscal Systems by E. B. Nortcliffe, Canadian Tax Reporter published by CCH Canadian Limited, and Information Guide for Those Doing Business Outside the United States of America published by Price Waterhouse & Co.

The information for each country has been classified under general headings as follows:

*Corporate tax rate.*—This section is designed to give the approximate rate of tax imposed on income of industrial corporations.

*Method of computing depreciation.*—The various methods (straight-line, declining-balance, etc.) of depreciation permitted or required to be used, together with any limitations on the use of a particular method, are covered in this section.

*Rates of depreciation.*—The method by which depreciation rates for assets are determined (i.e. statutory rates, negotiations with individual taxpayers, etc.) is discussed in this section, together with the treatment of salvage value and the relationship of straight-line and declining-balance rates of depreciation. It is difficult to determine with any degree of certainty the useful lives or rates of depreciation allowed in countries where statutory lives or rates are not provided. Just as tax lives of assets in the United States may vary widely from the administrative Bulletin F publication, lives may also differ considerably in foreign countries as a result of administrative practices. Thus, the rates of depreciation listed for individual assets in these countries must be regarded as rough averages from which a considerable degree of dispersion might be expected.

*Types of buildings or equipment not subject to depreciation.*—Listed here are assets, which would be depreciable under U.S. depreciation provisions, but on which depreciation is not permitted to be deducted in the foreign country.

**Accelerated depreciation.**—Under this heading are discussed initial or first-year depreciation allowances and statutory reduction of lives of assets. Countries having general provisions for initial or first-year allowances are France, Italy, Netherlands, and the United Kingdom, while Italy also has a general provision for reduction of lives. Special allowances, applicable only to certain assets or industries, are also permitted in a number of the countries.

**Incentive allowances.**—This topic covers provisions for deducting allowances in excess of the cost of the asset, but not including deductions based on the change in the price level. Countries currently having incentive allowances are Belgium, Netherlands, and the United Kingdom.

**Adjustments for price level changes.**—None of the countries covered currently permit adjustment for changes in the price level, although they have previously been permitted in Belgium, France, West Germany, Italy, and Japan. However, these prior adjustments, generally, may be used in computing current depreciation allowances on assets purchased prior to the time of the latest reevaluation.

**Treatment of gains on sale of depreciable property.**—Under this heading are discussed any special provisions for the taxation of gains on the sale of depreciable assets. Also discussed are provisions for the deferral of recognition of gain upon reinvestment of proceeds of sale.

**Treatment of losses on sale of depreciable property.**—The tax treatment of loss on sale of depreciable property is covered under this heading.

**Relationship of book and tax depreciation.**—Provisions limiting tax depreciation deductions to depreciation recorded on the books of account is covered in this section.

**Provisions of prior law.**—Expired provisions of the law, concerned either with accelerated depreciation or incentive allowances, are outlined under this heading.

#### BELGIUM

##### *Corporate tax rate*

The maximum effective rate of tax (after taking into account the deductibility of the previous year's tax from the current year's taxable income) is 30 percent on undistributed profits. The maximum effective rate on profits distributed as dividends is 47.2 percent.

##### *Method of computing depreciation*

The straight-line method of depreciation is used almost exclusively.

##### *Rates of depreciation*

Depreciation rates are determined by negotiation between the taxing authorities and individual taxpayers on a case by case basis. The fact that an asset may have a shorter useful life than its physical life may be taken into account in determining the rate of depreciation. Generally, salvage value is not considered in computing depreciation deductions. The following might be considered as average for negotiated depreciation rates:

	Percent
Industrial equipment.....	10-20
Office furniture.....	10
Industrial buildings.....	3-5
Trucks and cars.....	20-25

##### *Types of buildings or equipment not subject to depreciation*

Commercial buildings and administrative offices are not subject to depreciation.

##### *Accelerated depreciation*

There are no general provisions for accelerated depreciation. However, special accelerated treatment is given maritime and inland vessels. Depreciation is allowed on vessels at the rate of 20 percent in the first year, 15 percent in each of the 2 succeeding years, and 10 percent in each of the following 8 years.

##### *Incentive allowances*

A special deduction is allowed for 30 percent of the excess of investment during the year in industrial property over the sum of (1) depreciation for such year on property held at the close of the preceding tax year and (2) the proceeds realized during the year from the sale of land, buildings, machinery, and certain investment securities. The deduction is available only if the excess is more than BFr30,000 (\$600). The special deduction was enacted originally for 1959 and 1960 and has been extended to 1961 and 1962. The deduction is normally

distributed in equal amounts of 10 percent over a 3-year period beginning in the year in which the investment is made. However, if the profits in any year are insufficient, the unused portion of the deduction may be carried forward for 5 years. The deduction does not affect the depreciation allowance otherwise available on the property. Thus, the total of the special deduction and depreciation will exceed the cost of the property. The special deduction gives a maximum benefit of 9 percent of the investment (30 percent of the 30 percent maximum effective tax rate on undistributed profits). Since the deduction applies only to the undistributed profits tax, the result is, in a sense, only a tax deferment, with the deferred tax being collected at the time of distribution of the profits as dividends.

The deduction is available only to industrial enterprises engaged in the extraction, fabrication, or transformation of items. It does not apply, for example, to farmers, transportation firms, hotels, and beauty parlors. The source of funds used for the investment is not restricted. The tax incentive is aimed at expansion rather than mere replacement and, for this reason, the proceeds from the sale of capital assets during the year must be subtracted from the qualified expenditures during the year. Thus, an enterprise which replaces its buildings or machinery with other buildings or machinery of the same value does not obtain the benefit of the deduction. Investment qualifying for the special deduction must be made in "business real property and machinery." Such property includes land bought on which to erect "industrial buildings" as well as business buildings, apparatus, tools, office equipment and furniture, and laboratory equipment. It is immaterial whether the taxpayer buys new or used items. However, leased equipment may not be taken into account either by the lessor or the lessee. Only investments in items used in Belgium qualify for the deduction, although there is no rule that the items acquired must have been made in Belgium. Items under contract but not yet delivered may be taken into account to the extent that progress payments are made during the year. For new enterprises the entire amount of the investment during the first year qualifies for the special deduction.

#### *Adjustments for price level changes*

Taxpayers were allowed in 1947 to revalue assets acquired before December 31, 1940. Subsequent depreciation deductions are permitted on the basis of such revaluation in order to make allowance for the extraordinary rise in prices during and immediately after the war.

#### *Treatment of gains on sale of depreciable property*

Generally, gains on the sale of buildings and equipment are treated as ordinary income in the case of corporations. However, under a law enacted in 1959 and subsequently extended to 1962, only one-fifth of the gain is subject to tax if the proceeds of sale are reinvested in fixed assets or equipment located in Belgium. Total exemption of the gain is permitted if the reinvestment is made in designated regions which have suffered from high rates of unemployment.

#### *Treatment of losses on sale of depreciable property*

Losses on the sale of buildings, equipment, and machinery are fully deductible from income.

#### *Relationship of book and tax depreciation*

Depreciation allowed for tax purposes is limited to the amount shown on the books.

#### *Provisions of prior law*

A special deduction of 30 percent for "productive investment" in excess of BF250,000 (approximately \$5,000) per year was allowed between mid-1954 and mid-1956. This deduction was spread over a 3-year period and was independent of the depreciation deduction. It differed from the special deduction introduced in 1959 in that it was not related to depreciation or the proceeds from the sale of capital assets.

#### CANADA

#### *Corporate tax rate*

The maximum corporate tax rate is 50 percent including the 3-percent old-age security tax.

*Method of computing depreciation*

With the exception of certain farmers and fishermen permitted to use the straight-line method, all taxpayers are required to compute depreciation under the declining-balance method. Under the declining-balance method, depreciable assets are grouped into classes set forth in the income tax regulations, and depreciation is computed with respect to each class as a whole rather than for individual assets.

*Rates of depreciation*

The rates of depreciation which must be used under the declining-balance method are set forth in the income tax regulations. Under these regulations, all depreciable assets are grouped into classes with a specified maximum rate applying to each of the classes of assets. The classes and declining balance rates of depreciation are as follows:

Class 1 (4 percent): Property not included in any other class that is (a) a bridge, (b) a canal, (c) a culvert, (d) a dam, (e) a jetty, (f) a mole, (g) a road, sidewalk, aeroplane runway, parking area, or similar surface construction, (h) railway track and grading that is not part of a railway system, or (i) tile drainage.

Class 2 (6 percent): Property that is (a) electrical generating equipment, (b) a pipeline for oil, gas, or water, and (c) with certain exceptions, generating and distributing equipment and plant (including structures) of producers or distributors of electrical energy, gas, water, or heat.

Class 3 (5 percent): Property not included in any other class that is (a) a building or other structure, including component parts such as electrical wiring, plumbing, sprinkler systems, air-conditioning equipment, heating equipment, lighting fixtures, elevators, and escalators, (b) a breakwater (other than a wooden breakwater), (c) a dock, (d) a trestle, (e) a windmill, or (f) a wharf.

Class 4 (6 percent): Property that would otherwise be included in another class, that is (a) a railway system or part thereof, or (b) a tramway or trolley bus system or a part thereof.

Class 5 (10 percent): Property that is (a) a chemical pulp mill or ground wood pulp mill, but not including hydroelectric powerplants and their equipment, or (b) an integrated mill producing chemical pulp or ground wood pulp and manufacturing therefrom paper, paperboard or pulpboard, but not including hydroelectric powerplants and their equipment.

Class 6 (10 percent): Property not included in any other class that is (a) a building of frame, log, stucco on frame, galvanized iron, or corrugated iron construction including component parts, (b) a wooden breakwater, (c) a fence, (d) a greenhouse, (e) an oil or water storage tank, (f) a railway tank car, (g) a wooden wharf, or (h) an airplane hangar acquired after 1958.

Class 7 (15 percent): Property that is (a) a canoe or rowboat, (b) a scow, (c) a ship, (d) furniture, fitting or equipment (except radar and radio equipment) attached to a property included in this class, (e) a spare engine for property included in this class, (f) a marine railway, or (g) a ship under construction.

Class 8 (20 percent): Property that is a tangible capital asset that is not included in another class (except an animal, a tree, shrub, herb or similar growing thing, a gas well, a mine, an oil well, radium, a right-of-way, a timber limit, and tramway track).

Class 9 (25 percent): Property that is (a) auxiliary electrical generating equipment of a taxpayer not engaged in business of distributing electrical energy, (b) radar equipment, (c) radio transmission equipment, (d) radio receiving equipment, or (e) electrical generating equipment having a maximum load capacity of not more than 15 kilowatts.

Class 10 (30 percent): Property not included in any other class that is (a) automotive equipment, (b) harness or stable equipment, (c) a sleigh, (d) a trailer, or (e) a wagon, and property that would otherwise be included in another class that is (f) a building acquired for the purpose of gaining or producing income from a mine (g) contractor's movable equipment, (h) a floor of a roller skating rink, (i) gas or oil well equipment that is normally used above ground, (j) mining machinery and equipment, (k) property acquired for cutting and removing timber which will be of no further use to the taxpayer after all merchantable timber has been removed from a timber limit, (l) mechanical equipment acquired for logging operations, (m) access roads and

trails for the protection of standing timber against fire, insects, and disease, or (n) property that was acquired for a motion picture drive-in theater.

Class 11 (35 percent): Property not included in any other class that is an electrical advertising sign owned by the manufacturer thereof and used to earn rental income.

Class 12 (100 percent): Property not included in any other class that is (a) a book that is part of a lending library, (b) chinaware, cutlery, or other tableware, (c) a kitchen utensil costing less than \$100, (d) a die, jig, pattern, mould, or last, (e) a medical or dental instrument costing less than \$100, (f) a mine shaft, main haulage way or similar underground work, sunk or constructed after the mine came into production, (g) linen, (h) a tool costing less than \$100, (i) a uniform, (j) the cutting or shaping part of a machine, (k) apparel or costume used for the purpose of earning rental income therefrom, and (l) video tape.

Class 16 (40 percent): Property that is (a) an aircraft; (b) furniture, fittings or equipment attached to an aircraft; or (c) a spare part for a property included in this class.

Class 17 (8 percent): Property that would otherwise be included in another class, that is a telephone or telegraph system or a part thereof, except radio receiving and transmission equipment and property included in class 10.

A taxpayer may elect to include in class 1 all properties which would otherwise be included in another class or, a taxpayer whose chief depreciable properties are in class 2, 4, or 17, may elect that any other property from the same business be included in class 2, 4, or 17.

*Types of buildings or equipment not subject to depreciation*

None.

*Accelerated depreciation*

A special depreciation allowance to encourage reequipment and modernization was part of the 1961 budget proposals to encourage and assist Canadian business to become more competitive in markets abroad and at home. The purpose of the allowance is to help business undertake new capital installations including machinery, equipment and buildings.

The reequipment and modernization allowance takes the form of a 50-percent increase in the rates of capital cost allowance for the year in which a new asset is acquired. This additional allowance will apply to new assets acquired in the period June 21, 1961, to March 31, 1963. Since this allowance is intended to encourage reequipment and modernization it applies only to those capital expenditures which are in excess of normal or ordinary capital expenditures. The regulations provide that the expenditures which qualify for the additional allowance are those made in the taxation year which exceed a certain base amount. The base amount is the aggregate of the amounts spent for depreciable property acquired in the last complete taxation year of the taxpayer ending before June 21, 1961, or the average for the last 3 years if the average is smaller. In order to guard against existing operations being split up into new ones for tax savings purposes, there are provisions for the carryover of base expenditures in the case of certain incorporations and reorganizations.

Nearly all assets depreciable on the diminishing balance basis will qualify for the additional allowance. Property which is already eligible for accelerated depreciation under a certificate issued by the Minister of Defense Production, and property which is already eligible for a 100-percent rate of depreciation does not qualify for the new allowance. In addition, secondhand assets are not eligible nor is property acquired for use entirely outside Canada.

The amount of capital expenditures qualifying for the allowance is the excess of the aggregate expenditures over the base amount. The excess is not computed on the basis of expenditures for various classes of assets under the Canadian class depreciation system. Thus, qualifying expenditures might all be for automobiles, while the base period expenditures were for buildings. If the taxpayer has acquired property of more than one class, he may allocate the qualifying expenditures in any manner he desires to the various classes of acquisition.

The following example illustrates the operation of this allowance:

Computation of base amount: Assume that capital expenditures for depreciable property for 1958, 1959, and 1960 (the last complete taxation year ending before June 21, 1961) were \$60,000, \$50,000, and \$40,000, respectively.

The base amount would be \$40,000 since this is less than the 3-year average expenditures of \$50,000

Computation of amount on which additional allowance may be claimed :

Purchases of depreciable property in 1962 :

Buildings (class 3).....	\$20,000
Machinery (class 8).....	30,000
Automotive equipment (class 10).....	15,000

Total..... 65,000

Base amount..... 40,000

Amount on which additional allowance may be claimed..... 25,000

The taxpayer may claim the additional allowance with respect to any of the property acquired by him in 1962. Assume the following allocation :

Buildings (class 3).....	
Machinery (class 8).....	\$10,000
Automotive equipment (class 10).....	15,000

Total..... 25,000

The additional allowance would be computed as follows :

	Normal rate	Rate of additional allowance	Cost of property	Allowance
	<i>Percent</i>	<i>Percent</i>		
Machinery.....	20	10	\$10,000	\$1,000
Automatic equipment.....	30	15	15,000	2,250
Total.....				3,250

The taxpayer's total deductions under the class system would be computed as follows given the undepreciated cost at December 31, 1961, and disposals credited to the accounts during the year :

	Class 3 (5 percent)	Class 8 (20 percent)	Class 10 (30 percent)	Total
Undepreciated cost at Dec. 31, 1961.....	\$110,000	\$135,000	\$5,000	\$250,000
Additions, 1962.....	20,000	30,000	15,000	65,000
Disposals, 1962.....		(5,000)	(6,000)	(11,000)
Total.....	130,000	160,000	14,000	304,000
Normal allowance.....	6,500	32,000	4,200	42,700
Additional allowance.....		1,000	2,250	3,250
Depreciation, 1962.....	6,500	33,000	6,450	45,950
Undepreciated cost at Dec. 31, 1962.....	123,500	127,000	7,550	258,050

Another form of accelerated depreciation may be claimed in respect of most types of assets acquired after 1960 which are used either (1) in making a product not previously produced in Canada or (2) in making a product not previously produced in an area of labor surplus. The taxpayer must apply to the Minister of Trade and Commerce for certification of the project as qualifying under the regulations. Structures, machinery and equipment, and patent and license costs are eligible for the special allowance. No distinction is made between new and used assets. However, office furniture and equipment, automobiles, and assets having a capital cost allowance rate in excess of 30 percent are not eligible. The additional allowance is equal to the maximum normal allowance for the year in which the assets are acquired. The full amount of the allowance may be taken in the year of acquisition of the assets or in either of the 2 years following ac-

quisition or the allowance may be apportioned in any manner over these 3 years. The additional allowance reduces the undepreciated cost of the asset and thus also reduces the normal depreciation allowance in the following years. Both this allowance and the re-equipment and modernization allowance discussed above may be claimed with respect to the same property. Special provisions are also in effect for accelerated writeoff of certain coal property, fishing vessels, and defense facilities.

*Incentive allowances*

None.

*Adjustment for price level changes*

None.

*Treatment of gains and losses on sale of depreciable property*

Under the Canadian class system, gains and losses as such are not computed upon the sale of depreciable property. Proceeds up to the amount of the original cost of the assets sold from a class during a taxable year are deducted from the undepreciated cost of the remaining assets in the class. Any proceeds which exceed the original cost of the assets sold constitute a capital gain not subject to income tax. Under "recapture" provisions, proceeds applied in reduction of the undepreciated cost which exceed the remaining undepreciated cost of the class are required to be included in ordinary income and are taxed at ordinary tax rates. Any undepreciated cost remaining after a taxpayer has disposed of all property in a class and has no property of that class at the end of a taxable year, may be deducted as a "terminal loss" from ordinary income. In general, the operation of the class system results in (1) the deferral of recognition of gain on the sale of depreciable property along with a reduction of future depreciation deductions, (2) deferral of losses on sale of depreciable property with an increase in future depreciation deductions, (3) ultimate recognition as ordinary income of gains on sale of depreciable property to the extent of depreciation previously claimed and ultimate recognition as ordinary deductions of losses on sale of depreciable property.

The following examples illustrate the operation of the class system with respect to disposals of property of a particular class :

	1	2	3	4	5
Original cost of assets in class.....	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000
Accumulated depreciation.....	75,000	75,000	75,000	40,000	50,000
Undepreciated cost before disposition.....	25,000	25,000	25,000	60,000	50,000
Dispositions:					
Original cost.....	35,000	35,000	35,000	20,000	100,000
Proceeds.....	20,000	30,000	40,000	50,000	40,000
Proceeds deducted from undepreciated cost.....	20,000	25,000	25,000	20,000	40,000
Capital gain.....	0	0	5,000	30,000	0
Ordinary income under "recapture" provisions.....	0	5,000	10,000	0	0
Ordinary loss under "terminal loss" provisions.....	0	0	0	0	10,000
Undepreciated cost remaining.....	5,000	0	0	40,000	0

*Relationship of book and tax depreciation*

Depreciation is allowed for tax purposes without regard to the amount of depreciation recorded on the books. For the years 1949-53, depreciation could be deducted for tax purposes only to the extent that it had been recorded on the books. This provision was repealed effective for 1954 and subsequent years.

*Provisions of prior law*

In general, depreciation was deferred on assets purchased after April 10, 1951, and before January 1, 1953, unless the Minister of Trade and Commerce had issued a certificate of eligibility for depreciation. The original term of deferral was 4 years. However, this restriction was lifted and beginning in 1953 depreciation was allowed to commence on such assets.

## FRANCE

*Corporate tax rate*

The corporate income tax rate is 50 percent.

*Method of computing depreciation*

For all depreciable assets acquired prior to January 1, 1960, straight-line depreciation continues in effect until the assets are fully depreciated. The declining-balance method becomes mandatory for certain types of assets acquired after January 1, 1965. The taxpayer has an election to apply the declining-balance method to qualifying assets acquired between January 1, 1960, and January 1, 1965, or may continue using the straight-line method. However, the same system must be applied to all assets acquired during this period to which the election applies. It should be noted that the various special acceleration provisions will, in general, continue to apply under the straight-line method, but may not be used in conjunction with the declining-balance method.

Assets qualifying for the declining-balance method must be new when acquired by the taxpayer and has a normal useful life of more than 3 years. The following types of assets qualify for depreciation under the declining-balance method: (1) Machinery and equipment used in industry for manufacture, transformation, or transport; (2) handling equipment; (3) water and air purification installations; (4) installations for the production of steam, heat, or energy; (5) fire-detection and firefighting equipment, burglar alarms, and industrial safety devices; (6) medical equipment; (7) business machines, except typewriters; (8) machinery and equipment for scientific and technical research; (9) equipment for the storage of merchandise; and (10) all buildings and equipment of enterprises in the hotel business (lodging or meals and lodging) but excluding installations for enterprises in the restaurant business only. Other types of assets must be depreciated under the straight-line method. Such types include all buildings, except hotel buildings, trucks of less than 2-ton capacity, passenger cars, buses, office furniture, and typewriters.

Under the declining-balance method, a switch to the straight-line method may be made when the point is reached at which the straight-line method produces a greater annual deduction than the declining-balance method.

*Rates of depreciation*

Rates of depreciation must be "within limits of those customarily applied in each branch of industry, commerce, or business." Negotiations for rates are in most instances with individual taxpayers, but may sometimes be with industrial groups. Factors such as obsolescence and particularly intensive use may be taken into account in determining depreciation rates. Typical rates under the straight-line method are:

	<i>Percent</i>
Industrial buildings.....	5
Commercial buildings or housing.....	2- 3
Machinery and office furniture.....	5-10
Motor vehicles.....	20-25

The rates under the declining-balance method are determined by applying coefficients to the straight-line rates. The coefficients are 1.5 for assets having a normal useful life of 3 or 4 years, 2 for assets having a life of 5 or 6 years, and 2.5 for assets having a life of longer than 6 years.

*Types of buildings or equipment not subject to depreciation*

None.

*Accelerated depreciation*

As explained above, the declining-balance method is mandatory for certain categories of assets acquired after January 1, 1965, and may be elected for qualifying assets acquired between January 1, 1960, and January 1, 1965. A number of forms of accelerated depreciation have been in effect and continue in effect for assets acquired between January 1, 1960, and January 1, 1965, if the taxpayer continues to use the straight-line method. However, these acceleration provisions do not apply if the taxpayer elects to use the declining-balance method with respect to such assets.

For office equipment (other than typewriters), handling equipment, water and air purification equipment, equipment for production of steam, heat, or

energy, security equipment, and equipment for scientific research acquired new after January 1, 1954, and utilized for purposes of modernization, a 10 percent initial allowance is permitted. If the 10 percent allowance is claimed, other depreciation deductions are on the basis of 90 percent of cost. For orders placed between May 29, 1959, and January 1, 1960, the 10 percent initial allowance was extended to (1) machine tools for metalworking and other named industries; (2) machine tools having a life of at least 5 years for the food, rubber, plastic, ceramics, shoe, textile, paper, and certain other industries; (3) equipment of building contractors having a life of at least 5 years; (4) trucks weighing 5 tons or more; and (5) various kinds of electrical and radiological equipment.

New machinery with a useful life of at least 5 years, if used in industry for manufacture, transformation, handling, or transportation, is subject to accelerated depreciation. This accelerated depreciation takes the form of a double deduction in the first year. The taxpayer, under this procedure, computes annual depreciation for each year in the normal manner, takes two annual deductions in the first year, and the period of depreciation deductions is reduced by 1 year. For qualifying equipment, both the 10 percent initial allowance and the double deduction in the first year may be claimed. The following table compares the annual deductions available under the straight-line method assuming the 10 percent initial allowance and double deduction in the first year are both applicable with the deductions available under the declining balance method for a \$1,000 asset having a useful life of 10 years.

	Straight-line method with 10 percent initial allowance and double deduction in 1st year	Declining-balance method		Straight-line method with 10 percent initial allowance and double deduction in 1st year	Declining-balance method
1 year.....	280	250.0	6 years.....	90	59.0
2 years.....	90	188.0	7 years.....	90	44.5
3 years.....	90	141.0	8 years.....	90	44.5
4 years.....	90	105.0	9 years.....	90	44.5
5 years.....	90	79.0	10 years.....	0	44.5

Under a 1958 provision, 50 percent of the cost of buildings or machinery acquired for scientific or technical research may be deducted in the first year. The remainder of the cost is deducted in the normal manner over the useful life of the facilities.

In order to stimulate exports, a special "export" depreciation deduction was established in 1957. The amount of the deduction is determined by multiplying the ordinary depreciation allowance for the year by the ratio between the firm's export sales and total sales for the year. In 1959, this deduction was increased by 50 percent. Steel and coal companies have been permitted to use "output" depreciation based upon a percentage of sales or output.

To encourage modernization of facilities, newspapers and magazines were allowed to expense their acquisitions, writing off the cost of equipment in full, in the year of acquisition. They are also entitled to deductions for certain amounts put in reserve for future acquisition of equipment. The 1961 Finance Act extended these incentives for another 2 years.

#### *Incentive allowances*

None.

#### *Adjustments for price level changes*

From 1945 through 1958, taxpayers were permitted an annual revision of their balance sheets to reflect, by the use of Government-specified coefficients, the decline in the purchasing power of the franc. Depreciation and gain or loss on the disposition of assets were computed on such revalued amounts. Under a 1959 law revaluation was abolished. However, firms were permitted (mandatory for taxpayers with an annual turnover of more than 500 million old francs) a final revaluation as of June 30, 1959. Such revaluation is made by multiplying the cost of the asset (less, where taken, any 10 percent initial allowance claimed)

by a stipulated coefficient for the year of acquisition. Similarly, each annual depreciation allowance applicable to the asset is multiplied by the coefficient for the year for which the depreciation was claimed. The total of the revalued depreciation allowances in subtracted from the revalued cost of the assets to obtain a new value which is used as the basis for computing annual depreciation allowances for the remainder of the useful life of the asset. The difference between the old value of the asset and the new value constitutes a special valuation reserve and a tax of 3 percent was imposed on the amount of such reserve. The coefficient of revaluation for depreciable assets acquired in 1914 and prior is 243; 1924, 51.8; 1935, 64.8; 1944, 16.3; 1954, 1.25.

#### *Treatment of gains on sale of depreciable assets*

Gains on sale of depreciable assets are taxable at ordinary income tax rates. However, the taxpayer may defer the taxation of the gain by reinvesting the proceeds of sale in other capital assets within 3 years following the end of the year within which the sale took place. The reinvested gain serves to reduce the basis of the assets in which reinvestment is made.

#### *Treatment of losses on sale of depreciable property*

Losses on sale of depreciable property may be deducted in full from ordinary income.

#### *Relationship of book and tax depreciation*

A taxpayer may deduct for tax purposes only such depreciation as is actually recorded in the books of account.

### WEST GERMANY

#### *Corporate tax rate*

The corporate tax rate is 51 percent on retained income and 15 percent on income distributed as dividends.

#### *Method of computing depreciation*

Either the straight-line method or the declining-balance method may be used in depreciating movable property. However, only the straight-line method may be used in computing depreciation on buildings. Individual items costing not more than DM600 (approximately \$150) may be fully written off in the year of acquisition.

#### *Rates of depreciation*

Depreciation rates are based on the economic life expectancy of the assets under the particular conditions of the taxpayer. Rates are negotiated between the tax authorities and individual taxpayers. Unusual wear and tear and technical obsolescence may be taken into account in settling the depreciation rates. Normally, salvage value need not be considered unless it can reasonably be expected to be substantial. Rates of depreciation under the declining balance method are twice the applicable straight-line rates. However, the declining-balance rate may in no case exceed 20 percent. Some typical lives and depreciation rates under the declining-balance method are as follows:

	Estimated life	Declining balance depreciation rate
	Years	Percent
<b>Iron and steel industry:</b>		
Blast furnace.....	10	20
Open hearth furnace.....	10	20
Electric furnace (for melting).....	10	20
<b>Automobile industry:</b>		
Boring and turning mills.....	2-5	20
Radial drill.....	10	20
Steel forging hammers.....	10	20
Engine lathe (automatic).....	6	20
Hydraulic press.....	8	20
Shearing machines.....	10	20
<b>Textile industry:</b>		
Carding machines.....	10	20
Combers.....	12	16
Dyeing machines (wood).....	5	20
Dyeing machines (metal).....	10	20
Looms (single).....	12-15	13-16
Knitting machines.....	8-12	16-20

Industrial buildings, which may be depreciated only under the straight-line method, typically have an estimated life of 50 years.

*Types of buildings or equipment not subject to depreciation*

None.

*Accelerated depreciation*

In addition to the acceleration provided by the use of the declining-balance method a number of special provisions are in effect. These special allowances are not applicable to the acquisition of used assets. Buildings, if two-thirds of the capacity is used for dwellings, may be depreciated 7½ percent in the year of completion and an equal amount in the following year. For the next 8 years, 4 percent per annum may be claimed. All investment in Berlin is eligible for special acceleration provisions. Movable assets may be depreciated up to 75 percent during the first 3 years if they will continue to be held in Berlin for an additional 3 years. Housing in Berlin may be depreciated up to 10 percent in each of the first 2 years and up to 3 percent in each of the following 10 years. Refugees and victims of Nazi persecution are granted an initial allowance of 10 percent of business construction costs in each of the first 2 years. Accelerated depreciation is also granted on a case-by-case basis for investments in certain eastern border areas. A special first year allowance of from 20 to 30 percent is permitted on certain imported items which are either subject to wide price fluctuation or are vital to the smooth functioning of the economy.

Farmers who keep books of account may depreciate movable assets up to 50 percent and fixed assets up to 30 percent during the first 2 years. These allowances are in addition to the normal depreciation during this period. However, the total depreciation may not exceed 50 percent of the gross income from agriculture or forestry. Other farmers may write off 25 percent of the cost of movable assets and 15 percent of the cost of fixed property in the year of acquisition. Improvements to buildings constructed before June 21, 1948, and with more than 50 percent of the capacity used for dwellings, may be written off up to 10 percent per annum during the first 10 years.

Private hospitals primarily serving low income groups may write off up to 50 percent of the cost of movable assets and up to 30 percent of the cost of fixed assets in the year of acquisition and the following year in addition to normal depreciation for these years. However, total depreciation may not exceed DM100,000 (approximately \$25,000) in a single year. Fifty percent of investments in movable assets and 30 percent for fixed properties used for the control of sewage and waste may be written off in the first 2 years. Movable assets for the control of air pollution may be depreciated up to 50 percent during the year of acquisition and the following year. Both of these allowances are in addition to depreciation otherwise allowable for these years.

*Incentive allowances*

None.

*Adjustments for price level changes*

Currently no adjustments for changes in the price level are allowed. However, taxpayers were permitted to revalue assets acquired prior to June 21, 1948, on the basis of replacement cost in August 1948. Subsequent depreciation is computed on the basis of such revaluation.

*Treatment of gains on sale of depreciable property*

Gains on the sale of depreciable property are taxed at ordinary rates except upon the sale of an entire plant. In such cases, special tax rates of from 10 to 30 percent are provided.

*Treatment of losses on sale of depreciable property*

Losses on the sale of depreciable property may be deducted in determining ordinary income except when an entire plant is sold in which case losses are only partially deductible.

*Relationship of book and tax depreciation*

Depreciation need not be recorded in the books of account to be deductible for tax purposes.

*Provisions of prior law*

The declining-balance method of depreciation was introduced in 1952 for all depreciable assets having a life expectancy of 10 years or more. The usual rates of depreciation were 3.5 times the straight-line rates. In 1956, the declining-balance method was limited to movable assets, but was allowed regardless of the expected life. At the same time, the rates were reduced to 2.5 times the straight-line rates with an absolute maximum of 25 percent. In 1960, the rates were further reduced to 2 times the straight-line rates with a maximum of 20 percent.

A number of incentives to investment through depreciation allowances have been available to taxpayers in Western Germany since 1948. Under all of these incentive provisions the total chargeoff was limited to the original cost of the asset. Generally, the incentive allowances in the early years of the life of the asset were in addition to the regular depreciation allowed for such years. For new assets acquired between January 1, 1949, and June 30, 1951, taxpayers could write off a total of 50 percent of the cost in the first 2 years up to an annual limit of DM100,000 (approximately \$25,000). For ships acquired or constructed after January 1, 1949, and before June 11, 1958, a deduction of up to 15 percent of the cost was allowed in each of the first 2 years. Under the investment assistance law of 1952, investment in coal, iron ore, iron, steel, and energy-producing industries was encouraged by allowing a writeoff within the first 5 years of 50 percent of the cost of newly purchased equipment and 30 percent of the cost of buildings, provided these expenditures served immediately, directly, and exclusively to increase the output in these basic industries. This provision expired in 1960.

## ITALY

*Corporate tax rate*

Because of the complexity and variations in the tax structure it is not possible to give a precise total rate for corporate income tax. In general, the maximum Central Government rate may be said to be approximately 40 percent.

*Method of computing depreciation*

Depreciation must be computed under the straight-line method.

*Rates of depreciation*

Although not having the force of law, Ministry of Finance tables of depreciation in 1957 are the standard base for maximum depreciation allowances. These rates are established, generally, for broad groups of items within a specific industry rather than for specific types of equipment. In exceptional cases of intensive production processes this maximum may be exceeded. Salvage value is not considered in the computation of depreciation. Some typical rates of depreciation are as follows:

	Percent
Iron and steel industry, furnaces of any type-----	10
Rod and wire mill:	
Automatic-----	14
Nonautomatic-----	10
Metal products industries, machine tools:	
Automatic-----	8
Nonautomatic-----	12½
Textile industry (cotton, wool, and other natural fibers):	
Ordinary machinery and equipment-----	10
Machinery used in corrosive solutions-----	12½
Special equipment-----	25
Industrial buildings (of any construction and size, including plumbing, lighting, and heating):	
Agricultural buildings-----	3
Nonferrous metal fabricating buildings-----	4½

*Types of buildings or equipment not subject to depreciation*

None.

*Accelerated depreciation*

The normal period of depreciation of new plant and equipment and of expenditures for expansion, conversion, and reconstruction of existing plant and equipment may be reduced by not more than two-fifths. Thus, an asset which normally would be depreciated over 20 years at a 5 percent rate may be depreciated over 12 years at an 8½ percent rate. In addition, for the initial period and for each of the three succeeding periods an additional amount not exceeding 15 percent of the cost of the asset is added to normal depreciation.

*Incentive allowances*

None.

*Adjustment for price level changes*

At the present time, there is no general provision for adjusting depreciation to take account of changes in the price level. However, not later than 1953, taxpayers were permitted to revalue assets acquired prior to 1948 by coefficients reflecting the depreciation in the value of the currency. Such revalued amounts are used in computing subsequent depreciation.

*Treatment of gains on sale of depreciable property*

Gains on the sale of depreciable property are taxable as ordinary income.

*Treatment of losses on sale of depreciable property*

Losses on the sale of depreciable property are deductible from ordinary income.

*Relationship of book and tax depreciation*

In order to be deductible for tax purposes depreciation must have been recorded in the books of account.

*Provisions of prior law*

The present system of accelerated depreciation was originally adopted in 1951. In 1957, this system was temporarily superseded by a special deduction for 10 percent of the excess of expenditures for new plants over the depreciation for the year. The deduction was limited to 5 percent of income and was independent of and in addition to the depreciation otherwise allowable on the property. This special deduction was permitted for 1957, 1958, and 1959. In 1960, the original accelerated depreciation provisions were substituted for the special deduction.

**JAPAN***Corporate tax rate*

The maximum corporate tax rate on undistributed profits is 38 percent. The maximum rate on profits distributed as dividends is 28 percent.

*Method of computing depreciation*

Either the straight-line method or the declining-balance method may be used in computing depreciation. Generally, assets having a cost of 10,000 yen (\$28) or less may be written off in the year of acquisition.

*Rates of depreciation*

Useful lives for various assets have been prescribed by the taxation authorities. Such lives must be used in computing depreciation unless permission is obtained for the use of shorter lives. Salvage value of 10 percent of the original cost is required to be set up for machinery and equipment. Declining-balance rates are applied to the original cost of the asset, while straight-line rates are applied to original cost reduced by salvage value.

The general formula for determining the declining-balance rate of depreciation is

$$1 - n\sqrt{10}$$

where  $n$  equals useful life.

The following is a comparison of the straight-line rate and declining-balance rate for various useful lives:

[In percent]

Useful life	Rate	
	Straight-line	Declining-balance
2 years.....	50.0	68.4
3 years.....	33.3	53.6
5 years.....	20.0	36.9
8 years.....	12.5	25.0
10 years.....	10.0	20.6
15 years.....	6.7	14.3
20 years.....	5.0	10.9
25 years.....	4.0	8.9
40 years.....	2.5	5.8

Some typical useful lives and depreciation rates under the straight-line and declining-balance methods are as follows:

Asset	Useful life	Rate	
		Straight line	Declining balance
<b>Iron and steel industry:</b>	<i>Years</i>	<i>Percent</i>	<i>Percent</i>
Blast furnace.....	17	5.8	12.7
Rod and wire mill.....	18	5.5	12.0
Open hearth furnace.....	18	5.5	12.0
Electric furnace.....	12-16	8.3-6.2	17.5-13.4
<b>Metal products industry:</b>			
Boring and turning mills.....	12-17	8.3-5.8	17.5-12.7
Radial drills.....	12	8.3	17.5
Wire drawing machines.....	12-13	8.3-7.6	17.5-16.2
<b>Textile industry:</b>			
Cording machines.....	11-13	9.0-7.6	18.9-16.2
Combers.....	13	7.6	16.2
Spinning frames.....	10-18	10.0-5.5	20.6-12.0
Dyeing machines.....	5-11	20.0-9.0	36.9-18.9
Looms.....	13-15	7.6-6.6	16.2-14.2
Knitting machines.....	13-17	7.6-5.8	16.2-12.7
<b>Industrial buildings:</b>			
Wooden buildings.....	8-20	12.5-5.0	25.0-10.9
Others.....	20-55	5.0-1.9	10.9-4.1

**Types of buildings or equipment not subject to depreciation**

None.

**Accelerated depreciation**

Specified new equipment in major heavy and technical, mining, and refining industries, agricultural cooperatives, and experimental and research equipment is subject to a 33½ percent first-year depreciation allowance. This first-year allowance is in addition to the depreciation otherwise allowable in the first year on the equipment. The effect is to shorten the overall period of depreciation. The additional first-year depreciation may be claimed only to the extent that regular depreciation plus the first-year allowance does not exceed one-half of the corporation's taxable income prior to depreciation.

The following table shows the depreciation deductions for an asset qualifying for the first-year allowance and costing \$1,000 with a useful life of 10 years under both the straight-line and declining-balance depreciation.

	Depreciation	
	Straightline	Declining balance
1 year:		
1st-year allowance (33¼ percent of \$1,000, less \$100 salvage).....	\$300	\$300
Regular allowance.....	90	206
Subtotal.....	390	506
2 years.....	90	102
3 years.....	90	81
4 years.....	90	64
5 years.....	90	51
6 years.....	90	40
7 years.....	80	32
8 years.....		24
9 years.....		
10 years.....		
Total.....	900	900

New houses which are built for rental and put into use between April 1, 1957, and March 31, 1962, may be depreciated at double the regular rate for the first 5 years.

#### *Incentive allowances*

None.

#### *Adjustments for price level changes*

The taxpayer is allowed to make adjustments in the depreciation base by applying a special price level index prepared by the Bank of Japan. This index is revised when there are significant changes in the price level. The most recent revisions occurred in 1950 and 1953.

#### *Treatment of gains on sale of depreciable property*

Gains realized from the sale of depreciable assets are taxed at ordinary rates under the corporation income tax.

#### *Treatment of losses on sale of depreciable property*

Losses sustained on the sale of depreciable property are deductible in determining ordinary income.

#### *Relationship of book and tax depreciation*

Depreciation must have been recorded on the books in order to be deductible for tax purposes.

#### *Provisions of prior law*

Prior to April 1, 1961, several provisions for accelerated depreciation were in effect. Depreciation at 150 percent of the normal rate was allowed for each of the first 3 years on machinery and equipment designated by the Minister of Finance as necessary for the development of the Japanese economy or for the modernization of cooperative business activities. Depreciation of 50 percent was allowed in the first year on machinery and equipment designated by the Minister of Finance as necessary for the modernization of important industries or for use in developing new manufacturing processes. Fifty percent of the cost of machinery and equipment approved by the Minister of Finance for use in experimentation and research could be deducted in the first year, and 20 percent could be deducted in each of the second and third years. In general, these provisions were consolidated into one system of 33¼ percent first-year depreciation allowances as of April 1, 1961.

## NETHERLANDS

*Corporate tax rate*

For an annual taxable profit under f40,000 the tax rate is 44 percent. For f40,000 to f50,000 the rate is 44 percent plus a 15 percent surtax on the amount over f40,000. Any taxable profit above f50,000 has a 47 percent tax rate applied to it. The above rates will be replaced once the Dutch Government issues a decree implementing a law passed by Parliament which reverts rates back to the previous 40 and 43 percent, respectively. In addition the new law provides that the tax rate on distributed profits shall be 15 percentage points under the rate for undistributed profits. The decree has not as yet been issued.

*Method of computing depreciation*

Taxpayers may use either a straight-line or diminishing-balance method of depreciation. There is no restriction on the method used according to the type of asset acquired. Low value items forming a customary part of initial or production expenses may be written off at the entire cost in the year of acquisition under the "de minimis rule."

*Rates of depreciation*

The basis for depreciation is historical cost not replacement value. Depreciation rates are determined through negotiations between tax authorities and taxpayer. Where useful life of the asset is shorter than the physical life, because, for example, of technological obsolescence, the taxpayer may use this in determining depreciation rates. Salvage value is taken into consideration, the taxpayer is only allowed to depreciate the difference between historical cost of the asset and its salvage value. Rates under either the straight-line or declining-balance method must result in depreciation to salvage value at the end of the useful life of the asset. Conventional rates are stated to be 10 percent for machinery and 1½ to 3 percent for buildings per year. The general formula for the declining-balance method is:

$$d = \left( 1 - n \sqrt[n]{\frac{s}{c}} \right)$$

with  $d$  = annual depreciation rate  
 $s$  = salvage value  
 $n$  = life of asset in years  
 $c$  = historical cost

*Incentive allowance*

A special investment allowance is given which allows individual or corporate taxpayers to deduct a percentage of new investment from taxable profits. The allowance has no connection whatsoever with depreciation. Eligible investment can be acquisition of new or used assets or improvement of already owned assets, but the amount of investment must exceed 3,000 florins (approximately \$800) during the tax year concerned. Investment must be in business assets to qualify for the allowance, land and residential property being ineligible. For such assets for which orders were placed after April 29, 1960, the allowance is 5 percent of cost in each of the first 2 years. In effect, this means that 110 percent cost can be recovered by the investor. If the assets are sold within 10 years, the taxpayer must add back to income in the 2 years following disposition the amount of the allowance.

*Adjustments for price level changes*

The taxpayer may not make adjustment in the amount of depreciation on the basis of price fluctuations. However, if substantial changes occur in the salvage value of the assets, appropriate adjustment may be allowed by the authorities.

*Treatment of gains on sale of depreciable property*

All gains from the sale of assets are treated as ordinary income.

*Treatment of losses on sale of depreciable property*

Losses resulting from sales of assets may be deducted from profits.

*Relationship of book and tax depreciation*

Fiscal treatment of depreciation is independent of treatment in books of account.

*Provisions of prior law*

When the loss of Indonesia forced the Netherlands to emphasize increased industrialization of the homeland, substantial initial allowances for depreciation of plant were granted. Accelerated depreciation was first introduced for assets ordered after December 31, 1949. The period over which the one-third of the cost could be depreciated has been changed frequently. For example, in 1950 and 1951, all of the one-third of the cost of buildings could be written off in 1 year. For buildings, other than new factory buildings, the period was extended to 3½ years in 1953. This same period became effective for new factory buildings after November 1, 1955. For 1959 the period for new factory buildings was changed to 2 years. Similarly, different rates have been in effect for automobiles, office furniture and fixtures, intangible assets, and other machinery. A more specific summary of some of the provisions making different accelerated depreciation methods permissible is as follows:

- (A) The total permissible amount may be written off at once.  
 (B) The annual amount is limited to 10 percent of cost.  
 (C) In 1952 for certain assets accelerated depreciation was limited to 10 percent of cost; after that year the limitation was withdrawn.  
 (D) In the first year the amount is limited to 16⅓ percent of cost.

These possibilities may be applied to various classes of assets as follows:

Class of assets	Period in which ordered or acquired †	Possibility
<b>Buildings:</b>		
All buildings.....	1950-51.....	A.
New factory buildings extending production capacity....	1952 to Oct. 31, 1955.....	A.
	Nov. 1, 1955 to 1958.....	B.
New factory buildings.....	1959 to Apr. 29, 1960.....	D.
Other buildings.....	1952 to Apr. 29, 1960.....	B.
<b>Automobiles:</b>		
All automobiles.....	1950-51.....	A.
All automobiles operated by a transport enterprise.....	1952 to Oct. 31, 1955.....	A.
	Nov. 1, 1955 to 1958.....	B.
	1959 to Apr. 29, 1960.....	D.
<b>Automobiles not operated by a transport enterprise:</b>		
Passenger cars.....	1952 to Apr. 29, 1960.....	B.
Lorries, vans, etc.....	1952-58.....	B.
	1959 to Apr. 29, 1960.....	D.
<b>Office furniture and fixtures.....</b>	1950-51.....	A.
	1952 to Apr. 29, 1960.....	A.
<b>Intangibles.....</b>	1950-51.....	A.
	1952.....	C.
	1953 to Oct. 31, 1955.....	A.
	Nov. 1, 1955 to 1958.....	B.
	1959 to Apr. 29, 1960.....	D.
<b>Other assets.....</b>	1950 to Oct. 31, 1955.....	A.
	Nov. 1, 1955 to 1958.....	B.
	1959 to Apr. 29, 1960.....	D.
<b>Other assets ordered in 1950-52 and not paid for at Dec. 31, 1952.....</b>		O.

† Possibility D is applicable only if the asset is ordered and acquired after Jan. 1, 1959. For an asset ordered in 1958 and acquired in 1959 possibility B remains applicable.

The special incentive allowance on investment was introduced in 1953 and several changes have been made in the rates and time of deducting the allowance. The following table summarizes these changes:

Period in which commitments were entered into or self-made assets were manufactured	Investment deduction		Disinvestment additions when sold within 10 years †	
	Number of years	Percentage per annum	Number of years	Percentage per annum
Apr. 1, 1953, to Nov. 5, 1956.....	5	4	15	14
Nov. 6, 1956, to May 20, 1958 (except for certain ships and aircraft (see below)).....				
May 21, 1958, to Dec. 31, 1958 (except for certain ships and aircraft (see below)).....	4	4	4	4
Calendar year 1959. Only for ships and aircraft to be used mainly for international traffic.....	5	4	5	4
As from 1959 to Apr. 29, 1960.....	2	8	2	8

† No addition when sold in the period Nov. 6, 1956, to Dec. 31, 1958.

The rate per year has no specified limitation, but the taxpayer must remain within the limits of good commercial practices. The Netherlands allows depreciation to begin when the asset is "contracted for." To stop abuse through excessively long production delays a bill is now pending before Parliament which would restrict depreciation to the portion of the asset already paid for.

*Types of buildings or equipment not subject to depreciation*

None.

*Accelerated depreciation*

Due to a labor shortage assets purchased after April 20, 1960, can now only have one-third of their total cost written off by accelerated depreciation at a lower rate and over a longer time than previously. Under this new formula,  $8\frac{1}{3}$  percent of investment per year in machinery and equipment may be written off the first 4 years, and 6 percent for the first  $5\frac{1}{2}$  years of buildings, that is, the total accelerated depreciation,  $33\frac{1}{3}$  percent of cost, is taken at 6 percent per year for 5 years, leaving  $3\frac{1}{3}$  percent for the sixth year. The final two-thirds cost may be written off over the entire life of the asset in the regular manner. An exception is the 16 $\frac{2}{3}$  percent per year accelerated writeoff allowed for investments by shipping and air transport companies engaged in international traffic. The accelerated provisions are not now applicable to office equipment and motor cars not used primarily for commercial road transport. The accelerated depreciation in respect of an asset need not be applied in the first year in which this is permitted, but if it is applied in a subsequent year the normal depreciation previously applied must be taken into account. Accelerated depreciation applies to used as well as to new property in the Netherlands.

SWEDEN

*Corporate tax rate*

The national corporate tax rate is 40 percent.

*Method of computing depreciation*

Two alternative methods of computing depreciation on machinery and equipment are available. The "book depreciation" method, used by most taxpayers, permits the deduction of whatever depreciation the taxpayer chooses to take on its books, provided the deduction does not exceed the higher of two alternative limitations. One of the alternative limitations is the amount computed by applying a 30-percent rate under the declining-balance method for all machinery and equipment. The other alternative limitation is the amount necessary to reduce the book value of all machinery and equipment to a figure equal to (1) its total acquisition cost reduced by (2) depreciation at the rate of 20 percent, on a straight-line basis, since acquisition. In effect, the taxpayer may write off the entire cost of machinery and equipment in 5 years. The "planned depreciation" method allows taxpayers to write off the cost of machinery and equipment, on the straight-line method, over the estimated useful life.

Equipment having a useful life of 3 years or less may be written off in full in the year of acquisition.

Buildings must be depreciated on the straight-line method over the estimated useful life.

*Rates of depreciation*

Under the "book depreciation" method described above machinery and equipment may be depreciated at any rate desired by the taxpayer, subject to the limitation. Effectively, this method allows the writeoff of machinery and equipment over a 5-year period.

Rates of depreciation for buildings are, generally, between  $1\frac{1}{2}$  and 3 percent under the straight-line method.

*Types of buildings or equipment not subject to depreciation*

None.

*Accelerated depreciation*

Except for the acceleration provided by the "book depreciation" method of depreciation for machinery and equipment, no special accelerated depreciation allowances are in effect.

*Incentive allowances*

No direct incentive allowances are made. However, the operation of the investment reserves for economic stabilization may, in effect, permit the taxpayer either accelerated depreciation or an incentive allowance. Corporations are permitted to set aside up to 40 percent of their pretax business income as an investment reserve for economic stabilization. Amounts allocated to the investment reserve are deductible for tax purposes. Forty-six percent of the amount so allocated must be deposited with the Bank of Sweden, the other 54 percent remaining as part of the working capital of the corporation. The control of the use of the reserve is vested in the Labor Market Board. The Board may authorize a corporation to use all or part of its investment reserve whenever the economic and employment situation so warrants. Under the law, the Board may even direct a corporation to use all or part of its investment reserve. The purposes for which the reserve may be used include the construction of buildings, the acquisition of new machinery and equipment, the purchase of inventory, and the development of mineral deposits.

When an investment reserve is used with the permission of the governmental agency, the amount so used is not restored to taxable income. However, the basis of assets acquired by use of the reserve must be reduced correspondingly. A corporation using an investment reserve with the permission of the Labor Market Board receives a special additional "investment deduction" of 10 percent of the amount of the reserve so used. If a reserve is used without permission of the Board, the amount of the reserve plus a penalty of 10 percent must be added to taxable income. However, after 5 years, the corporation may withdraw up to 30 percent of the reserve without Government permission without incurring the 10-percent penalty.

*Adjustments for price-level changes*

None.

*Treatment of gains on sale of depreciable property*

Gains on the sale of machinery and equipment are not taxable as such under the "book depreciation" method. However, any proceeds of sale reduce the basis for depreciation of other machinery and equipment. However, gains on the sale of buildings are considered capital gains. Capital gains are taxed on a sliding scale so that no tax is levied if the buildings have been held 10 years or more.

*Treatment of losses on sale of depreciable property*

Losses on the sale of machinery and equipment are not deductible as such on the "book depreciation" method. The proceeds of sale are credited to the basis of the entire stock of machinery and equipment and thus, any loss is deductible in the form of future depreciation allowances. Losses on the sale of buildings are considered capital losses which are deductible only to the extent of capital gains.

*Relationship of book and tax depreciation*

Depreciation on machinery and equipment under the "book depreciation" method must be recorded in the books of account in order to be deductible for tax purposes. Other depreciation may be deducted even though it is not recorded on the books.

*Provisions of prior law*

Beginning in 1938, taxpayers were allowed, under the "book depreciation" method to write off the cost of machinery and equipment in the year of acquisition or to depreciate the cost in any manner chosen by the taxpayer. The present limitations on the amount which may be written off in any one year became effective in 1956.

A temporary tax on certain capital expenditures, the investment tax, was in effect in 1952 and 1953, lifted for 1954, and in effect again in 1955, 1956, and 1957. The tax applied to the total of the taxpayer's taxable investment in excess of an annual exemption. The rate was 12 percent for 1957, but since the tax was deductible for ordinary income tax purposes, the effective rate was somewhat lower. This tax was levied as an anti-inflation measure.

## UNITED KINGDOM

*Corporate tax rate*

The maximum corporate tax rate is 53¾ percent.

*Method of computing depreciation*

Depreciation of plant and machinery may be computed under either the declining-balance or the straight-line method. The declining-balance method is most commonly used. Industrial buildings and structures are required to be depreciated on the straight-line method.

*Rates of depreciation*

The rates of depreciation for machinery and equipment are determined by the Commissioners of Inland Revenue and a list of basic rates is published. However, the taxpayer may apply for an increase in these rates. The basic rate under the straight-line method assumes a residual salvage value of 10 percent. Therefore, the formula for the straightline rate is

$$0.9$$

anticipated normal working life

The formula for the declining balance rate is

$$1 - n \sqrt{0.10}$$

where  $n$  = anticipated normal working life. The basic rates as determined above are multiplied by 5/4 to obtain the rate actually used in computing the depreciation deduction. The rates of depreciation for certain machinery and equipment are as follows:

[In percent]

	Rate	
	Declining-balance	Straight-line
Iron and steel manufacturing machinery and plant.....	9	3.75
Manufacture of motor vehicles:		
High-speed precision plant.....	15	6.6
Steam engines, boilers, and shafting.....	6	2.5
Other manufacturing machinery.....	9	3.75
Cotton spinning and manufacture:		
Motive-power machinery.....	6	2.5
Process machinery.....	9	3.75

Industrial buildings and structures which are new in the hands of the taxpayer are subject to a 2-percent straight-line rate. Buildings which are used when acquired by the taxpayer are depreciated on a straight-line rate determined by the following formula:

$$1$$

50—number of years since construction of building

In no case may depreciation be claimed for any period more than 50 years after the date of construction of a building. Also, in general, a purchaser of a used building may not depreciate any portion of his cost which is in excess of the original construction cost of the building.

*Types of buildings or equipment not subject to depreciation*

Depreciation is not permitted on structures used as dwellings, retail shops, showrooms, hotels, and offices.

*Accelerated depreciation*

Besides the acceleration provided by the use of the declining-balance method for plant and machinery, a system of first-year allowances is in effect. These initial allowances are in addition to the regular depreciation allowed in the first year. However, the initial allowances reduce the basis of the asset for

purposes of the computation of subsequent years' depreciation under the declining-balance method. The current rates of initial allowance are:

	Percent
New assets:	
Industrial buildings and structures.....	5
Mining works.....	20
Automobiles.....	30
Agricultural buildings.....	0
Scientific research assets.....	0
Ships.....	0
Other plant and machinery.....	10
Used assets, including ships and cars.....	30

Assets used for scientific research may be depreciated 60 percent in the first year and then 10 percent for 4 years. Agricultural and forestry buildings may be depreciated at a 10 percent rate for 10 years.

#### Incentive allowances

An "investment" allowance is permitted on the acquisition of many types of new depreciable property. At the present time, both the allowance and the additional first-year depreciation may be claimed on the same property. Rates of allowances are:

	Percent
Industrial buildings and structures.....	10
Agricultural works.....	10
Mining works.....	20
Scientific research assets.....	20
Ships.....	40
Cars.....	0
Other plant and machinery.....	20

The following table gives the deductions allowable with respect to a \$1,000 new asset, having a 10-year life and qualifying for a 10-percent first-year depreciation and a 20-percent incentive allowance. The regular rate of depreciation for such an asset is 25 percent under the declining-balance method and 11 percent under the straight-line method.

	Declining- balance method	Straight-line method
<b>1 year:</b>		
Regular depreciation.....	\$250	\$110
1st-year depreciation.....	100	100
Investment allowance.....	200	200
Subtotal.....	550	410
2 years.....	163	110
3 years.....	122	110
4 years.....	91	110
5 years.....	68	110
6 years.....	52	110
7 years.....	38	110
8 years.....	29	110
9 years.....	22	20
10 years.....	165	0
Total.....	1,200	1,200

<sup>1</sup> Remaining undepreciated cost of asset.

#### Adjustments for price level changes

None.

#### Treatment of gains on sale of depreciable property

Gains on the sale of depreciable property are taxable as ordinary income to the extent of depreciation previously allowed with respect to the property. Any gain in excess of this amount is nontaxable as a capital gain. A taxpayer may elect, in the case of plant or machinery, instead of paying the tax on the gain to reduce correspondingly the basis of the replacement property for purposes of computing the initial depreciation and regular depreciation. However, the election does not decrease the investment allowance on the new asset.

*Treatment of losses on sale of depreciable property*

Losses on the sale of depreciable property are allowable as deductions in computing ordinary income.

*Relationship of book and tax depreciation*

Depreciation need not be recorded in the books of account to be deductible for tax purposes.

*Provisions of prior law*

The system of first-year allowances was introduced in 1946. The rates of allowances have been changed frequently since that time, the present rates being effective for expenditures made after April 7, 1959. Some of the general rates that have been in effect are as follows:

[In percent]

	Machinery and equipment	Industrial buildings
Apr. 6, 1946, to Apr. 5, 1949.....	20	10
Apr. 6, 1949, to Apr. 5, 1952.....	40	10
Apr. 6, 1952, to Apr. 14, 1953.....	0	0
Apr. 15, 1953, to Apr. 14, 1958.....	20	10
Apr. 15, 1958, to Apr. 7, 1959.....	30	15

Investment allowances were first introduced in 1954, and several changes in rates have been made. Up until April 7, 1959, taxpayers could not claim both an investment allowance and first-year depreciation on the same assets. However, for assets acquired after that, both allowances may be claimed. Prior general rates of investment allowances have been:

[In percent]

	Machinery and equipment	Industrial buildings
Apr. 6, 1954, to Feb. 17, 1956.....	20	20
Feb. 18, 1956, to Apr. 7, 1959.....	0	0

Senator PROXMIRE. We would like to know in detail, because I have in my hand, here, the hearings before the Finance Committee and the statement of the Honorable Douglas Dillon, Secretary of the Treasury, and on page 82 this chart is put in. It is just put in on the same basis, with no indication of the sources or techniques of deriving the figures.

And I do think that this is a somewhat telling point. I still feel that the investment credit as a method of increasing business investment by increasing cash earnings is redundant. McGraw-Hill came up and told us on the basis of their very careful survey—that the increase in investment resulting from the investment credit would be something like \$300 million, and with a \$1 billion loss of revenue on the part of the Treasury, it seems to me this would be a mighty expensive stimulation.

Furthermore, the Wall Street Journal's survey—also a competent and fair group of people—indicated that after inquiries of 68 of the leading corporations of our country, 67 of them said they would not change their investment plans because this investment credit opportunity was available. Of course many of them said they would welcome the windfall.

And I presume, like any tax advantage, it will not have much trouble now getting through Congress, although I will stand shoulder to shoulder with Harry Byrd on opposing it.

But it seems to me that this is a special privilege which is awfully hard to justify, has already been expanded, as I understand it, to furniture in motels, can be expanded indefinitely, and could become almost as much of a nightmare as the depletion allowances.

Secretary DILLON. I would like to comment on a couple of things.

First, on the question of cash flow. This is not the primary reason for the investment credit, as I said, I think, when you happened to be out of the room.

There is, I think, generally speaking, or there has been, adequate cash flow, although it has not been adequate for certain specific industries, and I mentioned the steel industry as one possible example. But for industry as a whole, I do not think cash flow is the problem.

It is the question of profitability. And certainly this investment credit is designed primarily to increase profitability and to increase the speed at which one's investment is returned, and in that way, it makes an incentive to invest.

I would like also to comment upon what you mentioned, the McGraw-Hill survey, and the Wall Street Journal article.

You reported them correctly in the sense that this is what they reported for immediate investment plans. And I think it is very likely that their reports are correct, because companies make their investment plans rather far in the future, certainly a year to 18 months in the future, and I think there is no doubt that when they were asked: "Would you change your plans in 1962?"—which was the way the Wall Street Journal's questions, I remember, went—the answer was "No, because our plans are already too far advanced."

That does not mean there will not be very substantial changes in future years, when they have time to sit down and plan out the future of what they will do.

Certainly the credit has been strongly supported by many industries, with specific statements that it would increase their actual investment in plant and equipment.

I saw recently what I think is a very eloquent appeal, which was on the back of the third quarter earnings statement of a very large machine tool outfit in Milwaukee by the name of Kearney & Trecker.

Senator PROXMIRE. It would not surprise me at all.

Secretary DILLON. And they were very strongly for this.

Senator PROXMIRE. It is a fine firm.

Secretary DILLON. They hope that this will give more jobs to their employees by enabling them to sell a lot more machine tools.

Senator PROXMIRE. Thank you, Mr. Secretary.

I have got to run to the floor.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I want to come back to some more discussion of debt management. And I am happy that we are getting on the record some of these problems, because to me one of the most disturbing things has been that the people who have advocated deficit financing have done so without apparently any regard for the fact that the problems of debt management impinge upon monetary problems.

And they impinge on economic growth problems and problems of employment. And neither before Ways and Means, I again emphasize, nor before this committee, were the witnesses prepared in their prepared text to discuss the problems of debt management and which of those problems are aggravated when in a period of the debt, as we have it today, and deficit financing already, you add another item on to it.

And so we have discussed it to some extent; all too briefly, I might say. We have just touched some high spots.

Now, one way that these theorists have dismissed the problem of the debt has been to say that it is, after all, only 60 percent of the gross national product, when in 1945 it was 120 percent. To me, that is a very shabby way of dismissing a serious problem, and it does not dismiss it.

I want to put in the record for you, Mr. Secretary, what I had the staff prepare, going back to 1910, and just picking out quick dates as to the gross national product and the debt and the percentage.

And I might say this is in current dollars, as it should be, because it is relating things at the same time. I think it is important for the people of the country to become a little more educated on the difference between current dollars and constant dollars.

I might add that is something I wish the President would become informed on. In his speech the other night, he used current dollars when he should have been using constant dollars, in relating how well we had done in coming out of this recession.

The chart—and I will turn it over to the reporter—shows that in 1910 the debt in relation to GNP was 3.1 percent. I have the actual figures for GNP and debt, but I will not read them.

In 1920—and this was the result of World War I, obviously—it went up to 26.4 percent. In 1929, very properly, it had reduced to some 16.2 percent. In 1930, 17.8 percent. In 1940, as a result largely of deficit financing in the depression years, 43.6 percent.

And then in 1946, with World War II, 127.9 percent. In 1950 it declined to 90.4, and in 1960 to 56.9, in 1961 to 55.7, and with the second quarter annual rate of 1962, to 54.

(The material referred to follows:)

Year:	GNP (in billions of constant dollars)	Public debt (billions of dollars)	Percent
1910.....	33.7	1.1	3.1
1920.....	91.9	24.3	26.4
1929.....	104.4	16.9	16.2
1930.....	91.1	16.2	17.8
1940.....	100.6	43.9	43.6
1946.....	219.7	269.4	127.9
1950.....	284.6	257.4	90.4
1960.....	503.4	286.3	56.9
1961.....	518.7	289.0	55.7
1962.....	552.0	295.2	54.0

<sup>1</sup> 2d quarter at annual rate.

Representative CURTIS. Now, of course, we hope that our debt, in relation to our GNP, in peacetime, is considerably lower than during a war or right after the war. We would need some leeway, I would suggest, if we were to have a war.

Now, the point that I want to stress, and then I would appreciate any comments you would like to make, now, Mr. Secretary, or later for the record: The debt is a constant item, of course, while GNP is more of an economic flow item. I think it is even more important to relate the carrying charges, particularly in debt management, the interest upon the public debt as a percent of gross national product.

And if my figures are correct, the percentage of GNP of the interest on the public debt was just about the same in 1961 as it was in 1945. In other words, while the percentage of debt to GNP has gone down since World War II, the burden of carrying the debt, which takes about 10 cents out of every tax dollar, has not come down, and may even have gone up slightly.

Now, I think this is an area where we need further study. But it certainly bears on these problems of debt management which have been so cavalierly dismissed by students who were asked to present these problems and their solutions and their ideas on them to the two congressional committees.

Secretary DILLON. I would like to say just two things in this regard.

First, I think that from the figures which you have presented, the record of reducing the percentage of the debt to gross national product after the Second World War has been a good one, because, based on your figures during the 1920's, the debt was reduced about 40 percent, from 26 percent of the gross national product in 1920 to 16 percent in 1929; which you said was very proper and good, whereas it was reduced after the war from approximately 128 percent to 54 percent, which is approximately a 60-percent reduction, anyway a much greater reduction.

I am not satisfied with the 54-percent figure as a permanent figure. I think it ought to keep on going down.

Representative CURTIS. I am very happy it has gone down, and I share your belief that it should go down more.

We really have had practically no discussion on this problem. I remember when this committee held hearings on the report of the Commission on Money and Credit, I tried to pose some questions in regard to this problem of the debt in this way.

I said, "Isn't it theory today, accepted by most people, that we should have some debt?"

There are some people who keep saying that there should not be any. Our monetary policies are largely based on the fact that we have a certain amount of short-term indebtedness that has become the base of the operating monetary system.

Secretary DILLON. The other thing I wish to say in answer to your question is regarding carrying charges on the public debt, interest payments on the public debt as a percent of gross national product, which is important in a way.

It is one of the large transfer payments in public accounts, where we get the money by taxation and then pay it out again to the holders of the public debt.

At the end of the war, the interest as a percentage of gross national product was about 2.4 percent. That compared with 1.3 percent at the end of the First World War, 1919, and 1.1 percent in 1939. So there has been quite an increase, there.

That figure declined rather steadily and sharply until 1951, when it reached 1.7 percent. And it is quite true that since 1951 this has held about level. It has wobbled up to 1.9, and down to 1.6, and in 1961 it was again 1.7 percent.

What this basically reflects is the fact that debt of the United States was financed during the war at very low interest rates, and when pegs were removed and the long-term debt began to mature and was re-financed at higher rates, carrying charges went up.

The average interest cost of the debt, of course, went up quite substantially. This process is not completely finished yet, because there is still a substantial quantity of 2½-percent bonds issued during war-time outstanding. And as they come due—the last of them do not come due until 1971 or 1972—there will be presumably increases in the cost of carrying the debt.

But a great deal of this has been done, now, and I would assume that there would from now on be a decrease in interest as a percent of GNP, more in accordance with the decrease of the total debt compared to GNP. That has been the case in the last couple of years—1961 was better than 1960.

Representative CURTIS. I want to thank the Secretary.

My time has run out again. And I will leave the record open in case you want to make any further comments.

I will ask the chairman of the committee and the committee to consider whether we might not make a study into the debt management problem and how it does affect our economy.

I think it is quite clear that the marketplace is the discipline in debt management, and you just cannot come in here and say you can have more deficits.

I see it in the Ways and Means Committee. They are just saying to us, "Cut taxes." And then you figure out how you are going to sell the bonds.

I think we have to follow this through to see what the full economic impact is, in shifting from one way of Government financing to another, and the mix between the public and the private sector. The reason I am deeply disturbed about deficit financing is that at this time, with a balance-of-payments situation, I think we are asking for trouble to go further along this line of deficit financing.

And it is not because I have any shibboleth about it, or have any fixed cliches in my mind, as some people suggest.

Chairman PATMAN. Senator Pell?

Senator PELL. Thank you, Mr. Chairman.

Mr. Secretary, I apologize for our activity, but there have been a series of rollcall votes.

What do you estimate will be the amount lost to the Federal Government as a result of nonreporting of interest and dividends in calendar 1963?

Secretary DILLON. I think our figure that we submitted to the Finance Committee was about a billion dollars.

Senator PELL. About a billion. And do you have any estimate—I realize this is a very subjective impression—any estimate or thought as to how much, what percentage of that is avoidance, and what portion of it is evasion? Or—excuse me—what portion of it is willful and what portion of it is accidental?

Secretary DILLON. I think the two were somewhat intertwined.

I would hope there are not too many people that deliberately set out to say, "We will not report something that we know we should report." But it is often somewhat complex if you have a savings account under the present circumstances, and the interest you get is not reported to you unless you make a trip down to the bank and ask them what it is, and the individual may be busy and undoubtedly is, and does not do that, and he gets around to making out his tax returns, and it just never occurs to him. And he may very well know that he is supposed to, but he does not really think about it, thinks it is not very much, and so it is not done.

Under the provisions that have been provided by the Senate Finance Committee—which will impose a requirement on banks or savings institutions and corporations that pay interest or dividends to report to their stockholders and to their depositors as well as to the Government what these payments are—we would figure that there would be some improvement. It is hard to tell how much.

Our estimate in the committee bill and the committee report is that we would pick up, I think, \$240 million, maybe about a quarter of what we thought had been evaded. But any such estimate has to be rather a guess, and I do not think we can back it up. But that is the estimate of the Internal Revenue Service.

Senator PELL. Would you think it would be an incorrect statement to say that the majority of the people who do not report their income realize the fact?

Secretary DILLON. I would think they do now. With all this publicity, I cannot but believe that the majority of people now who do not report their interest income realize that they need to report it. That does not necessarily mean that they think of it at the time they are making out their return.

Senator PELL. They have a little mental block?

Secretary DILLON. That is right. But in general this is usually relatively small amounts of total income. A man has a job, and he also has a savings account. He reports through wage withholding, and he reports on his income tax, his income from his job. If he has a little savings account in the bank somewhere, or his wife has it, the interest is just a small amount.

Senator PELL. To put it in very simple terms, it would not be incorrect, then, to say that the Federal Government is being cheated out of better than half a billion dollars a year?

Secretary DILLON. It is certainly losing better than that.

Senator PELL. I like the word "cheat," because I think that brings it home. "Evade" and "avoid" are both simply five-letter words.

Secretary DILLON. I do not think people would like to be characterized in that way, and if they felt they were, they probably would not do it. So I think you are right, maybe, in using those words.

Senator PELL. Do you see any likelihood as we press forward in this project—I hope the administration does—that you will use the word “cheat” instead of “evade”?

Secretary DILLON. Well, we will be glad to think about your advice.

If you think that works well, maybe we should. But we are generally rather circumspect in the words we use as a Government toward many citizens that make up our country and pay taxes.

And certainly if you falsely accuse one person of cheating, I think it might be worse than if you properly accused five.

Senator PELL. I think, as we have said, that they are both five-letter words, but “evade” has a different connotation to many people than “cheat.”

On the question of depreciation and investment credit, have you given any thought at all to depreciation at will, as a method of simplifying the structure and hence not necessitating investment credit?

Secretary DILLON. What we have done in our new depreciation reform is to allow, in effect, any company to depreciate at will, provided they actually replace their machinery and equipment at that same rate.

If their record has been good in the past, they can start depreciating immediately at the faster rate they intend to use. We do not wait for 10 years to see that they have actually replaced their equipment. So we have gone a very long way in that regard.

Now, to go further, and to subsidize the replacement of machinery by allowing depreciation at a faster rate than the machinery is actually replaced—that is just a different form of subsidy for modernization. Some few countries—I think Sweden is one—do use that as the method.

We have calculated that if you use that method, it would be far more costly to the Government, to the Internal Revenue Service, than the investment credit, which we have chosen as the form of stimulation which is the least costly to the Government, and also has certain other specific advantages.

The way it has been drawn, it is especially favorable to small business; and as a result of that it has the wholehearted support of the National Small Business Association and small business throughout the country.

While we believe in generous stimulation of investment, we have wanted to do what we could to help small business, and it is very definitely helped by this bill.

Senator PELL. But the thought of depreciation at will would mean to my mind that a plant could, if it wanted, depreciate to 100 percent but not replace the machinery until some date in the future. It would mean very little policing. I was wondering if thought had been given to this approach.

Secretary DILLON. Yes. As I say, that is a form of subsidy, and no country I think goes that far. Sweden goes the nearest. I think they allow you to depreciate in 5 years, which is the fastest of any country. But they recognize that this is much more rapid than actual machinery would be used. It is the same sort of thing.

But we have given thought to it, and we have run figures on it, and the problem is that not only would it cost more, but we would be in the position of having, at least for the initial 10 years or so, no idea at all what our Federal revenue would be, because we would not know how fast people would want to depreciate.

One year they might go much faster than another, and we would have fluctuations in our corporate tax revenue that would be fantastic in their amount.

Senator PELL. But presumably in a free capitalistic economy, would it not be a fallacious theory to set depreciation rates in order to insure a steady source of revenue for the Government?

Secretary DILLON. Oh, it would if that were the only reason. We feel it should be set, and we have set it, on the basis that we think most accurately represents actual use of machinery by the business. That is what depreciation is. It is the charge that the company sets aside to offset the wear and tear on its machinery.

And we have now said that as your wear and tear occurs, you write it off, any way you decide. You are the judge of how much wear and tear. If you say you want to replace a piece of equipment in 6 years, that is all right, though we may think the equipment normally would last for 12 years.

But we do not go beyond that and say, "You can write off the whole wear and tear in 1 year," when you are going to use it for 6 years.

Senator PELL. I have just one final question to ask, and that is: Bearing in mind, as we all do, I am sure, that we are about the most overtaxed people in the world, I was wondering if the Treasury has any opinion concerning a preferred form of income tax cut.

Secretary DILLON. I think that is one way, one of the most rapid and quick ways, of putting a shot into the economy. I would say I agree with that.

There are two different concepts. There is the concept of the flexible tax reduction, the Commission on Money and Credit idea, of putting a temporary stimulus into the economy, and then there is our basic reform of the tax structure. They are quite different, and I do not think should be confused.

But certainly, from the point of view of quick action, one of the ways that would operate very quickly would be a change in the withholding rate. But if that were not accompanied by a change in the basic tax that was owed, the person who had less withheld would just owe more at the end of the year.

Senator PELL. Thank you very much.

Senator PROXMIRE. I want to apologize if I seemed a little antagonistic a little earlier. Sometimes we bring things out a little better when we do disagree.

I am happy to say there is one part of this presentation on which I find myself in wholehearted agreement, if I interpret you correctly.

You say our balance of payments deficit must be eliminated. But then further on you speak of—

**borrowing that in any event is attracted more by our unrivaled market facilities than by relatively small differences in the total cost of the credit to the borrower.**

Now, I interpret that to mean that in your judgment interest rate differentials are not a very important factor in capital flows. While they are significant and of some importance, they are not nearly of the importance that other factors are.

And this seems to be the position of Assistant Secretary Roosa on the basis of a paper, a very competent paper, which I put in the Congressional Record about a week ago, of Mr. Gemmill of the Federal Reserve Board, of Professor Bell of Haverford College, who has made a very careful analysis of this situation, and argues that the capital outflow and inflow, long term and short term, is not primarily affected by interest rates.

Secretary DILLON. Well, I would like to clarify my position. There are two quite separate points.

Certainly it is my feeling, and I think it is the feeling of Mr. Roosa, based on the paper which I think you put into the Record, that in the long-term area—the borrowing which this notation refers to—the primary reason for such borrowing is the ease of access to markets, the volume of the market, the ready availability of funds in the market.

Interest rates, of course, have some effect there, but their effect I do not think is controlling at all. I think there are some who felt that if our longer term interest rates were somewhat higher, the borrowing from abroad would change. I do not agree with that.

I still think it would continue. And therefore I do not think that the answer to the outflow of capital and the use of our markets by foreign borrowers is deliberately trying to increase long-term interest rates.

However, I do think the short-term rate is a very significant thing, as far as short-term flows are concerned; particularly the short-term flows by American corporations and American investors, who have become aware in recent years that they can sometimes get more return by transferring short-term assets abroad.

Senator PROXMIRE. A very thoroughly documented study by Dr. Bell of Haverford College refutes you on short-term obligations. Do you have any study to support your position?

Secretary DILLON. Well, we have, yes. And we are in the process of making a very thorough study, which has been underway since last spring.

We have a consultant, a Professor Kenen from Columbia University, who has been spending all summer at the Federal Reserve Bank of New York going over all the statistics, and he is now in the process of consulting with various banks and various corporations.

Senator PROXMIRE. The study by the Federal Reserve Economist Committee suggested this was something in the range of \$600 million to \$1 billion of flow of short-term amount, and that even this relatively small amount was swamped by other factors, speculation—

Secretary DILLON. Oh, of course. I would agree as to speculation. If someone thinks there is going to be devaluation of the currency—that sort of thing—the drive to move funds attributable to that motive is much greater than to interest rates.

But in the absence of that, interest rates in the short-term area are highly important. I think this is shown by the fact of the creation

and development over the last 3 or 4 years of the so-called Euro-dollar market. No one knows what the exact figure is, but the general agreement is that there is something upward of \$3 billion, maybe considerably more, of dollar funds that are held in banks abroad, where higher interest rates are available, and these funds are now being continually used by those foreign banks.

And certainly there is also general agreement that, if interest rates here had been higher, there would not be any such Euro-dollar market. And therefore this is a clear indication of the importance of interest rates in the short-term area.

Senator PROXMIRE. Let me say if this is the situation, in other words, for long-term obligations interest rate differentials are not as significant, and for short-term obligations while they are not controlling, they are of some significance, then it would seem to me it was a mistake to abandon Operation Nudge, which, as I understand, was for the purpose of protecting our balance of payments by getting our short-term interest rates high relative to long-term obligations, while the long-term would be relatively low, so that domestic economic expansion could continue.

In spite of that, the fact is that we have got a reversal of that situation, and the adverse discrepancy between the long term and the short term has been accentuated in 1960 and 1961.

We had a chart yesterday which showed very well that the long terms have relatively been rising in relation to short term very sharply. In 1960 they were above the trend line, and in 1961 they were. The statistics are very emphatic.

Secretary DILLON. I did not see the statistics, but I just do not understand them, because the facts are that short-term interest rates have continued to rise. During the course of this year, they have risen further.

And the facts are that since 1961, when we first came into office, there has been a rise of about five-eighths of 1 percent in short-term interest rates. Long-term interest rates generally have not increased at all, and in the case of mortgages they have gone down.

Senator PROXMIRE. Let me just interrupt. Here is a chart that shows the trend, and the relationship between long-term and short-term obligations. (See p. 550.)

Secretary DILLON. Oh, well. You have talked about long-term U.S. Government bonds, which are relatively immaterial.

The long-term rates that are important are the rates for long-term private corporate borrowing, the rates for long-term municipal borrowing, and the mortgage rates. Those are the three vitally important rates to our economy.

The rates of our long-term Government bonds have very little importance to our overall economy.

Senator PROXMIRE. But as I understand it, one of the principal ways the Treasury and the Federal Reserve can influence long-term private rates is through their influence on the long-term Governments.

Secretary DILLON. I do not think that the Federal Reserve can effectively influence long-term money rates, because of the fact that there are outstanding only maybe \$25 billion of long-term Government bonds. Other long-term obligations of States, mortgages, and corporations amount to hundreds of billions of dollars.

Therefore, in the long-term area, the Government bonds are a very small tail on a very big dog; whereas in the short-term market it is totally different.

All outstanding securities in the short-term market, practically, are Treasury securities. In the long-term area it is totally different.

Senator PROXMIER. I have a Federal Reserve chart book here which shows the movement of interest rates, corporate, VA, double A's, triple A's, and State and local government triple A's and Government bonds.

There is almost a precise parallel movement every year, every month, in which one goes down and the others go down. They are very closely interrelated, on the basis of the movement. And while there may not be as precise a causative factor as some people might argue, there is certainly a very close parallel.

You are completely correct in that non-Government bond yields have tended to fall off somewhat in 1962. And I certainly would not contend anything to the contrary.

My argument is that they might have fallen off further, and have been more encouraging to business, in the event of a more expansionary policy both on the part of the Treasury and on the part of the Fed.

Secretary DILLON. One thing that is of some interest, I think, is that the difference in rate—and I think that is probably what is shown there—in the last year between the market quotation of long-term Treasuries and the market quotation of corporate bonds has narrowed very significantly. Over the years, the difference has been in the neighborhood of three-fourths of 1 percent, getting as high as 1 percent at times. As recently as when we first started here, which was in the spring of 1961, it was nine-tenths of 1 percent.

This year it has narrowed down to, in the second quarter of 1962, only four-tenths of 1 percent. There has been a difference, in the closing of that gap, of a whole half of 1 percent. And that closing of the gap has occurred because of the decrease in the interest cost of long-term corporates; which is exactly what we were trying to do to stimulate private demand and help the economy.

The new triple A corporate issues that were brought out in the second quarter of 1961 were brought out at an average yield cost of 4.71. In the second quarter of 1962 they were brought out in average yield cost of 4.30—10 percent less in interest cost, roughly.

At the same time, long-term Treasuries were on a 3.80 basis in the second quarter of 1961, and a 3.90 basis in the second quarter of 1962.

So actually, you can see very clearly there, that while the interest rates on long-term Treasuries actually went up, there was a very substantial decrease in the interest cost for new corporate financing and for new municipal issues, which is exactly what we are aiming at.

Senator PROXMIER. Well, my time is up. I just feel that there must be some relationship, in view of the fact that long-term investors do have something of an option. Clearly there is nothing like a substitute. People who invest in corporates would necessarily consider a long-term Government bond as a good substitute, but it is a kind of a rough substitute, and there is, I would feel, some kind of competitive connection. But I would not stress it too hard.

With the indulgence of the chairman and Congressman Curtis, I would like to ask one more question.

Representative CURTIS. Surely. Go right ahead.

Senator PROXMIER. I know that you and your very fine staff in the Treasury Department are deeply concerned with the very high tax rates we have, as I am, and are anxious to reduce them. And I just feel that the great difficulty in our tax system is that we do have so many exceptions and privileges and deductions and so forth.

And I think you have done a very courageous job and a very helpful job in recommending programs here. That is why I am so deeply concerned about this investment credit, because it seems to me we are opening up an entirely new field of loopholes and while the loss is only \$1 billion this year, it can extend in all kind of ways in the future. And once you get it in, it is impossible to get these tax privileges out.

So that I am just wondering if the Treasury has given this aspect of this new request consideration. It is so important to reduce our rates, and so extraordinarily difficult to do so if we do have special privileges and advantages in tax leaks and losses.

Secretary DILLON. Yes. We have given it a great deal of thought, because it was very clear that we were at a competitive disadvantage here in the United States—our industry—with all the competitors in industrial countries elsewhere, in the matter of new investment machinery and equipment. And we felt that as a national priority for balance-of-payments reasons, among others, we had to put our own people on a level of equality with their foreign competitors. This was particularly true with the progress of the world toward freer trade. That is what we are aiming at with the Treasury bill, which is now before the Congress.

The freer the trade we have, the more we have got to be sure that our own corporations are in a fully competitive situation.

Now, there are various ways in which this could be done, all of which would give some form of extra stimulation or extra incentive to new investment.

One of them is the type of thing Mr. Pell suggested, similar to the 5-year rapid amortization certificates used during the Korean war, which allowed the company to write off its old investment in 5 years even though it kept on using the machinery for a much longer time.

It is our feeling that that sort of stimulation costs more than the investment credit. We figured the investment credit would be more helpful to small business, and that it would in every way meet the twin objectives of putting our business in a position equal to its foreign competitors, and at the same time minimize the drain on Government revenues. That is the reason we chose that particular method to recommend.

In view of your particular interest in interest rates, and the effect of interest costs on new investment in corporations trying to develop, I think you would be interested in, and you may recall, a very interesting bit of testimony on this subject that was given before this committee last February and March, when you had your hearings, by Professor Bernstein, who is certainly one of the greatest monetary authorities in the country.

And he pointed out that the effect of the investment credit—he was then talking about 8 percent, because that is what we were talking about at the time—was equivalent, on the new investment, a 10-year investment, to the difference in interest costs on borrowed money of 2 percent—the difference between 5 percent and 3 percent.

So it is a tremendous stimulus, and in that way is much more effective through a moderate change in interest rates. I just cite that as an indication of the stimulus that will be given by this for a relatively small cost.

Senator PROXMIRE. No. 1, the record shows interest rates are not very restraining on business investment, anyway. They are not a very important factor. But they are extremely important in construction; especially home construction.

And No. 2, the main objection I have to the investment credit is that it permits business to depreciate more than 100 percent. I think this is a very important principle.

I know the Finance Committee modified it. That modification, it seems to me, should be double what it is to provide a complete washout at 100 percent. But I am not satisfied, because I think this principle is so important.

The suggestion by Senator Pell I think is much more attractive to me, simply because that principle has not been violated. And to my knowledge, no other country permits a more than 100 percent depreciation.

Now, I may be wrong about that. What countries do?

Secretary DILLON. I think you are. The investment credit principle is in effect in the United Kingdom, and Belgium, and Holland.

Senator PROXMIRE. They permit a writeoff of more than a hundred percent?

Secretary DILLON. Yes. And it has just been adopted in Australia. I would not be surprised, myself—I know it is under discussion—if it was adopted in Canada soon.

Senator PROXMIRE. I do not mean to question you, because you undoubtedly are authoritative on this, but I do wish you could document that with legal references. We have been trying again and again to pick this up, and we have not been able to do it.

Secretary DILLON. I will be glad to furnish you with this same study we made of depreciation practices, which include those of all of these various countries. It is rather a formidable document, but it will give you what you want, I think.

Senator PROXMIRE. Well, I have a fine staff, but I think the Joint Economic Committee has a formidable staff, and I think they can handle it. (See p. 694.)

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Mr. Secretary, due to the late hour, I will not be able to go into tax reform as I wanted to, but I do want to get a couple of things clarified.

For one, there has been this constant reference to revision in the form of depreciation schedules as a tax cutting, when actually it is not.

Am I not right, Mr. Secretary?

Secretary DILLON. I do not think it is a tax cut. What I said in my statement is that it would reduce tax liabilities in the current year.

Representative CURTIS. Yes, because actually it is a return of capital. The reason we have depreciation schedules and depletion allowances is because the 16th amendment does not permit us to tax capital.

Secretary DILLON. I am very glad you pointed that out, because we have used the word "tax cut."

Representative CURTIS. I believe that liberalized depreciation is especially important when you have inflation. There is an advantage, and there can be an actual tax cut in there, because you can get your money back in 100-cent dollars instead of, 5 years later, in 75-cent dollars. And I have always felt that a great deal of the impetus behind this liberalized depreciation came from our post-World War II experience with inflation.

Now, this is to inform myself. The last I heard the Senate had cut from 100 percent to 93 percent the amount on which the investment credit would apply. Is that true?

Secretary DILLON. A company taking advantage of the present tax credit will then be able to depreciate only 93 percent of the investment. That is correct.

Representative CURTIS. Then there is a little bit of tax cutting there. But most of it, then, is no more than a further liberalization of depreciation; right?

Secretary DILLON. I would say a large part of it; yes. They have greatly reduced the economic impact of it.

Representative CURTIS. Well, and also the theory. I am very pleased with our liberalized depreciation, which relates to what I regard as the economic facts of today. Things become obsolete much sooner than they wear out. And that has been part of our difficulty.

Now, on this matter of inflation, I was very disturbed at the President's remarks Monday night, when he said that during the past 18 months we have had the greatest record of price stability since World War II.

Well, the figures actually reveal that we have had about a 1.5 percent increase, measured by the Consumer Price Index, which we usually use. Compare that with the 3 years, 1947-49, when there was no price increase, and with the years 1954-56, when the increase was only 0.1 percent.

Now, the only reason I bring it in, other than to try to do my best to get the right information to the people, is that I think it is an error to think that we do not have very strong inflationary forces at play in our economy. We must not ignore them, even though I appreciate the arguments being used that inflation is not a danger, because of this so-called underutilization of labor and idle plant capacity.

I was very interested in this Italian banker's testimony. He said that the idle plant capacity, as he saw it, in the United States, was for goods and services for which there was no demand. And I could not agree with that analysis more.

We do have, I think, traditional inflation in certain areas, in, for instance, the health field, where there are too many dollars or excess dollars changing too few goods. We see it coming out in two areas, one in labor demand.

There is a shortage of labor there, a very grave one. And the other is in prices.

The steel industry, I was intrigued to see, is spending heavily for more plant capacity. Not for more obsolete capacity, which they

have, but rather to make thin sheets so that they can compete with plastics.

Secretary DILLON. That is because their other kind of production has been made obsolete to some extent by the plastics' competition.

Representative CURTIS. Exactly. But you do not solve the problem by just putting more money into consumer purchasing power, which is this theory of deficit financing, because you have got that capacity.

I relate it to the agriculture sector, to make it dramatic, where you have got more production than our consumers can handle. Even if we increased consumer purchasing power by billions, it would not move the agricultural surplus.

And we have unemployment in this area, and we have underutilization of our plant, which is the acreage.

So all I am pleading for in this business of figuring out economic growth, is that we lay aside these aggregates that we have been using and get into some component parts so that we can see what the problem is.

And that leads me to this concluding observation. I want to join with Senator Javits in wishing that the administration would think about preparing a message to the Congress on tax reform for 1963.

Now, some of it has been exact, and I appreciate it, in rates. I could not agree with it more. I regard it as a reform. I regard it as permanent. I regard it as being one of the greatest impediments to economic growth. I do not regard that on the theory of the tax "quickie," which is to stimulate the economy.

But there are other areas in our tax structure which I think also are impeding economic growth. I believe it would be important for the President to point them out.

I try to point out areas where I think this is the case. It is true that what is one man's loophole is another man's equity; and that is the issue.

I think there are real loopholes. On the other hand, I think there are some instances where we probably are inequitable, because we do not have an accurate differential.

So I think it would help in the public understanding and debate, and also toward moving forward tax reform in this area, if the President could, before Congress adjourns, pinpoint some areas, at any rate, where he thought that tax reform was needed.

Secretary DILLON. I would like to just say one thing.

I think it might be useful to try to throw a little more light, at least on what I think is involved in these price comparisons of various performance.

What the President clearly had in mind was the comparative price performance, in comparable periods of the business cycle. In other words, the present recovery compared to preceding recoveries.

Obviously, in periods of recession, prices are apt to go down, and it is not very appropriate to compare a period of recovery with one of recession.

But when you do compare the present price action in this recovery with the preceding recoveries of 1958, 1954, and 1949, you can do it in three different ways. There is the action of the gross national product deflator, which is what you use to get constant dollars. There

is the action of wholesale prices. And there is the action of the Consumer Price Index.

In the case of the gross national product deflator, prices had risen, in the five quarters of the present recovery, 1.6 percent. The comparable figures for the recoveries from the recession of 1958 and 1954 and 1949 were 2.1, 1.9, and 8.4 percent. So on that index, certainly this was the best recovery price-wise.

If we take 17 months from the trough in each case, the wholesale price index in this recovery has gone down six-tenths of 1 percent. In April 1958, it had gone up three-eighths of 1 percent, and in August 1954, it had gone up—I mean 17 months from each date—1.3 percent. And then for the recovery beginning in 1949, there was inflation of a greater degree, and it had gone up 19 percent.

In the Consumer Price Index, the result is slightly different. It shows that from February 1961 to June 1962 consumer prices went up 1.3 percent, and in the preceding recoveries it rose 0.9 percent in 1958 and 1959, and in 1954–56 it went down three-tenths of 1 percent; and for the years 1949–51 it went up 8 percent.

So in this consumer area, because of the bigger increases in the service component—as I point out, wholesale prices and the prices of goods during their recovery did have the best performance—there were better performances at other dates.

But in two out of the three indexes, this last 16 or 17 months did turn out to have the best price result in any postwar recovery that we have had so far.

In the Treasury, of course, we are particularly interested—I know you expressed particular interest in the consumer index—in the wholesale price index, because it reflects the cost of our goods which go into export markets. And because of our interest in the balance of payments, we have been very interested in that area, and we have done well there, and I hope we can keep it up.

Representative CURTIS. I appreciate your remarks very much. I would have been reluctant to believe that the President made this up out of whole cloth.

However, the presentation was out of context, without explanation. In context, he was talking about consumer prices, because he was talking to consumers about the cost of living. And then, above all, if what he was doing was comparing the price record of this recovery with other recoveries, which is not the way it was, he certainly owned it to the people to say that this has been the weakest of all recoveries from any of the four post-World War recessions, which, indeed, it has been from almost all the indicators.

Secretary DILLON. That may have something to do with the price action.

Representative CURTIS. I am really glad to hear what the explanation was, because I could not figure out how the President could even make such a statement, in light of the record.

But in relating it to how prices acted in previous recoveries, it is a little bit understandable. But it certainly was misleading. And certainly as it relates to the problem of inflation, which is the one that concerns us, I think it is an error to distract our attention from inflationary forces which are very strong and which are showing up.

I might add that when inflationary forces hit the dam of balance of payments, which is the one thing that is keeping costs down, they are prevented from causing price increases. Instead, it comes out in unemployment.

Chairman PATMAN. All of us may extend our remarks, without objection, in connection with our testimony, and insert any materials or charts or statements that are material or germane.

Thank you very much, Mr. Secretary. You were very nice to give us so much of your time, and we appreciate the information you have given us, sir. It will be helpful to us.

Secretary DILLON. Thank you.

Chairman PATMAN. This afternoon we will have a meeting at 2 o'clock in this room. Mr. Ewan Clague, Commissioner of the Bureau of Labor Statistics, Department of Labor, will be the witness.

The committee will be adjourned until 2 o'clock this afternoon.

(Whereupon, at 1 p.m., the committee was recessed, to reconvene at 2 p.m., the same day.)

#### AFTERNOON SESSION

Representative REUSS (presiding). Good afternoon.

The session of the Joint Economic Committee's inquiry into the economic situation will resume.

This afternoon we are privileged to have with us Mr. Ewan Clague, Commissioner of the Bureau of Labor Statistics of the Department of Labor, accompanied by two members of his staff.

Would you be good enough, Mr. Clague, to identify for the record the lady and gentleman who are with you today?

#### STATEMENT OF EWAN CLAGUE, COMMISSIONER OF LABOR STATISTICS, U.S. DEPARTMENT OF LABOR; ACCOMPANIED BY MISS GERTRUDE BANCROFT, ASSISTANT CHIEF, MANPOWER AND EMPLOYMENT STATISTICS DIVISION; AND ROBERT L. STEIN, CHIEF OF BRANCH OF EMPLOYMENT AND UNEMPLOYMENT ANALYSIS

Mr. CLAGUE. Yes, sir.

This is Miss Gertrude Bancroft, who is the statistician in charge of this work in the Bureau of Labor Statistics, and the other is Mr. Robert Stein, who is her assistant.

Representative REUSS. You are all extremely welcome.

Mr. Clague, would you proceed in your own way, either by reading your statement or summarizing it, or any other way.

Meanwhile, your statement and the accompanying tables, in accordance with our practice, will be admitted for the permanent record.

Mr. CLAGUE. Thank you, Mr. Chairman.

I think, in view of the fact my statement is rather short and precise, I would like to read it, and then I can submit myself to questions.

I am very glad to have this opportunity to discuss with you and members of this committee the behavior of the labor force during the past year and over the long run. The slowdown of labor growth during the past year has been of great interest and concern to all of us who keep track of our economy's performance. It is of particular interest to the members of this committee and others faced with the re-

sponsibility for decisions which might affect economic activity and our manpower situation.

The labor force statistics come from the monthly survey of the population, conducted by the Bureau of the Census for the Bureau of Labor Statistics. This survey is also the source for our monthly figures on the employed, the unemployed, and their characteristics. There has been no change in the operation of this survey since 1956 when the sample was last expanded. There has been no change in the sample areas included, in the methods of interviewing, or in the quality control methods used by the supervisory staff. No revisions in the concepts and definitions of labor force, employment, and unemployment have been made since 1957.

The only new element in the statistics is the introduction into the estimation procedure of population data by age, sex, and color from the 1960 census to replace those from the 1950 census. Each month, the sample results are weighted up to population totals by age, sex, and color moved forward month by month from the latest census. It is a standard procedure to introduce the population controls from the new census as soon as they become available and this was done in April 1962. The change had the effect of reducing employment and the civilian labor force by about 200,000, mainly because the new population data showed more people in the age groups over 65 and a smaller number in the prime working ages. The change had virtually no effect on the level of unemployment or on labor force rates and unemployment rates by age and sex. The revision and its effects were fully described in the monthly report on the labor force for April 1962. In each subsequent month, our statements about year-over-year labor force growth always make allowance for this revision.

It is not possible to revise previous data to take account of this change and it would probably not be desirable anyway, because the overall effect was only about 0.3 percent of the civilian labor force. However, in assessing over-the-year growth—that is, during this past year—this difference of 200,000 must be taken into account.

Of course, even with the best survey techniques in the world, a certain amount of statistical variability is bound to enter into the month-to-month and quarter-to-quarter trends in the labor force. This is partly because the figures are based on samples rather than complete counts. Our sample has been designed in accordance with the best statistical methods available. And sampling is the only way the Government can obtain reasonably accurate, current figures at a moderate cost. Nevertheless, we know that some fluctuation will arise because of sampling and we take account of this in our analyses.

Another source of irregularity in labor force behavior over the short run is very bad weather—storms, hurricanes, et cetera, that cannot be corrected for by seasonal adjustment techniques. This is particularly important in the farm labor force where family members who are prevented from working in a particular week do not seek other jobs and therefore do not appear in the labor force figures for that week. Finally, we face the problem that most of the variation in labor force growth (both over the short and the long run) is caused by the very persons whose labor force status is most difficult to measure—teenagers, married women, older men—because their work is often intermittent or part time.

An example of statistical fluctuation in the labor force series was the change from first quarter of 1960 to first quarter 1961, which was unusually high, but which we know by subsequent analysis to be due to extreme sampling variability. However, this does not affect the data accumulated during the last year—that is, from the summer of 1961 to the present summer of 1962—which do indicate pretty conclusively that there has been a slowdown in labor force growth. For example, if we get only seasonal changes from now until the end of the year, the growth in the labor force between 1961 and 1962 will average out to only 200,000 for the civilian labor force (allowing for the change in estimating procedures) and to 500,000 for the total labor force, including the Armed Forces. For the postwar period as a whole (1947-61), labor force growth has averaged about 900,000 a year. However, the annual growth has been very uneven, ranging from 1½ million in 1956 to only 400,000 in 1957 even though the unemployment rate was about the same in both those years.

This raises the question as to what extent labor force growth is related to changes in the level of general economic activity. My first chart bears on this point.

We have there a comparison of the gross national product charted against the civilian labor force.

It shows the civilian labor force and the gross national product (in constant 1954 dollars), indexed in terms of seasonally adjusted quarterly averages with the first quarter of 1948 as the base period. The chart shows that there is not a very close relationship between the two series during periods of moderate cyclical change.

I want to call your attention to the fact we have used different scales on the two series in order to facilitate the comparison in their up and down movements.

In order to get a better understanding of labor force behavior, it seems to us that it is essential to look at the major segments—adult men, adult women, teenagers (both boys and girls), older persons—since very different forces affect each group. The behavior of the large number of intermittent workers (students, housewives, semiretired persons) is particularly important. There are a great many such persons in the American labor force—for example, in 1960 our peak employment month of July had 68.7 million persons employed but there were over 80 million people who had employment at some time during the year. This suggests a great deal of short-term employment and turnover.

My second chart focuses on the adult men in the prime working ages (20-64) who are overwhelmingly year-round members of the labor force. These are the persons you normally expect to be in the labor force at work or unemployed. On a seasonally adjusted quarterly average basis, their civilian labor force participation rates (which measure people's propensity to work) have remained fairly steady at high levels under a variety of economic conditions. In the last year or so, however, the rate for men 55 to 64 years of age has been edging down slightly, no doubt reflecting in part the recent changes in the social security law lowering the retirement age for men to 62 as well as more retirements under private pension plans.

Chart 3 depicts the trend in labor force rates for women 25 to 64 years of age. Our most important finding to date is that most of

the half million difference between (a) the labor force growth that has actually taken place during the past 12 months, and (b) the increase that might have been expected on the basis of past trends, was among women 25 to 54 years of age. That is, women in the prime working years of life.

In other words, these adult women, who have accounted for such a large part of the expansion in our work force since World War II, have not been entering the labor force during the past year as they had in the former years.

We are not sure that shortage of job opportunities is the full explanation for this development. Over the year, the labor force participation of women 55 to 64 years of age rose sharply, as it has in all recent years; it is not clear why jobs should be available for them, but not for younger women. Moreover, if this slowdown for women 25 to 54 is related to job opportunities, it is not clear why it should have taken place since the summer of 1961, in view of the continued business recovery.

We have done a good deal of work on this problem and will continue to study it carefully. Our present thinking is that it may be partly related to labor supply as well as demand. It is possible that among women 45 to 54 years of age, for example, with one out of every two already in the labor force, we have already tapped most of the readily available supply of such workers. Moreover, evidence is starting to accumulate that indicates at least a temporary leveling off even in the professional and service occupations where we feel confident that demand for labor continues to be strong.

Finally, we turn to the young workers and those past the usual retirement age. As the next chart shows, the labor force rates for these groups have been going down throughout the postwar period and continued to do so in 1962. There does not appear to be any unusual speedup in the rate of decline during the past year. The main reasons for these long-term trends are well known to you—the tendency for young people to remain in school longer and the push toward earlier retirement at the upper ages. Both groups have also been affected by the long-term decline in agriculture which has always been an important source of employment for teenagers and older men.

We do not regard these developments as unfavorable. This committee is certainly aware of the importance of formal education to young people entering the labor market. And to the extent that retirement represents a preference for leisure over work, it is also a healthy sign.

On the other hand, to the extent that lower labor force participation among youth occurs among school dropouts, it can be a serious social and economic problem. We are vitally concerned about this and in fact are planning a special survey of the employment status, work experience, education, and training of out-of-school youth 16 to 21 years of age. We are also disturbed by the possibility that some older workers retire only after prolonged unemployment and inability to find suitable jobs. Some additional insight into this problem may come from detailed studies to be undertaken in the coming year.

**Mr. Chairman, that concludes my general statement.  
(The charts referred to are as follows:)**

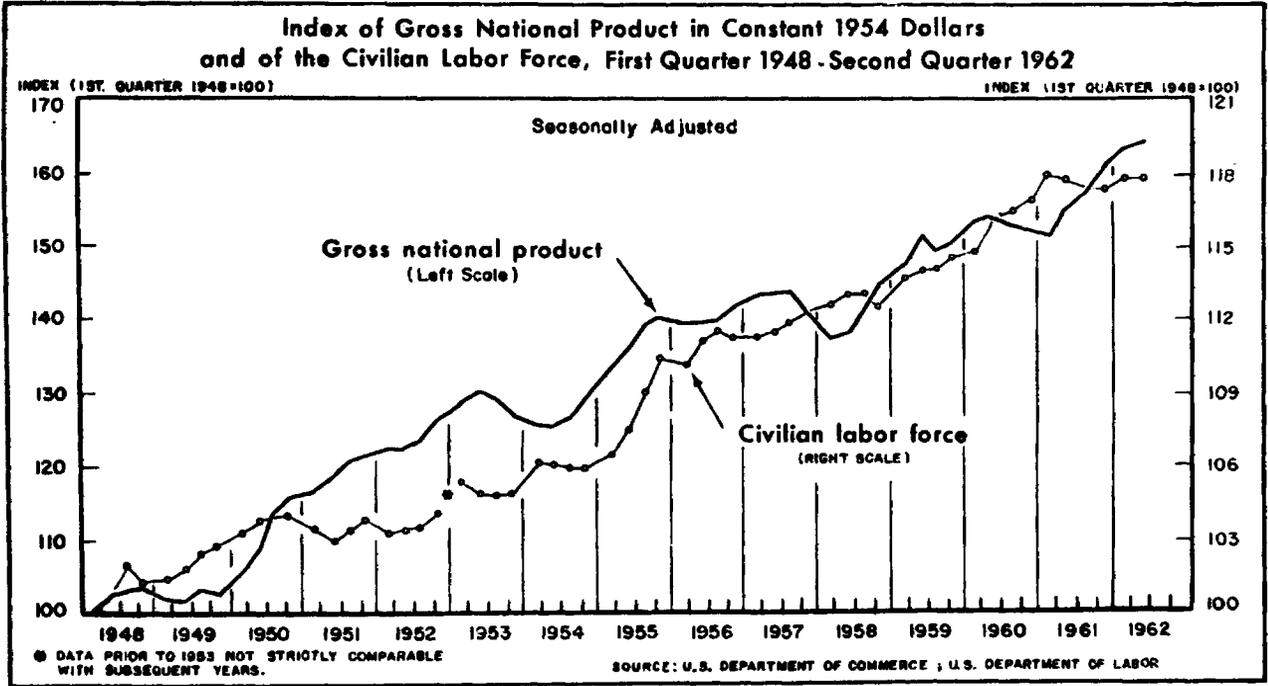


Chart 2.

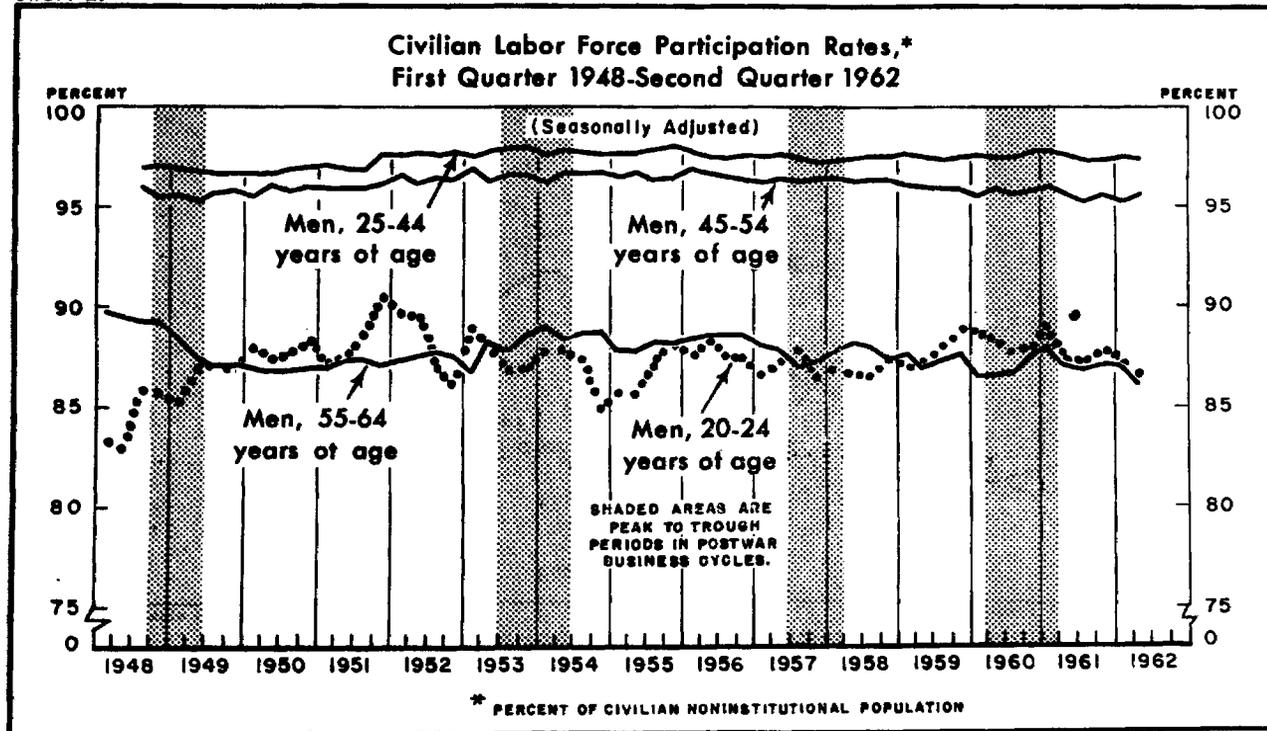


Chart No. 3

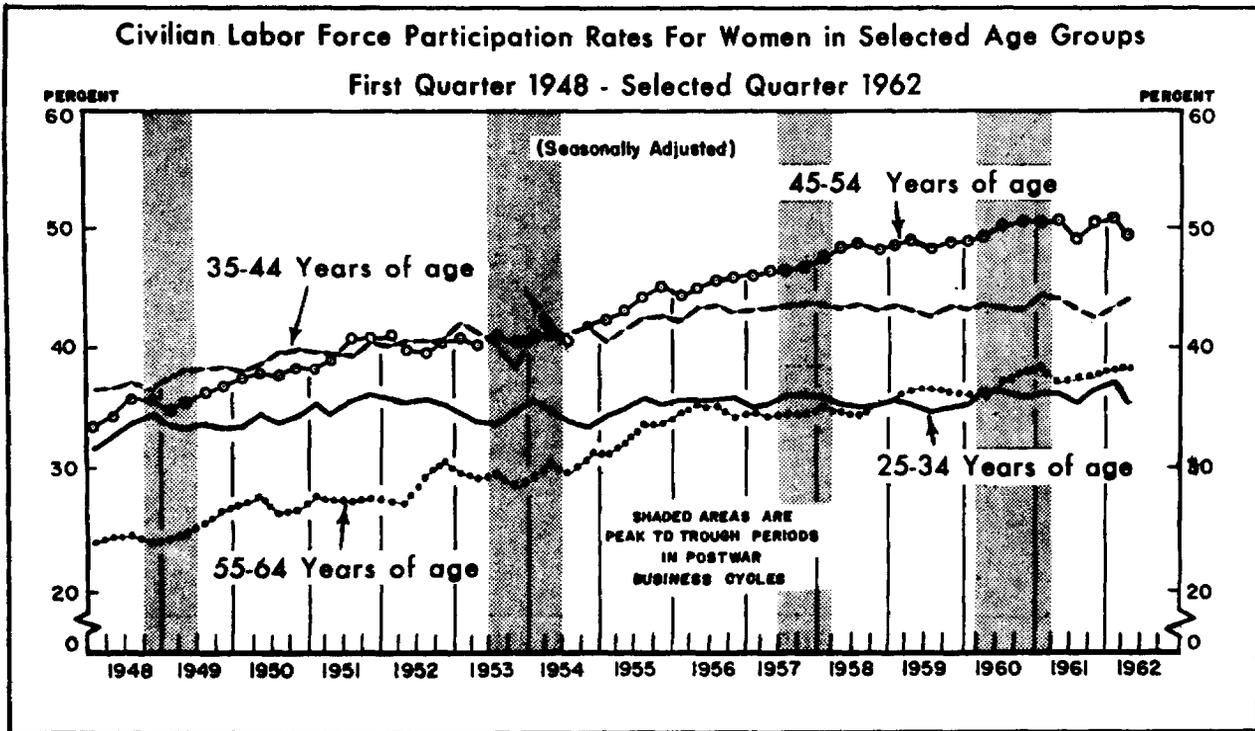
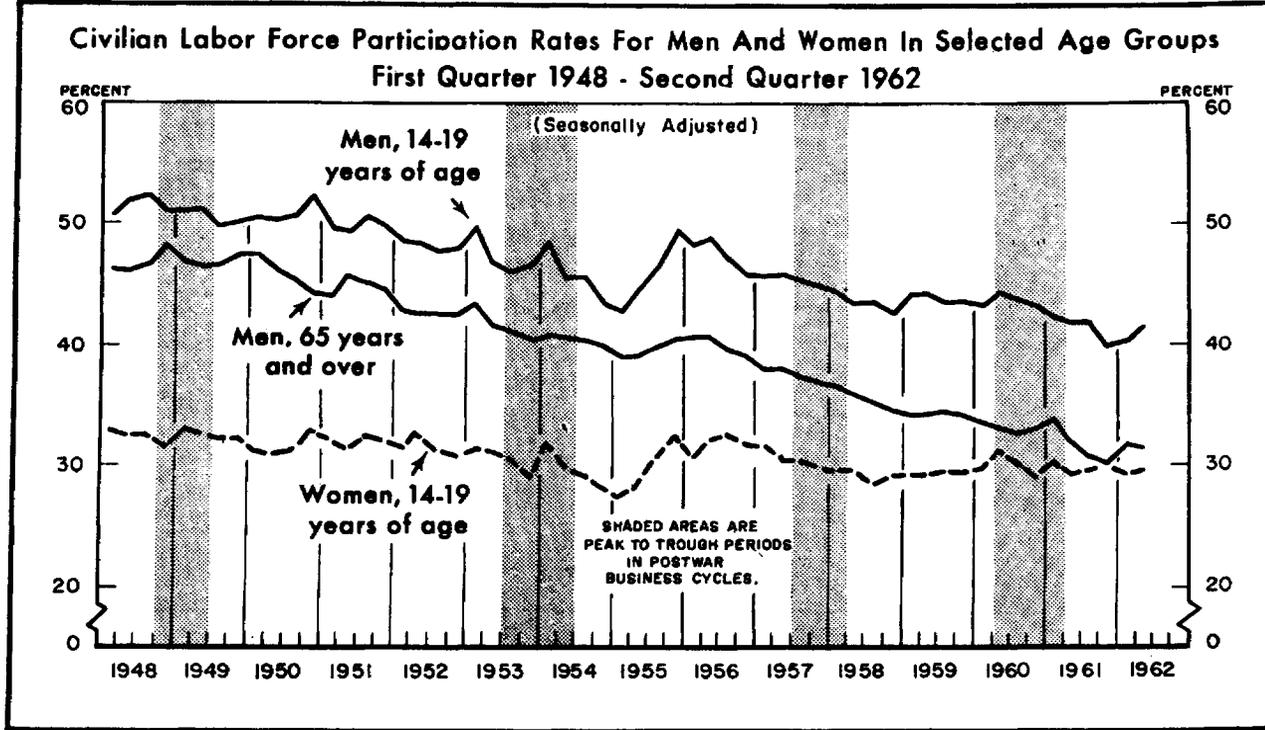


Chart 4.



Representative REUSS. Thank you, Mr. Clague.

I am delighted that your organization is conducting a number of studies into these mysteries, and mysteries they are, as economics and sociology change. I suspect that answers to many of the economic problems that plague us can result from these studies if they are as well done as I feel confident they will be.

I am staggered at being told that one out of every two women from the ages of 45 to 54 is a member of the labor force.

This includes all women, married and unmarried?

Mr. CLAGUE. Yes; that is correct.

Representative REUSS. And those who are incapacitated and so on?

Mr. CLAGUE. That is right; all women of those ages, except those in institutions.

Representative REUSS. What has happened to this figure historically?

Certainly 50 years ago it was not true that one out of every two women 45 to 54 was in the labor force, was it?

Mr. CLAGUE. Oh, no; of course not.

We do not have these kinds of figures for 50 years ago, except the decennial censuses, as you know, because we did not have any such statistics as we have now.

On the other hand, this number of women, of older women in this age group and surrounding age groups, this number has been growing steadily for, I would say, at least 25 years.

Miss BANCROFT. Very sharply since World War—

Mr. CLAGUE. Miss Bancroft might answer that in more detail.

Representative REUSS. Before Miss Bancroft answers, I want to add that while World War II brought in a great many, I would have thought that after World War II the labor force participation of this group would have declined.

I see you making a nod of your head.

Miss BANCROFT. It has been rising almost continually since World War II, and at a really quite rapid rate.

Representative REUSS. Do you have any breakdowns of the marital composition of the 50 percent of the women 45 to 54?

Miss BANCROFT. We do have—I am not sure that we have it with us; but we know that most of them are married.

Representative REUSS. Would you file at this point in the record such supplementary breakdowns as you have?

(The reply to this inquiry appears in a letter dated August 23 which appears at p. 744, below.)

Miss BANCROFT. Yes.

For example, in 1950, or even back in 1949, in the second quarter of the year, 35.6 percent of these women were in the labor force. That is 1949.

In 1962 it is 49.7 percent.

Mr. CLAGUE. In 13 years it has gone up from about 35 to 50 percent.

Representative REUSS. This is very interesting to me, and I do not know what to make of it, but maybe with the benefit of your breakdowns, which you will file at this point, we can turn it over in our

minds and ask you some more intelligent questions the next time that we see you.

Miss BANCROFT. It has been due, in part, I think, to a shortage of young workers during these years. The number of young workers in the population has been limited because of the low birth rates in the 1930's.

Representative REUSS. Yes; but that certainly is not true today, as the next paragraph shows. We are worried about unemployment among our young workers.

Miss BANCROFT. The young worker group has just recently started to increase in size in the population. We now have in the 20-year-olds the result of the first increase in the birth rate during 1942, and the 14- and 15-year-olds are increasing in size because of the increase in the birth rate directly after the war.

But, really, you could say that the teenage population is just now beginning to increase in numbers.

So that is one of the reasons, I think, why these middle-aged women have increased their labor force activity so fast since the end of World War II.

Mr. CLAGUE. And, I might add, perhaps this is an indication that hereafter their rates may be leveling off because job opportunities may not be available for them, when younger women, perhaps better educated and better trained, enter these professional and service occupations.

Representative REUSS. This age group of women obviously did not have the benefit of vocational education as good as young people get today?

Mr. CLAGUE. That is right.

Representative REUSS. So that having obtained their skills in on-the-job training, they are likely to run into competition from those with a better vocational education?

Mr. CLAGUE. Yes.

But we should say, Mr. Chairman, some of them are women who have been out during child-bearing years and have come back in. I do not mean to imply that many of them are not reasonably well educated and well able to handle their jobs.

Representative REUSS. At least one of these entries is accounted for by my wife, who recently took up teaching—

Mr. CLAGUE. Oh, yes.

Representative REUSS (continuing). Although she is not quite in the 45 to 54 age group.

(The following was later received for the record :)

U.S. DEPARTMENT OF LABOR,  
BUREAU OF LABOR STATISTICS,  
Washington, D.C., August 23, 1962.

HON. WRIGHT PATMAN,  
Chairman, Joint Economic Committee,  
New Senate Office Building, Washington, D.O.

DEAR MR. PATMAN: At the committee session on August 17, we agreed to furnish several items for the record. They are listed below:

1. Marital status of women aged 45 to 54 in the civilian labor force in July 1962: Of the 5,173,000 women aged 45 to 54 in the labor force in July 1962, 3,809,000 were married and living in the same households as their husbands. The remaining 1,804,000 were separated, widowed, divorced, or single.

2. Effect on labor force of raising school-leaving age: We estimate that if the 16-year-olds now in school would continue in school at least 1 year longer, the labor force would decline by perhaps 100,000. If the school-leaving age were uniformly set at 17 in all States, and there were no dropouts of 14- to 17-year-olds, the labor force might drop by about 300,000.

These estimates assume that larger numbers of teenagers would remain in school than at present but that they would continue to work after school or on weekends at the same rate that they do now. Our latest study, for October 1961, shows that 90 percent of the 14- to 17-year-olds were enrolled in school, and 20 percent of those in school were also in the labor force, mostly as part-time workers.

3. Effect on labor force of lowering retirement age: A reduction in the permissible age of retirement from 62 to 60 under OASDI would probably have only a limited effect on the size of the labor force, particularly if the benefits and conditions surrounding the reduction were similar to those of the recently enacted reduction in the permissible age of retirement for men from age 65 to 62.

Although these latter provisions have been in effect for about a year, only a slight reduction in the labor force rates for men 62 to 65 years old has been recorded so far. On the basis of experience for the 62- to 64-year-old men, it may be estimated that as many as 150,000 men in the labor force might apply for benefits the first year after the retirement age was lowered to 60. It is probable that most of these persons would not leave the labor force, however. The benefits would be comparatively low and they would continue to work as permitted under the provisions of the OASDI system. The number who would leave the labor force if the retirement age were lowered to 60 would, therefore, probably be substantially less than 150,000.

For women, it is estimated that 75,000 women in the labor force would apply for benefits if the permissible age of retirement were dropped to 60. Many of these would also continue to work and would not leave the labor force. The principal reason for the smaller number of women who might leave the labor force is that there are fewer women than men in the labor force.

The above estimates should be regarded tentative for many reasons. Possible future increases in the level of OASDI benefits combined with possible changes in provisions of private plans to allow for earlier retirement at age 60 may bring about reductions in the work force similar to those noted after age 65. If this occurs, the number of persons leaving the labor force would be much larger than indicated in these estimates.

Sincerely yours,

ROBERT J. MYERS,  
*Acting Commissioner of Labor Statistics.*

Representative REUSS. Turning now to the next group, the young workers, you point out that one of the troubles is that the long-term decline in agriculture has reduced some opportunities.

What studies have been made—I do not know whether your outfit would be the one to make it, but somebody should be doing it—what studies have been made about opportunities for young people that are presented by changing technology and social habits?

Certainly there are a great many more opportunities for young people today running a mechanical lawn mower than there were 20 years ago, because suburbia has come up strongly.

Has anybody put his mind on this question?

Maybe one of the reasons for more unemployment than anybody likes among young people is the lack of organization of some of these service trades, particularly service trades which do not require much training and do not require dedication to the task for a long period of time.

Who worries about that?

Mr. CLAGUE. Well, we are making some studies in technological unemployment and trying to get what we call an early warning system of places where changes might be occurring.

We have done none in relation to agriculture, as such. But I think I would like, Mr. Chairman, to call attention to two of my charts over there, which at least highlight the point you are raising there.

On that large chart to the left, "Employment in Goods Producing Industries," you will see a blue line there, a heavy blue line, which represents employment in agriculture, drawn from our monthly report on the labor force.

Those years run from 1953 to 1962.

You will see that we had about 6.5 million employed in 1953, and, as you can see, our recent figure is about 5.25 million.

Now, that means there has been a decline in the last 9 years of about 1.25 million persons in agriculture.

Since I used to be in agriculture myself many years ago, I might make another remark about it.

In agriculture itself, there is a persistent movement toward higher technical competence, both in relation to farmers who must now be biochemists almost, and in relation to common labor; the kind of common labor I did on the farm 40 years ago does not exist any more.

They do not jig sacks, and in many other areas in agriculture the worker has to be now a machinist or a mechanic, but not an old man with a hoe.

Representative REUSS. We have all had this experience. I am sure Representative Curtis and Senator Proxmire have had the same experience I have had of mothers coming to me in recent summers saying, "My son has not been able to get a job on a farm his father had when he was his age."

Obviously somebody ought to be studying this great movement whereby the family farm is being replaced by larger, mechanized units. The joys of the family farm are, to an increasing degree, transferred to suburbia, but the head of the household there is getting fed up with the excess gardening that is thrust upon him, and complains, if I hear the cries of my neighbors right, that he cannot get anyone to do this.

Well, maybe some organization, some repair of wage scales and so on might be of some help.

So let us just throw this out as something we all ought to be thinking about.

Representative Curtis?

Representative CURTIS. Thank you, Mr. Chairman, and thank you, Dr. Clague, for giving us this information.

First, let me ask how firm is our employment figure? I had always thought that was pretty much an actual figure, but you mention on page 2 this reference:

The change has the effect of reducing employment, and the civilian labor force by 200,000.

So, evidently, it is a less exact figure than I thought it was.

I thought our employment figure was pretty factual.

Would you develop that a little bit? How do we get the employment figure?

Mr. CLAGUE. Well, the employment figure comes from visits to the family in the household survey.

Representative CURTIS. Oh, it is the same—

Mr. CLAGUE. It is from the same source. It is a solid figure in the sense that being employed is much more tangible than whether or not you are unemployed.

Representative CURTIS. Oh, I thought that some way you geared in actual employment.

Mr. CLAGUE. No.

Representative CURTIS. You do not.

This is part of the same survey?

Mr. CLAGUE. Yes.

Representative CURTIS. I was under a misapprehension.

Mr. CLAGUE. Yes.

Let me explain, Mr. Curtis, what that is.

We had to work with the 1950 population census and its distribution by age and sex and color.

We had to use that as the basis for current estimates for translating our sample up into the nationwide figures, which we do, moving from the families that we survey up to the national total.

When we actually got the 1960 census figures, the new census figures that the census developed for the whole Nation, it turned out that our picture of age and sex and color, the breakdown of the population, was somewhat different, as we indicate in our paper there.

It turned out there are more old people than had been estimated by the census. In 1960 it showed more of them than the estimation brought out.

So now our multiplication factor, moving from our sample up to the Nation, just showed that we had 200,000 too many in the labor force, and that showed up entirely in the employed group.

Representative CURTIS. Yes, I can see that.

Now let me ask on that sampling, the questions go something like this:

Are you employed or are you not? And they answer, if they are employed, of course.

If they say that they are unemployed, then there is a further question asked, is there not? Are you looking for work? Is that the way the question is worded?

Mr. CLAGUE. I should ask Miss Bancroft to answer that, since she is the one who has been working on this for 20 years.

Miss BANCROFT. No, there is no question, "Are you unemployed?" After a person says he has not done any work, then he is asked, "Were you looking for work?"

Representative CURTIS. I see. In other words, the question really is, "Are you working?"

Miss BANCROFT. Yes.

Representative CURTIS. Or, "Is someone in the family working?" and you put it down.

Then, if the answer is negative, the further question is asked, "Are you looking for work?"

Miss BANCROFT. "Were you looking for work?" yes.

Representative CURTIS. Do they break that down further to say, "Were you looking with regularity?" or do you just have that one simple question?

Miss BANCROFT. It is that one question. Then we ask how long they have been looking for work and what their last job was.

Representative CURTIS. Yes. It would be nothing like, "Have you registered with an unemployment bureau?"

Miss BANCROFT. Not regularly. We have asked this question occasionally, but we do not ask it each time.

Representative CURTIS. Because this is a subjective question.

I am just wondering, just examining this to see whether or not the psychology of people in answering the question could be explained here, because "Are you looking for work?"—

Miss BANCROFT. "Were you."

Representative CURTIS. It is, "Have you been looking?"

Miss BANCROFT. "Were you looking for work?"

Representative CURTIS. "Were you looking for work?"

Miss BANCROFT. "Last week?"

Representative CURTIS. It is, "Were you actually looking for work?"

Miss BANCROFT. That is right.

Representative CURTIS. But, in your judgment, if there is such a psychological factor that might change this, you do not believe that is of any consequence?

Miss BANCROFT. I do not believe there is any evidence that the effect of the psychological factor has changed over time.

Representative CURTIS. Has changed?

Miss BANCROFT. There is undoubtedly some of it.

Representative CURTIS. Here is the overall thing that bothers me about this work force figure.

It is composed of two components:

- (1) The work force, or the people employed; and,
- (2) The people unemployed.

I took a look back at 1929, and I think at your own statistics, and noticed that the only time we have not had an increase in the work force has been in war years. We had increases even in the depression. I was told by one of the staff that the figures from 1929 to 1940, or anything before 1940, were really interpolations. Is that right?

Miss BANCROFT. They are estimates.

Representatives CURTIS. Estimates?

Miss BANCROFT. Contrived and put together from various sources, but they were not the result of direct measurement.

Representative CURTIS. There could have been a year in that period when the work force, the civilian work force, could have declined, then. I think I averaged it out around an increase of 400,000 a year.

Miss BANCROFT. I believe that that is true. I would not put too much faith in those annual changes, in those early figures.

Representative CURTIS. Since 1945, in all four or all three of the post-World War recessions, we had an increase in the civilian labor force.

Your estimates are that we will not have an overall decrease in the work force for 1962, although the months—I looked at January, February, and I looked at June, those months showed declines. Do you think that overall, we are going to have a little increase?

Mr. CLAGUE. Yes. You see, Congressman, with our readjustment of the 200,000 downward, which we had to make because we got the new 1960 figures—

Representative CURTIS. Yes.

Mr. CLAGUE (continuing). You must make allowance for that over the previous year, you see, since we did not have that information at that time. So that gives you 200,000. Then the increase in the military gives us about 300,000. So you must remember those 300,000 would probably be working if they were not in the Army.

Now instead of 1 million growth that we might have expected on the basis of past trends, we had 500,000.

Representative CURTIS. Let me stop you there.

I raised that point earlier this year myself about the military. They would be working, but I suspect someone might have taken their jobs. That is what did happen?

Mr. CLAGUE. Oh, yes, yes; to some extent.

Representative CURTIS. So I think on that you probably just moved them over from the unemployed sector.

Mr. CLAGUE. Yes; that is correct, but you might not have had new people entering the labor force. If they came from the unemployed, they were in the labor force already.

Representative CURTIS. Yes.

Mr. CLAGUE. In other words, those 300,000 would reduce the unemployment that much.

Representative CURTIS. Yes; I see.

Mr. CLAGUE. So you must allow that we are about half a million above last year by the time you make both these allowances.

We ought to reduce last year by about 200,000, because probably our 1960 census adjustment would have applied to that year as well as to this.

So let me say to you about half a million is our increase this year.

But we had projected something more like 900,000 or 1 million on the basis of past trends.

Now, those are the missing people that you are putting your finger on.

Why are they not here?

Representative CURTIS. Yes.

Mr. CLAGUE. And, incidentally, this is not a recession year. Since last summer we have been in business revival.

Representative CURTIS. That is right.

Mr. CLAGUE. Where are these people?

Well, as I indicated in my paper, we find there are three places where they are.

Mostly, it is women in these prime working ages of between 25 and 55 years of age.

They have not increased as they normally would have. I say "normally would have"—as they used to do.

There is a slowdown in their entry into the labor force. That is the most important factor, with some minor factors on the older men retiring, which is probably due to social security which took effect last July.

Representative CURTIS. I want to get into those components a little later.

I want to stick still to this.

Mr. CLAGUE. Yes.

Representative CURTIS. The thing that struck me the most, of course, was that this seemed to be a new phenomenon; that we had not had this experience before.

But I can see that if we did not have the breakdown, say, in the 1930's, and if the figures that we have for those years are estimates that there might have been a decline in the labor force.

I am trying to see if this is signaling something new in our economy.

Have you projected into the future on the basis of this what you think is going to happen to the civilian labor force?

Mr. CLAGUE. Mr. Chairman, let me make two remarks there:

First, there is not a very close relationship between fluctuations in economic activity and labor force growth. For example, 1956 and 1957 had the same unemployment rate but we got about 1.5 million increase in the labor force from 1955 to 1956 and in the next year only 400,000.

Second, I would like to say, in general, it looks to us as though this may be something more significant than what has happened before.

We do need to call attention to the fact that perhaps the flood of young people coming into the labor market may enlarge the labor force. But at the moment they are staying in school longer.

Apparently more and more of them are staying in school, so the full effect of those youngsters may be delayed for a year or 2 or 3 years.

But eventually by 1965 we will have a lot of young women, teenagers—and those in their early twenties, who will be ready to take these service jobs.

They may very well have an impact upon the employment of women, say, 40 to 60 years of age.

We may be seeing the beginning here of a moderate change, not a fast but a moderate change, in the composition of the labor force, working against older people generally, including both the older men and older women.

Representative CURTIS. Well, now, our baby crop is——

Mr. CLAGUE. That is right.

Representative CURTIS. Our baby crop is now really getting into this thing, just beginning.

Mr. CLAGUE. Just beginning; that is right.

Now, that would enlarge the labor force at the lower end of the scale.

This labor force is going to grow. The growth is not over.

On the other hand, we may have a few years here in which the youngsters are staying in school, not entering the labor force so early, while the oldsters may be losing their job opportunities because the youngsters that have entered the labor force are picking up their jobs.

Representative CURTIS. My time has expired, and I will come on back.

Representative REUSS. You have been pursuing a very interesting line.

Do you wish to proceed for a few minutes?

Representative CURTIS. I have a lot of things, so go ahead.

I think it would be better to rotate.

Representative REUSS. One of the very interesting things that emerges from your chart here on employment in service-producing industries from 1953 to date is the relative lines for State and local government employees and Federal Government employees.

By the way, have you presented to the committee these charts on a reduced scale?

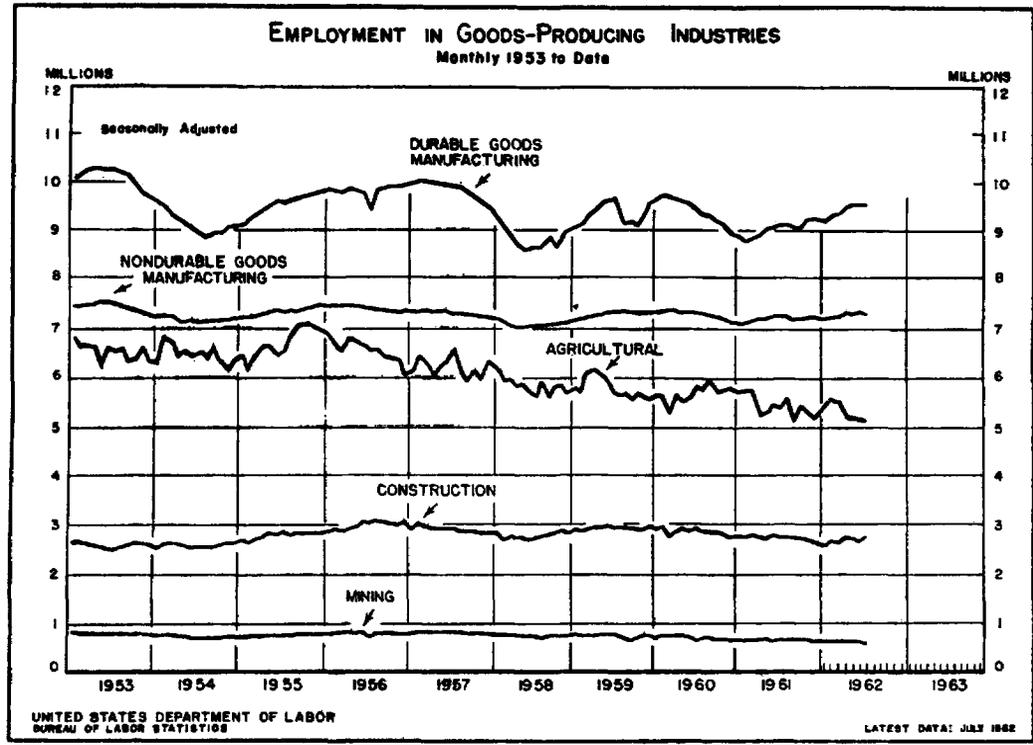
Mr. CLAGUE. No, we have not, but we can.

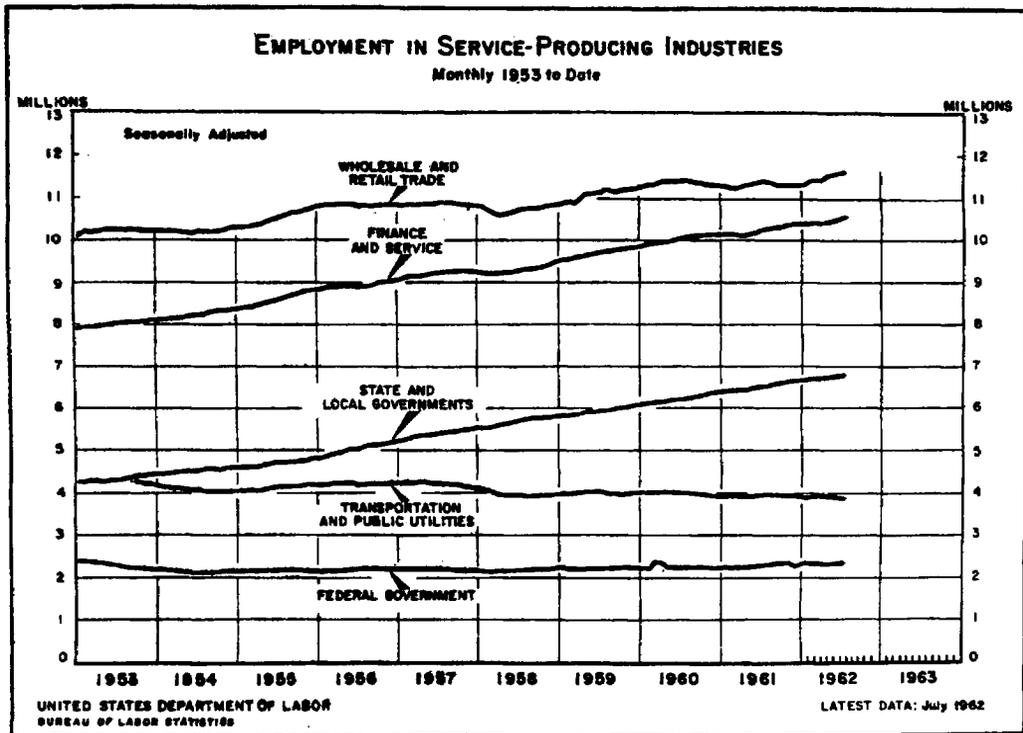
Representative REUSS. Will you do that?

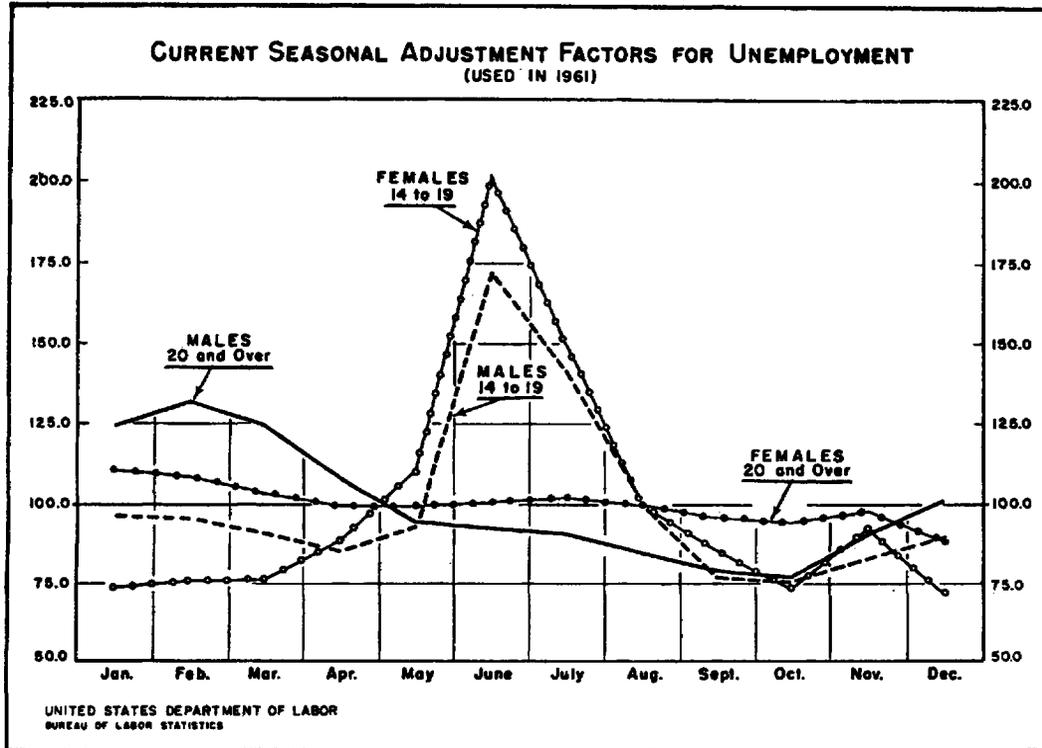
Mr. CLAGUE. Yes.

Representative REUSS. And, without objection, the three charts, "Employment in Service-Producing Industries," "Employment in Goods-Producing Industries," and "Current Seasonal Adjustment Factors for Unemployment," will be made part of the record.

(The charts referred to are as follows:)







Mr. CLAGUE. Mr. Congressman, I might explain the uses that are made of those charts.

The one at your left, the first one on goods production; we use that to show that in the heavy industries, we have had, in general, less employment today than we had 9 years ago in 1953.

Representative REUSS. Yes.

Mr. CLAGUE. You will see durable goods manufacturing there which had about 10.25 million in 1953, and now has got 9.5 million.

Soft goods is about the same: 7.5 million, no gain; agriculture, down 1.4 million; construction, no gain; and mining, a loss of about 200,000.

Then we try to find out where is our employment increasing, and you will see that there are just three places.

One is wholesale and retail trade, which has gone up from 10 to 11.5 million; about 1.5 million there.

Then there is finance, banks, insurance companies, and what we call service, which would be hotels and restaurants and things of that sort.

You will notice they have gone up from 8 to 10.5 million.

I might interrupt to say those two combined make up about one-third of all the employment in the country.

In other words, there is where the job opportunities have been developing in the last 9 years.

Then State and local government has gone up from about 4.5 million to nearly 7 million.

That, of course, is teachers and all the services connected with population, et cetera.

Then there is the service of transportation and public utilities, which includes railroads, buses, trucks, airlines, et cetera, as well as gas and electric utilities. And finally there is the Federal Government.

These last two groups are behaving like the employment in goods producing. They are not increasing. They are remaining stable.

Representative CURTIS. Mr. Chairman, would you yield for a point?

Representative REUSS. Surely.

Representative CURTIS. For State and local government, is that curve ahead of the population curve, or is it just about equal to it?

Mr. CLAGUE. Oh, way ahead.

That has increased nearly 60 percent in the last 9 years from about 4.5 million to 6.8 million, nearly 7 million.

Representative CURTIS. Yes.

Mr. CLAGUE. A lot of those are the schoolteachers coming in to take care of the youngsters that are in school. That is the school expansion.

Representative REUSS. You say a 60-percent increase in the 10-year period 1953 to 1962?

Mr. CLAGUE. Yes.

Representative REUSS. And that is the largest percentage increase of any?

Mr. CLAGUE. Of any of those groups; yes.

Representative REUSS. Of any segment of employed people?

Mr. CLAGUE. That is right.

Representative REUSS. This is very interesting, indeed.

It is a fact, is it not, that in the 10-year period we are talking about, 1953 to date, Federal Government employees group has not increased at all?

They are precisely where they were in numbers 10 years ago?

Mr. CLAGUE. Yes.

They do not change much, about 2.25 million.

Of course, I should say, Mr. Congressman, Federal expenditures help support some of the State and local government employment, because of our various kinds of Federal grants in aid.

Representative REUSS. Surely.

Mr. CLAGUE. So some of your Federal budget relates to the State and local government, but the strictly Federal employment remains fairly constant, as you can see, from year to year.

Representative REUSS. Congressman Curtis and myself happened to have been in Congress for approximately that time, from 1953 to 1962.

Are we not justified in being rather proud of the fact that in that period the employees of the Federal Government have been able to do a vastly expanded job—have been able to show vastly increased productivity—and have not increased at all in numbers?

Mr. CLAGUE. Well, I think on behalf of the Federal employees I would like to say I think we do have increasing productivity. It is pretty hard to measure.

I believe some attempts are now going to be made to measure our productivity to see if we cannot find some way of crediting our performance against our numbers of personnel.

But we have not had any such system so far.

Representative REUSS. And inasmuch as the line of Federal employees is substantially uniform both during the period of the Republican Eisenhower administration and during the period of the Democratic Kennedy administration, I am not in error, am I, in saying that the honors can be shared between Republicans and Democrats?

Mr. CLAGUE. Well, sir, we have got the figures right along.

You can just take the figures either off the chart or the actual figures.

Representative REUSS. They seem to bear that out.

Mr. CLAGUE. They are about the same all the way.

Representative REUSS. I notice that the one little divergence from this record occurred in early 1960 when there was quite a pronounced upward hump.

Can you tell me what caused that bulge in Federal employees?

Mr. CLAGUE. That was taking the 1960 census.

Representative REUSS. Those were patronage employees, were they, very largely?

Miss BANCROFT. Largely.

Representative CURTIS. They were taking the census.

Representative REUSS. Not regular civil service.

Mr. CLAGUE. Those were the 175,000, or so, special agents that had to be taken on.

Representative REUSS. And the only other little pimple on the line occurs at the end of 1961, and that is a downward bump.

Can you explain that?

Mr. CLAGUE. These figures come from the Civil Service Commission, and they are a complete count of Federal employees so far as you can get it. You will recall that the Federal employment normally jumps quite a bit in December because the Post Office hires a lot of youngsters to help deliver mail.

The Post Office is becoming more mechanized, however, and it could be that this resulted in hiring fewer workers last year at that time of extra activity. Since these are seasonally adjusted figures, such a development would explain the slight dip.

Representative REUSS. If that is so, it would certainly show a lack of desire to taken on any unnecessary employees during that period, would it not?

Mr. CLAGUE. Well, I guess I had better say I am not sure that I have given the full explanation.

Representative REUSS. I brought this out because it seems to me that the public would be very interested to know that Federal employment has remained almost entirely uniform for the last 10 years, whereas State and local government has gone up by a recordbreaking 60 percent.

Mr. Curtis?

Mr. CLAGUE. There, you see, Mr. Chairman, the State and local governments are the ones who service the population of the country, and, of course, as you know, education is almost 100 percent a State and local government operation.

So their employment reflects, in part, this servicing of our youth population, which is now starting to enter our labor force after all these years.

Representative REUSS. Yes, but in conclusion, I would remind you of what you said a moment ago: Much of this population increase also demanded and got a far wider variety of Federal services.

Mr. CLAGUE. Yes.

Representative REUSS. And these seem to have been provided by substantially the same number of employees.

Mr. CLAGUE. Yes.

Representative REUSS. Which is a real tribute to the efficiency and productivity of Federal employees, and I am glad to pay this tribute to them.

Representative CURTIS. I think it is very important to take note of the State and Federal Government employment. The field of health care also is one that is primarily conducted not even by the State governments, but by local governments.

Mr. CLAGUE. Local.

Representative CURTIS. And to me it has been a tragedy that the Department of Health, Education, and Welfare still does not have figures on what is being spent at the local governmental level in the field of health care.

They have got the State figures, but in my State of Missouri and the State of Texas and in other States on their charts they show nothing as being spent.

I think we do need to get a more accurate picture of where this occurs.

I note somewhat facetiously, but maybe it is so, that little dip in the curve looks like it occurred around November 1961; maybe that

was after the President got his Cabinet together and made his economy speech to them.

I read it in the papers.

But I notice it went right on back up again.

And then, to discourage my colleague from Wisconsin a bit, unless my eyes deceive me, there is a little increase since about 1961.

I have seen the figures, around 200,000, I believe, of an increase in Federal employment in that time.

Is there any indication, if my presumption is right, that that graph is going to continue up, or do you not know?

Mr. CLAGUE. No; I would not know about the future.

We have the actual figures month by month. There is some increase in the past 6 months or so, since the beginning of the year, but I cannot conjecture how it will go in the future.

Representative CURTIS. It could be related to the increase in the uniform armed services, because, as they increase, we do increase the civilian employment.

Noticing the dip from 1953, which was the Korean war period, a number of people do go in.

Mr. CLAGUE. Yes.

Representative CURTIS. Into the Federal Government in military work or with the military departments.

I guess that there probably is some sort of a ratio between the number of uniformed people to the number of civil service people that are in the Federal Government.

Mr. CLAGUE. Yes, Mr. Congressman, I think that is true.

I think, roughly, in very round numbers about a million are civilians in the Defense Department. About half a million are Post Office and about three-quarters of a million are the rest of us.

That is a very broad breakdown of the content of employment.

So it would be true, if the armed services expand, they could very well be taking on more civilian employment.

Representative CURTIS. Now, to get back to my aggregates before I get to the components, what about the percentage figures of civilian work force to population?

Some of our staff told me that that has been an amazingly constant figure, around 58 or 59 percent throughout the years.

Would you comment on that, and how important do you think that figure is?

I had always assumed that with the women coming into the work force the way they did during World War II, and then staying in, that it would have increased the percentage, the total percentage of the work force in relation to the total population.

But then I thought possibly if we got into components, we would see the impact of that balanced off by the longer period of time our people are spending in education.

Now, would you comment on that general area?

Mr. CLAGUE. Remember, Mr. Congressman, you must distinguish between the total population and the population of working age.

Representative CURTIS. Oh, I know that.

Mr. CLAGUE. You see, those under 14, large numbers of births or small number of births could make the ratio to the total population

of the work force swing, not because anything happened among the adults, but what was happening to the young, to the children.

Now, the population of working age would be 14 years and above.

That should be a more precise figure, and would normally be more stable.

Do we have that figure?

Miss BANCROFT. I think Congressman Curtis is right. The percentage of the working population in the labor force that is a very stable figure, but what has been happening is that the labor force rate of younger workers has been dropping since the end of the war, as Mr. Clague said, because they were staying in school longer and because their opportunities to work on their family farms are diminishing.

And, at the other end of the age range, older men have been reducing their labor force rates.

With each extension of social security, the labor force rates of men 65 and over have been going down since the end of the war. And replacing them have been these women 35 to 55.

The net effect of all this is that you have the same overall percentage, but there have been vast changes within the different age groups.

Representative CURTIS. Do you have those series of statistics, do you keep those up to date?

Miss BANCROFT. Yes, we do.

Representative CURTIS. And use them?

Miss BANCROFT. Yes, we do.

Representative CURTIS. One other thing.

Incidentally, this is just an aside, but why have you kept the age of 14 and 65?

It seems to me the age 14 is somewhat artificial today, is it not, in our society?

Miss BANCROFT. Well, it is.

There are many 14- and 15-year-olds who do work of a kind that you were talking about, grass cutting, babysitting, and so on, and they do make a contribution.

Representative CURTIS. We do not include housewives?

Miss BANCROFT. No, we do not include housewives.

Representative CURTIS. They make more of a contribution, in my opinion.

Miss BANCROFT. They surely do, but these folks get paid for it.

We do show enough age detail in our detailed statistics so you can leave them out.

The only reason, I think, for keeping them in through the years is to have a consistent series.

Representative CURTIS. I see.

Miss BANCROFT. And to avoid the disruptions.

Representative CURTIS. But for that you would think that it might be better to—

Miss BANCROFT. There are certainly reasons for dropping them out, I think.

Representative CURTIS. Are there statistics on man-hours in our society. I am talking about aggregates, man-hours per year. Is there some way of not just measuring the number in the work force but the amount of time actually spent working, so that we had a con-

cept of how many man-hours were put into the economy in a given year?

Mr. CLAGUE. In the monthly report on the labor force, we do attempt to collect the hours actually worked by the persons who are working, and that is shown in our figures on the hours of work.

But you are asking another question:

How many hours of work does a year-around worker actually work by the time you take account of his holidays with pay?

Representative CURTIS. That is right.

Mr. CLAGUE. And let us say vacation with pay and all of the lost time.

Representative CURTIS. And also looking at it as a national figure, multiplied by the workers.

It would be interesting for many reasons to know how many man-hours are spent in the year 1962 compared with 1960, or any other year, for that matter.

Mr. CLAGUE. Yes.

That figure would not now exist in our Bureau. We are attempting to collect some information on that from manufacturing corporations, who would keep this kind of information. We are collecting figures on the annual earnings and the annual hours the employees actually work.

We have some preliminary data just beginning on that.

Concerning the general trend, there is no doubt, Mr. Congressman, that there are more paid holidays, more vacations now; there is more leisure.

That is one of the ways some of the productivity is being taken.

Representative CURTIS. That is correct.

Mr. CLAGUE. But at the rate at which that is increasing, we just do not have figures to submit.

Representative CURTIS. You certainly anticipate what I am directing this to, to see how we could measure that.

The other question along that line is this. I know HEW has some figures on the length of time that the average person spends in school. There are many ways of figuring it, but it seems to me that whatever statistics we have on education and the number of people being educated ought to be related to your employment and your unemployment figures. It would not be the same series, by any means, but they would be related so you could look at it.

Today the average student, I think, goes on beyond high school—I think the national average does—when formerly, when they got 8 years, it was unusual.

Would you comment?

Mr. CLAGUE. Yes.

In other words, you say there might be three classifications of young boys and girls age 14, say, to 22, which would be the college graduating age: Those employed, those in school, those unemployed?

Representative CURTIS. Yes.

Mr. CLAGUE. And those not doing anything, staying in the home, as some of them would be. I guess that would be four groups.

Yes, it is true that as they stay in school longer, of course, that means they are not in the labor force.

It is true that in the summertime many of our—and that is what that chart over there shows, the chart with the two mountain peaks on it there shows how youngsters become unemployed in June, looking for summer work, but who go back to school in the fall.

In that sense a young person does gravitate between those different categories.

Miss BANCROFT. We do publish once a year information on the number of persons in school by age and the number of those that are in the labor force.

We do collect this information.

Representative CURTIS. Yes.

My time has run out again. I will be back.

Senator PROXMIRE. Then I will defer.

I wanted to ask Congressman Curtis whether he is satisfied on the basis of his inquiry, that these figures are not rigged.

There may be all kinds of economic reasons for these statistical developments, some of which are perhaps to be criticized in terms of economic policy, but I would hope that the Congressman would give some indication, because I think this was a very proper question that he raised, and I think it was a real service to raise it, but I think that, having raised it, it would be desirable to know if the Congressman has a conclusion, based on interrogation of the people who are most responsible for the integrity and honesty and accuracy of the figures.

Representative CURTIS. I am sorry, I was distracted. Will you redirect your question?

Senator PROXMIRE. Are you satisfied that Mr. Clague and his Department have done an honest and accurate job.

Representative CURTIS. There is no question about Mr. Clague.

I had a question, and there is a question in my mind, on the subjective aspects of the thing, but by no means did I think—and I said at the time—that there was anything involving integrity.

But I still wonder whether there is a psychological factor involved in these questions as to, "Are you looking for work"—I want to keep that right—"Have you been"—

Senator PROXMIRE. Let me ask you, Mr. Clague:

There has been no change, I take it, from your paper between June of 1961 and June of 1962, when there was this spectacular development of a far less than expected increase in the labor force.

There has been no change in the way the questions are asked, in the training of the questioners, or interrogators, or any other technical change that could account, or psychological change or subjective change that, in your judgment, could account for this variation in statistics?

Mr. CLAGUE. That is right, Senator.

From month to month, as I said earlier, you may have statistical variations, and we point this out right along; a swing from one month to another month or from quarter to quarter could occur statistically; and that is just one of the limitations of the figures.

These are small samples economically compiled.

The other point is we have not changed any of the definitions or any of the ways of asking the questions. On the other hand, you must remember that the survey is asking questions of a great many people throughout the country, people whose attitudes may change.

I might make one observation on this—

Senator PROXMIRE. But, in reply to that, it would seem to me that you would ask questions of something like 35,000 people.

Mr. CLAGUE. Households.

Senator PROXMIRE. Households?

Mr. CLAGUE. Yes.

Senator PROXMIRE. 35,000 households.

You have done it for many, many years?

Mr. CLAGUE. Yes.

Senator PROXMIRE. You have a great experience on this?

Mr. CLAGUE. Yes.

Senator PROXMIRE. And it would seem to me that if there were a variation, because people are all different, and their responses are different, this should wash out with that huge a sample which dwarfs any poll I know about, it dwarfs the Gallup poll or any of these other polls on which people base their judgments.

Mr. CLAGUE. I hope I made perfectly clear that, as far as this sample is concerned, it is absolutely adequate for the general—

Senator PROXMIRE. No statistician questions the adequacy of your sample.

Mr. CLAGUE. Within the range of accuracy which we point out.

On the other hand, you do have to recognize—and this has nothing to do with our statistics but with the people that are answering these questions—people are influenced as time goes by, by a variety of things.

I would like to point out—

Senator PROXMIRE. And there may have been a change in 1962 that would affect people generally?

Mr. CLAGUE. No.

Senator PROXMIRE. That might make the situation different?

Mr. CLAGUE. This we cannot tell yet. You must give us more time to find this out.

For example, we have a free labor market. Many of these people who are looking for work can decide to look for work or not look for work, as they feel about it.

Not everybody who is unemployed is in such urgent need that he keeps knocking employers' doors.

As we said in our testimony here, you have literally millions of people who come into the labor force during the year at varying times and who leave the labor force during the year.

Some of them are not unemployed before they come in, and they are not unemployed when they go out of the labor force. Now, these people are free enterprisers, if you want to say so. They can decide they do not want to work at the wages and at the conditions and at the jobs that are available. Whether or not there is a general shift in the attitude of women toward work, it is too early to tell yet.

But it could be that if this continued for another year, or two, it would clearly indicate that something more fundamental had occurred in either their desire for work or their opportunities for work.

Senator PROXMIRE. Very good.

Now, I would like to ask you about this slower growth of the labor force because I like to look at this as a constructive development, as well as a development which points to some problems in our society.

Mr. CLAGUE. May I add one more——

Senator PROXMIRE. We have been very critical of the attitude that the only way we can solve our problem is by a super increase in effective demand.

I have felt that one constructive way we can do it is by doing something about the supply side of the labor market.

In other words, to the extent that we have constructive reductions in the size of the labor force, this can represent a plus, an improvement in our society. I think of two things, particularly.

I introduced a resolution about a week ago calling on Governors and State legislators to give consideration to increasing the school age, leaving age, from 14, 15, 16, generally 16 throughout the country, 16 in my State, to 17 universally, and to couple this with training of the youngsters who are still in school, who do not want to go on with their education, in the vocational skills which are in demand in the local community.

It seems to me if we can achieve this, it will undoubtedly reduce the labor force, and I think by perhaps as much as 1 million people.

I am not sure how much, but it might be very substantial, in a constructive way.

When these youngsters do finish their schools, they will be better able to get a job, to hold a job.

Their contribution to society will be improved in this technological age in which we live.

It seems to me, while this means the labor force is less, less employment perhaps, nevertheless society is moving ahead, and unemployment would be sharply reduced.

There is one other thing that I intend to introduce in the next day or two, it is a tough bill to draft but we are working on it, and that is a reduction in the social security retirement age from 62 to 60, but on the same basis as the reduction from 65 to 62.

In other words, it would be voluntary.

You would have a reduced benefit, so there would not be any increase in social security cost, and the benefit would have to be substantially reduced.

I wonder if you could help me on the statistics on either end of this.

(The reply to this inquiry was made in a letter dated August 23, which appears at p. 744.)

Perhaps you could not this afternoon, but if you could make those statistics available to me, to show me what kind of an impact on the labor force a reduction in the social security age from 62 to 60 would make, assuming that you have about the same pattern of response as you had in the reduction from 65 to 62.

And, in the second place, if you can tell me what effect on the labor force it would have if we increase the school dropout age from 16 to 17 or from 14 to 17, because expert after expert in our country has told us that this is the most serious kind of unemployment we have a very high proportion of youngsters between 14 and 19 being unemployed, very damaging to them as persons and to their future and often very damaging to the cities in which they live.

If we can solve these two problems, it seems to me we can help improve our employment situation.

Mr. CLAGUE. Let me say that the logic of your argument is perfectly valid.

If youngsters stay in school longer, they will not be in the labor force, and if the schooling is doing them any good, they should be better participants later on.

If you increase the school leaving age, it will take some people who otherwise would be working out of the labor force.

As to the older age groups, you are perfectly right. The earlier you make it possible to retire, of course, the greater will be the reduction in the number of older people in the labor force.

Now, I believe that the Health, Education, and Welfare and the old-age and survivors' insurance has made a study of those men, age 62 to 65, who have taken advantage of this.

My memory—

Senator PROXMIRE. Mine would provide for men and women, because women were taken care of—

Mr. CLAGUE. Women were already eligible to retire at 62, but if you reduce it to 60, you will pick up both men and women.

Senator PROXMIRE. Right.

Mr. CLAGUE. Perhaps the Health, Education, and Welfare figures will be the better ones to use for this purpose. Their study will show how many of them were in the labor force before they retired.

I do not think there is any doubt about earlier retirement will produce a reduction in the labor force, particularly if retirement benefits are adequate.

Now, some older people still remain working because their benefits are not adequate really to sustain an adequate standard of living, and in some cases they stay in the labor force to earn this extra money which they are permitted to earn.

But you will have reductions in the labor force if you substitute school or earlier retirement for people who are now compelled to work—I mean compelled, who need to work.

Senator PROXMIRE. I would appreciate it if you could make those statistics available as soon as you can.

Mr. CLAGUE. We will see if we can give you any kind of quantitative figures.

It would be an estimate.

(The reply to this inquiry appears in a letter dated August 23, which appears at p. 744.)

Senator PROXMIRE. Do you have any questions in your questionnaire now in which you ask women why they have not entered the labor force?

Miss BANCROFT. No, we do not.

Senator PROXMIRE. Would that kind of questioning be possible?

Would this be one way of getting at this problem?

Incidentally, I do not think that that is necessarily a problem.

I think the fact that these women choose to retire, in many cases, or choose not to work may, in many cases, also be constructive if they are doing other things which do not constitute earning money, which may be far more useful to society.

Miss BANCROFT. We have made studies in the past on this, and we find almost always that there are several million women not in the

labor force who evince some interest in working, who say they want to work but turn out not to be looking for it or not to be readily available for it at the moment. It is a hard thing to measure in any meaningful way.

But we would like to do some more studies of this kind.

Senator PROXMIRE. See if you can find a question or two for women in this age group as to why they have dropped out of the labor force or why they choose not to enter it.

Miss BANCROFT. I think you could ask why—

Senator PROXMIRE. A factual kind of analysis on which we could base a judgment.

Miss BANCROFT. I think we could ask, "Why have you stopped working or looking for work?"

I think it is much more difficult to say, "Why aren't you working or looking for work?" for people who have not shown any such activity.

Senator PROXMIRE. I see.

Thank you very much. My time is up.

Mr. Curtis?

Representative CURTIS. In line with one of the points Senator Proxmire is making, I was interested in an article by Sylvia Porter, which you may have seen. I got it from the Evening Star of Tuesday, August 14, 1962, "How Workers Are Disappearing."

She was talking about the people over 62, and then this is what I wanted to direct your attention to.

She says:

Why? Is it because as the jobs of many of these older people have been erased, they have dropped out to live on whatever pensions and savings they have? Is it because the steady rise in social security and pension protection permits them to retire voluntarily?

And then she answers it by saying, "Probably both."

Would you tend to agree with that, or would you have any comments?

Mr. CLAGUE. Yes; I think I would agree with that. Many older people would like to retire and live in complete retirement and not be in the labor force, but unless they have an adequate private pension or adequate social security, they may need to take either a part-time job or even a full-time job to keep up their standard of living.

In that sense, I think one factor has undoubtedly been the increasing benefits under social security which have made it possible for more of these people to live comfortably in retirement.

Representative CURTIS. Plus the pension plans which are growing rapidly, too?

Mr. CLAGUE. Private pension plans are now beginning to turn out industrial personnel, who with the supplement social security, move into full adequacy and leave the labor force.

Representative CURTIS. This phenomenon, by the way, to me is by no means presumed to be unhealthy. I suspect it is probably healthy, but I think it is a real phenomenon.

That is as near as I can see this decline here.

Let me ask just one very technical question.

I understand that you did change your actual forms of the workers, of these people who took these samples.

This white sheet is the one that has been handed to me as being the one you used to use, and this yellow card is the one now.

When was that change made?

Miss BANCROFT. The change was made in October.

Representative CURTIS. Of 1961?

Miss BANCROFT. Of 1961, yes.

Representative CURTIS. But it is the same material, is it not?

Miss BANCROFT. It is exactly the same.

Representative CURTIS. I can see that this would be much more efficient.

Miss BANCROFT. I think the change is the other way, sir. The yellow card is the old one; the white sheet is the new one.

Representative CURTIS. This looks more efficient than this.

Miss BANCROFT. I know, but the other one is more efficient, presumably.

On the white sheet you can get three members of a family, and on the yellow card you have just one person.

The white sheet is the form which goes directly onto computer tape without any punching, and was adopted in October of 1961.

The yellow card goes through a machine that makes punchcards which then go to computer tape.

Representative CURTIS. But you are satisfied this change in form would not have any effect?

Miss BANCROFT. I cannot see that it would have had any effect.

Representative CURTIS. I am just looking for possibilities, because any time there seems to be a real breakthrough, I think it does deserve going over. It was in that sense, Senator Proxmire, that I was raising the question on this, because I thought it was that serious and that important.

Usually a trend does not come in abruptly. That was the reason.

Let me ask one other general line of questioning.

Does the U.S. Employment Service compile vacancies, jobs that are not filled, the other side of the coin, the affirmative side?

Mr. CLAGUE. The Employment Service has, of course, in each local office, a record of job orders that come to them, which you might call vacancies. But, in addition, there has been some pressure on us in the Bureau of Labor Statistics to set up an actual statistical system of measuring vacancies.

Representative CURTIS. Yes, sir, because I am one trying to put the pressure on.

Mr. CLAGUE. Oh, are you?

Representative CURTIS. I do not know whether it is possible, but I am very, very interested in this.

Mr. CLAGUE. Let me explain to you, Mr. Congressman, first, there is no question about the fact that there are literally hundreds of thousands, perhaps even millions, of vacant jobs in the country, theoretical, potential jobs.

Representative CURTIS. Yes.

Mr. CLAGUE. Maybe a lot of these workers are not taking them because the wages are too low or they are not going to work those long hours, or the job is one they cannot possibly fill.

There are not only job vacancies, but job potentials, that we do not hear about, but which could be developing.

Now, our problem in statistics is how to measure them.

The British have a very efficient employment service and a good labor-statistics operation, and they kept it pretty well during World War II, and I believe even during the Korean war during the early 1950's.

But they had a requirement that every order of an employer had to go through the employment office, with the result that by compulsion, all the job openings had to go into the employment service. Then they succeeded in getting quite good measures of job vacancies. In fact, one of the British economists suggested that full employment was a condition in which job vacancies and unemployment were equal. That would show that you had some frictional difficulties here and there, but you had an even balance.

Now, we do not have that situation in this country. As you know, there are so many ways of filling a job. The employment service in this country has never had the penetration ratio, it has never had the full opportunities to manage the labor market that it has in other countries, and, therefore, its vacancies would come nowhere near measuring the total number of vacancies that exist.

The other statistical problem that faces us is what is a "job vacancy" and how do you define it. You see, we could send out to a manufacturer and say:

"Will you tell me how many vacancies you have as of this moment on your rolls," but would this mean orders that he had actually placed?

Or would this mean vacancies as I have them in the Bureau of Labor Statistics: so many jobs I am not filling because I do not have money to fill them? Only as I get turnover are they filled?

You have a number of different ways of measuring that. We are now committed to make an exploratory survey to see if we can devise some method of getting a reasonably accurate measure of really developing job vacancies. Those that are on the way to being put into the market.

Representative CURTIS. I think and am hopeful that with the Manpower Training Act, which I was very happy to see come on—I did a lot of work on it—that possibly that will lead us into this area of better statistics.

Let me ask one other detail.

Do we have statistics in regard to what we might call the handicapped?

Of course, we now do have the social security disability. Do our census figures or your own labor figures have any category such as handicapped?

Mr. CLAGUE. I think not ours. Gertrude, will you answer that?

Miss BANCROFT. I believe that in the national health survey, which the Census Bureau conducts for HEW, they are now getting information on physical disabilities of persons in the labor force.

Representative CURTIS. I think one of the greatest areas for moving forward is in this rehabilitation field. As the people dealing with the handicapped like to say, we regard no one as really being totally disabled.

Of course, that is not actually so, and we all know that, but I think it is the right approach to take in the rehabilitation field. I have followed statistics on accidents, industrial accidents, and so forth.

Mr. CLAGUE. Yes.

Representative CURTIS. Which is an interesting statistic, but I think this matter of handicapped and rehabilitation is an important item in this.

One final area: Do you have any estimates in the Bureau of Labor Statistics on communities, large and small, in this country which have unemployment rates of over 10 percent?

Mr. CLAGUE. That is not done by us in the Bureau of Labor Statistics. That is done by the Bureau of Employment Security, which works with the State employment security agencies.

Those State agencies are the ones under instruction from the Bureau of Employment Security who make those estimates of local unemployment.

Representative CURTIS. Oh, I see. And who publishes those, then?

Mr. CLAGUE. They are published by the Bureau of Employment Security.

Representative CURTIS. I see, yes.

Mr. CLAGUE. They are not ours.

Representative CURTIS. That is out of your field. I had one other question that has eluded me.

Senator PROXMIER. Maybe Mr. Widnall would like to go ahead.

Representative CURTIS. Yes, my time is up anyway.

Representative WIDNALL. Mr. Clague, do you have any statistics to show the reasons why—I am talking about men, now, in the 45-and-over group, have failed to get employment.

Do you have anything broken down as to the causes?

Mr. CLAGUE. No, not firm statistics of the kind you are talking about.

Secretary of Labor some time ago—this may be several years ago—had a committee of businessmen meet on that general subject.

There was a popular impression that older men, particularly in the light of pension plans, would find it harder to get a job in a concern, and the general, prevailing opinion among those businessmen was that this was not an important factor; that, on the whole, if a man was qualified, they were inclined to take him. That committee made such a statement in their final report.

Now I believe since then the Canadians have done some work on this subject and have come out with a finding that this does make a difference in some cases. I do remember that some of the businessmen on that committee, too, particularly in retail trade, said that in the narrow margins in which they operated, they would have to think twice about hiring a person, say, beyond the age of 50 because of their pension plan.

Representative WIDNALL. Is it not also true that an older person would have a salary or wage requirement higher than the younger person going into a job?

Mr. CLAGUE. Well, this is not statistics, Mr. Congressman, but I would say this is human psychology. The answer is certainly "Yes."

As we move along in life and get more wages and salary, we hate to go backward. One of the difficulties undoubtedly with older people is their hesitancy to reduce their wage demand or their salary requirement in the light of their failing powers.

Representative WIDNALL. Of course, actually, I think, most people would honestly recognize that their needs, outside of health needs, are less as they grow older than when they are younger, as far as wage and salary requirements are concerned.

I am particularly interested in chart 2 that you just submitted, showing that men in the 45 to 54 years of age category have remained at an almost constant level, running across the page, and, yet, in recent years there has been so much emphasis on finding employment for that group and promoting employment for that group. Now I wonder, have we failed?

Do you have anything that would show whether or not there has been any increase in employment, a material increase or a material demand to employ those people, or whether we have been ineffective in what we have been trying to do?

Mr. CLAGUE. That line you see on the chart, of course, represents both employed and unemployed, so it would not necessarily show whether they had worked or not.

Representative WIDNALL. That is right.

Mr. CLAGUE. But, second, the unemployment rates of men 45 and 55 and perhaps up to 65 are not especially high. Remember that while they have the handicap of getting back into a job, they also have strong seniority rights and experience in holding on to jobs.

Their turnover is lower. Fewer of them are laid off, so their unemployment experience is not so bad as a group.

The real problem of the older worker is that when he loses his major job or his chief job, then he finds it more difficult to get back in, and his duration of unemployment is generally always longer than the average.

Representative WIDNALL. Probably what I am thinking about now is not a proper question to ask you and should be asked of a welfare worker or somebody in an entirely different field, but I just wondered whether, in talking about the failure to get into the employment field of the number of women, whether it is not attributable to larger families being formed now, where people who formerly would be going into the labor market, trying to obtain a job, are now staying home.

Also, the emphasis now on juvenile delinquency, and when mother is away from the home, why, therefore, you are leading to a broken home, and you are contributing to juvenile delinquency, whether there is a better sense of responsibility that is keeping somebody home, rather than just going out for additional funds for the home.

Mr. CLAGUE. It is true, Mr. Congressman, that more married women are working today than ever before. During the 1930's marriages were postponed because of heavy unemployment.

Earlier Congressman Curtis was asking a question about the size of the labor force at that time. There is no question about the fact that there were delayed marriages and young single girls went into the labor force and stayed there as one of the wage earners, under the family circumstances that existed at that time.

Now, recently, many more young people are married and many women between the ages 25 and 35, are rearing children. Their labor force rates have gone up very little compared to women in the older age groups.

Representative WIDNALL. What bothered me a little bit, in thinking about this whole, overall picture is whether or not, because you have got X number of people, you have got to feel you have got to put X number of people into employment.

Now, I am sure there are plenty of families where they do not require employment, they do not have to have employment, and, yet, you think about the overall picture as though, because there are so many people, so many should be employed, whether this is a right perspective, the right picture that we should be looking at.

Mr. CLAGUE. Mr. Congressman, this is one of the things that we have had the most difficulty in making clear to the public.

Our unemployment figures are not necessarily an indication of need for employment.

Many unemployed persons do not need a job in the sense that they are going to starve if they do not get it. Unemployment is an economic statistic. It shows the number of persons, according to their own interpretation, who are either in the labor force, working or indicating the intention of doing so.

There is obviously an indirect connection with need. If a person is out of work for a considerable period of time, he is more than likely going to have need for a job more urgently. But our figures on unemployment represents what we like to have called an economic statistic.

It is available labor supply offering itself on the market, and it ought to be interpreted in that light.

I would like to say one more word there. It is certainly true that many of these persons are on the fringes here—I use that word in no derogatory sense—are on the fringes of the labor market. They go in and out, depending on whether there is a job there that would really appeal to them and that they would like to do.

Their being out of the labor force does not mean at all that they need a job or even want a job or are interested in it.

And, yet, with a new opportunity opening up, they might jump in very quickly.

Representative WIDNALL. Mr. Clague, earlier you mentioned a number of reasons why you felt people were not going into the labor market, picking up jobs that were available. Now, I find one in particular: continuity of a job. There is a reluctance on the part of a lot of people who have been employed steadily to take any part-time job that is going to last only 2 or 3 days, and this is in many categories of employment.

Now, I can understand their desire to have steady employment, but, at the same time, there are a lot of part-time jobs available that pay well.

Mr. CLAGUE. Yes.

Representative WIDNALL. And the people do not want to take them because there is no continuity to the job, although it would appear that they could piece together some of those part-time jobs and have full-time employment.

If we could in some way piece these jobs together to provide the employment steadily for people, I think it would be a healthy thing.

Mr. CLAGUE. Well, yes, Mr. Congressman.

Just take a worker who has been working for a firm for 10 or 15 years and now is laid off. He is drawing unemployment benefits. Perhaps he has supplementary unemployment benefits. He has a right to health and pension benefits in that company.

Now, you ask him to take a temporary job at half the wages and lose his benefits, because he would be an employed worker earning enough to disqualify him. His incentive is to remain attached to the firm where he belongs.

Not only that, he will say to any employer who wants to hire him, "Yes, I would like to work for you, but the minute I get a call back from my old employer, I am going to return."

So many employers would not want to hire him. This is a right and a privilege which many workers now have, which certainly operates to, let us say, keep them trying to remain attached to the firm where they would be entitled to a permanent job.

You can see why they would not try to piece together 2- and 3-day jobs at low wages, just because they are out of work.

Representative WIDNALL. This I understand completely. I have found a dearth of applicants in the domestic field, not for my own home but up in the area where I live in, where some of these people have lovely air conditioned rooms, for the servants, a regular 5-day week in a home, television in the rooms and everything like that, better than the best motel you ever saw, and, yet, people do not want to take these because they are tied down for 5 days a week and tied within that house for 5 days a week, and they cannot operate their own home, and, yet, they have the ability to save more in such a job today than any outside job.

They are covered under social security, too, and, yet, there is a reluctance to take that type of work.

Mr. CLAGUE. You are right.

Mr. WIDNALL. I think retired Congressmen ought to take these jobs. It is better than the job they have got right now. [Laughter.]

Mr. CLAGUE. You are right. At the two extremes there are two kinds of jobs that are now unfilled in this country. One is at the upper levels of skill and professional ability and highly technical knowledge that you can't fill because there are not enough people of that ability. At the lower end of the scale you have relatively lower wage jobs, I was going to say, relatively less desirable jobs, the jobs that people don't like, domestic services, dishwashing, lawn mowing, let's say, things of that sort. Workers just don't want to take those jobs and won't do so.

Mr. WIDNALL. Actually, they could net more today than they could out of a lot of other available jobs that seem to have more substance to them.

Mr. CLAGUE. In domestic services in some respects that would be true.

Mr. WIDNALL. That is all.

Representative CURTIS. I might say, picking up there, trying to get your help from people abroad. I know that my family has been able to get people to live in that kind of one-room thing, only this is outside the home. But invariably we have had to sponsor some person coming to this country from abroad. And I might say I was intrigued a long

time by the head of a clothing store in St. Louis who told me he couldn't get tailors. I was asking about it and he took me up and we went through the plant.

I guess they must have had about 80 people employed. He told me to talk to them. Then afterward he wanted to ask me a question, which he did. He said, "What did you notice about the group?"

I said, "I don't know what you wanted me to notice but I did notice they all spoke with an accent."

He said, "That is the problem. We can't get people in this country apparently to study to be tailors."

I don't know what the problem was. Look at their wage scales, and so on. Which leads me to this point.

The one thing in the Manpower Training Act which to me is the key whether the Department of Labor develops this additional skill information. I know they are trying to update what they have to include the new skills coming in, as well as knocking out the obsolete skills, and then relating that to our vocational educational program throughout the country. Very little has been done apparently in that area.

Let me ask just two general questions. Senator Douglas always points out the area of underemployment. Each time he does I wish I were present because I always say then, how about the statistics on moonlighting? How many people are holding down two jobs?

What ways do you have, if any, of measuring those two related aspects of employment, one the underemployment, and the other, the possibility of people holding down two jobs?

Mr. CLAGUE. We worked out some material on that which we supplied to this committee last December. We took the underemployment which we get from the figures on hours of work that Miss Bancroft has been talking about here, and determined how far they fell short of 37½ hours, which we used as the standard. In a sense, we were able to convert the number of part-time employed persons into the missing hours of work. Incidentally, we produce statistics now on that every month in our monthly report on the labor force—statistics on labor force time lost through unemployment and part-time work.

Representative CURTIS. I want to apologize for not knowing that, too.

Mr. CLAGUE. Now, let me go on to the second point. We then also took the moonlighting that you mentioned. We collect figures periodically, through this same system on how many people hold two or more jobs and how many hours are they working on those jobs.

My memory tells me that our last figure showed an average of 50 hours a week worked by those people.

Then we measured the "overage" against the "underage." At times, the "overage" ran beyond a hundred percent. You would get 102, 104, 105. In other words, if you reduced all the jobs to a standard level, you would have had actually a shortage of workers.

At other times, underemployment dominated and the index fell to 97, 96, 95, and so forth. But it was interesting to note that it fluctu-

ates back and forth around the complete balancing of those two factors.

Representative CURTIS. I did want to know a little bit about what you do toward future projections. Do you do some projecting in the future on unemployment?

Mr. CLAGUE. No. Not on unemployment.

Representative CURTIS. What do you project?

Mr. CLAGUE. We project the labor force. We did that some years ago, projected it through to 1965 and 1970. You may recall Secretary Mitchell published a chart book, which contained those projections, relating them to the kind of people who would be in the labor force during the next 10 years: the young versus the old, women versus the men, their educational requirements, and so on.

We are now working on a revision of those projections. Some years have gone past now and we are now working up another set of projections designed to improve those, and to take account of the way in which there have been variations up to date.

Representative CURTIS. When do you expect those might be ready?

Mr. CLAGUE. Well, they will be ready shortly. We expect them to be coming out in the next month or so. They will be tentative, revised projections based on the population of the 1960 census and interim revisions of the population projections from that date. There will be a more permanent revision in another year when we will try to have a firmer set of estimates into 1965 and 1970.

Representative CURTIS. Now, in light of what is happening in the slowdown, or whatever it is, in 1962, can you tell me, do these projections show a continuation of that or do you anticipate the labor force to continue to move upward as it has been?

Mr. CLAGUE. I would say I think the major change we are making in our projections is on the basis of revisions in the population projections reflecting the 1960 census.

Representative CURTIS. Rather than—

Mr. CLAGUE. Rather than too much influence on this latest development. I might ask Miss Bancroft, did last year's development have much influence on our present thinking?

Miss BANCROFT. No. These are projections that are supposed to reflect high employment conditions.

Representative CURTIS. I see.

Miss BANCROFT. And we have not taken account of recent developments.

Representative CURTIS. You assumed high employment factor rather than—

Miss BANCROFT. Yes.

Representative CURTIS (continuing). Rather than project this?

Miss BANCROFT. They were not taking off from the present level.

Representative CURTIS. Yes. Did you have anything further?

Mr. WIDNALL. No.

Representative CURTIS. Does the staff have any questions?

Well, it falls on my shoulders to close the hearing, and thank you very much for your extremely helpful testimony.

Next week—Monday—what is the schedule? The committee stands adjourned, then, until Monday morning at 10 o'clock, in the Atomic Energy hearing room of the Capitol, Lee Loevinger, Assistant Attorney General of the Antitrust Division of the Department of Justice, will appear.

(Whereupon, at 3:40 p.m., the hearing adjourned, to reconvene at 10 a.m., Monday, August 20, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

MONDAY, AUGUST 20, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representative Patman; Senators Sparkman and Proxmire; Representative Reuss.

Present also: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. We have as our witness this morning Assistant Attorney General Lee Loevinger. Are you ready, judge?

Mr. LOEVINGER. Yes, sir.

Chairman PATMAN. Do you have some statements?

Mr. LOEVINGER. I apologize, Congressman Patman. I do not have a statement. Mr. Johnson telephoned me while I was at the American Bar Association in San Francisco, and I have not had an opportunity to confer with my staff extensively or prepare a formal statement.

Chairman PATMAN. That is all right, sir. Before we start, however, I want to say something for the record.

A few days ago, a letter was addressed to the Honorable William McChesney Martin, Jr., Chairman of the Board of Governors, Federal Reserve System, by me, for the Joint Economic Committee, concerning the minutes of the Federal Open Market Committee for the year 1960. The letter was dated August 14, 1962.

Today I have received a reply, dated August 16, 1962, from Mr. Martin, stating that the matter that was presented in the letter will be taken up at a meeting of the Federal Open Market Committee on August 21, which is tomorrow; and answers to our questions will be given to us as promptly as possible.

Without objection, both letters will be placed in the appendix of the record.

(Letters referred to appear in the appendix at p. 955.)

Chairman PATMAN. We continue hearings on the state of the economy and on policies to achieve maximum employment, production, and purchasing power.

We turn our attention this morning to policies for maintaining competition.

As we know, the traditional policy of the Federal Government is to rely on free and open markets, and on competition in those markets, as the main forces bringing about maximum employment of our re-

sources and a fair distribution of the income and other fruits of private enterprise.

Our witness today is the Honorable Lee Loevinger, Assistant Attorney General in charge of antitrust.

General Loevinger, we are delighted to have you, sir. You may proceed in your own way, and when you finish, the members of the committee will ask you questions.

Judge Loevinger.

**STATEMENT OF LEE LOEVINGER, ASSISTANT ATTORNEY GENERAL  
IN CHARGE OF ANTITRUST DIVISION, DEPARTMENT OF JUSTICE**

Mr. LOEVINGER. Thank you very much, Mr. Chairman.

I apologize for my failure to prepare a formal statement. I have, as I have explained, had relatively little time to prepare specifically for this appearance. However, I have been engaged in studying the problems and the issues under consideration here for a number of years, and at least as early as 1953 have published a paper on antitrust and economics, so that I appear not wholly without preparation.

I believe that the significant points that are relevant to an inquiry of this committee can be stated fairly simply and fairly clearly.

In the first place, I think that we must recognize that economic performance is the result of complex and multiple causation. There is always a tendency to simplify and to look for or talk about the cause of phenomena, such as prosperity, unemployment, the balance of payments, and so forth.

It is very dramatic to point to a single factor and say, "That is the cause of our present condition," whether the condition is good or bad. In fact, such oversimplification is usually misleading if not actually false.

The President has pointed out in his Yale University address that in order to deal with the complex problems of the modern world, we need a realistic and sophisticated approach. This I think involves at a minimum the recognition of the complex multiple causation of the phenomena concerning which we are inquiring.

In the second place, competition is, as the chairman has suggested, a stimulant to productivity, efficiency, technological process, and prosperity. I believe that this is demonstrated by American history.

Up until World War II, America and Europe were roughly equivalent in resources and population. If anything, Europe had somewhat greater population and greater resources through its oversea colonies. However, during that period the United States had a vigorous antitrust policy, whereas the European countries in general did not.

There is little doubt that the industrial and technological progress of the United States was in large part the result of its vigorous competitive antitrust policy during that period. President Kennedy in his speech at New Orleans recently has recognized this in saying: Competition and innovation have long been a significant part of the American character.

I think that there is some tendency on the part of certain commentators to suggest that while this may be true, competition should

not be too vigorous or should not involve the crucial factor of price.

Analysis by economists for the Antitrust Division, observation by those in charge of the Antitrust Division, as well as the analysis of disinterested commentators, indicates, I believe, that price competition is at least as important and crucial as any other type of competition.

It has many influences and many ramifications. To avoid being permanently saddled with excess plant capacity, with persistent unemployment, and with budgetary deficits, we must maintain price competition.

Many key industries are of course dominated by a few firms, and in such industries idle capacity and unemployment tend to be aggravated by the administration or stickiness of prices. By this is meant the unresponsiveness of prices to normal economic influences.

Firms in such industries may prefer to reduce production rather than lower prices when demand lessens. Conversely, when demand rises, prices may move above the legitimate levels of increase justified by costs and increasing demand.

Because of the basic character of some of these industries, their price policies have a great impact on the economy as a whole. Competition in price we believe has proved its value time and again by enlarging consumer markets, providing more jobs, increasing quality and technical innovations, increasing output, and generally stimulating a growing economy.

We therefore have grave reason for concern if symptoms of abuse, disuse, or denial of price competition appear, or if the signs of weakening in the vigor of price competition begins to become evident.

It is basically price competition that functions as the impersonal disciplinarian of the market, forcing high-cost producers to improve technology, passing on to consumers the benefits of increased productivity and innovation, and acting as the catalyst of technological change and economic growth.

One of our greatest judges, Learned Hand, has said, in the *Aluminum* case, that:

The antitrust laws are based on the premises that possession of unchallenged economic power deadens initiative, discourages thrift, and depresses energy; that immunity from competition is a narcotic and rivalry is a stimulant to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone. Competitors versed in the craft as no consumer can be will be quick to determine opportunities for saving and new shifts in production and be eager to profit by them.

It would be a mistake, however, to assume that the effects of competition are purely economic. It has other political and social benefits.

As the Supreme Court has recently declared in the Northern Pacific Co., decision, and I quote:

The Sherman Act was designed to be a comprehensive charter of economic liberty, aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality, and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic, political, and social institutions. Economic history in Europe since World War II has evidenced the same.

As this committee is probably aware, since World War II, most of the countries of Europe have adopted laws against restrictive business practices, which more or less parallel our own antitrust laws. There are, of course, differences, but the basic thrust of most of them is in the same direction.

Similarly, the great communities of Europe, particularly the coal and steel community and the economic community, or the so-called Common Market, have had antitrust provisions in their basic charters.

Incidentally, these provisions are being implemented. There are regulations that have been promulgated recently by the Economic Community, and there are professional staffs in the organizations of both communities engaged in enforcing these provisions.

Professor Albert Coppe, who is vice president of the high authority of the European Coal and Steel Community, which was the first European common market, has commented on the experience under that organization in these words:

Even among those of us who looked for great results from the Common Market—

he is here referring to the Coal and Steel Community—

there was astonishment at the swiftness with which the intensification of competition produced a considerable increase in investments. In various sectors of the Community's industries, investments are now going up swiftly. There has been a 40-percent increase in coal-mine investments, and an increase of nearly 50 percent in the steel industry, as compared with the first years of the Common Market.

With this increase in capital investment has come increased productivity in the Community's industries. Certainly productivity is the key to higher living standards in a modern industrial economy.

Therefore, another lesson to be learned from our experience is that by establishing a climate of competition it becomes possible, because it becomes commercially necessary, to increase investments, boost productivity, and thus contribute to higher living standards.

In the third place, antitrust is necessary, in our view, to secure and to maintain competition. The basic thrust of the antitrust laws, of course, is against restraint of trade, which means, in popular language, undue limitation of competition; and also against monopoly.

Essentially, restraint of trade and monopoly are the same thing. Restraint of trade is the limitation of competition by several enterprises in combination. Monopoly is a restraint of competition by a single enterprise acting alone.

Since the time of Adam Smith, observations have shown the tendency of business to form cartels or establish monopolies if not prohibited. I shall not repeat the famous quotation from Adam Smith to this effect.

It may be more relevant to note that Prof. John M. Clark, one of our outstanding contemporary economists, has noted that competition and security are polar alternatives in business. The drive or the desire for security is as strong as the desire for profits.

Restraint of trade and monopoly are thus attractive, since they represent security, and therefore the drive toward restraint of trade and toward monopoly is not always an attempt to secure exorbitant profits, but may be equally and perhaps more frequently simply a desire to attain profits with security.

Thus arises the tendency noted by Judge Hand in the quotation that I gave a moment ago.

The experience of the Antitrust Division in enforcing the antitrust laws also shows that such laws are needed to protect the overwhelming preponderance of independent enterprises. Probably 99.9 per cent of all American enterprises, of the total number of between 4½ and 5 million American enterprises, require the antitrust laws, in order to secure their right and their ability to survive as independent enterprises, to thrive, prosper, and grow.

In this connection, it is noteworthy that two-thirds of the complaints received by the Antitrust Division under the antitrust laws come from business enterprises that are seeking the protection of the antitrust laws.

In markets of few sellers, those which are called oligopolistic by the economists, combination and collusion are obviously easier and market forces are likely to be less effective than in markets that are less concentrated. In such oligopolistic markets, antitrust is thus even more necessary than where there are many sellers.

It is sometimes said that antitrust is ineffective, because there has been an alleged drift toward greater economic concentration in the United States. We are doing a great deal of work in attempting to analyze the concentration figures, and I shall not enter into that subject now.

The concentration figures at best are certainly somewhat equivocal. It is probably difficult to say with accuracy that there is a general overall economic tendency that can be demonstrated by economic statistics of this sort.

Certainly tendencies toward concentration or away from concentration can be demonstrated for particular industries and particular markets. However, the fact that a market or an industrial area is moving toward concentration or is already concentrated to a degree is not evidence that the antitrust laws are archaic or unnecessary, but rather is even greater evidence of the necessity for the antitrust laws in order to maintain some degree of flexibility, some degree of freedom and independence within these oligopolistic markets.

There is no Government policy other than antitrust that can cope with the problem of collusion in oligopolistic markets.

Observation and analysis by the Antitrust Division—I might say by myself prior to assuming my present position, and by many economists—indicates that collusion in oligopolistic markets is more prevalent and constitutes a greater problem today than the traditional simple form of naked monopoly power.

The fourth point is that for these reasons, antitrust laws appear indispensable to prosperity in a free enterprise economy. There is, I think, no substantial dissent among economists from this view.

There are differences among economists as to the relative importance of the factors influencing economic performance. There are disputes as to whether the economy has an inherently stable or unstable equilibrium. There are disputes as to whether the level of productivity is affected more or less by one or another governmental policy, and whether or not government should intervene at all in an attempt to affect the level of productivity. However, so far as I am aware, all economists concede that antitrust and competition are indispensable

to the achievement and to the maintenance of prosperity in a free enterprise economy.

In the fifth place, however, we must recognize, as I suggested initially, that there are many factors other than antitrust that affect economic performance.

Without attempting to be exhaustive or to give an economic analysis for which I am not qualified, let me suggest that some of the obvious ones are these: Monetary and fiscal policy, tax policy, foreign trade policy, technological developments, limitations on entry into various fields, either by governmental licensing policy or by economic conditions, Government procurement policies, social welfare programs, psychological attitudes, and certainly numerous adventitious factors such as population growth, foreign economic conditions, and military operations. Undoubtedly there are many more.

I suggest no judgment as to the relative importance and influence of these factors. That is a matter for economic analysis by the economists, the Council of Economic Advisers, and by this committee.

However, I do suggest, and this is my sixth point, that the effectiveness of Government influence in such policies as monetary and fiscal policy, tax policy, and trade policy, depends on the maintenance of a free, responsive, and flexible economy. This means a competitive economy which requires antitrust enforcement.

In a free enterprise society, the Government does not dictate economic decisions. Rather, it seeks to stimulate and encourage economic influences. Thus, interest rates, tax rates, depreciation rates, tariff rates, and similar matters depend for their economic influence on the multiplier effect in stimulating numerous private decisions to raise or lower rates or prices and thus encourage buying, production, and other economic performance.

Where there is a monopoly or where there is an oligopoly acting in concert, the effects of Government policy may be minimized, nullified, or indeed wholly subverted, by private decision and private action. Thus, the effectuation of Government policy seeking general economic performance requires the kind of economic structure and conduct that is secured by antitrust enforcement.

Let us be clear that antitrust does not insure the success of Government economic policies. Antitrust does, however, secure the possibility of effectiveness for such policies, and therefore of success in securing prosperity.

In conclusion, therefore, I suggest that an appraisal of the significance of the antitrust laws in the economy depends upon a logical distinction that is fundamental but often overlooked.

Antitrust is a necessary but not a sufficient condition for economic performance and prosperity. To achieve the goals of economic policy outlined by the President in his Economic Report and in his recent speech to the Nation, I think that we must make continuing efforts to keep the economy vigorously competitive. This means continuing to strive for effective enforcement of the policy contained in the antitrust laws.

Chairman PATMAN. Thank you, Judge Loevinger.

In discussing bigness in relation to antitrust violations and acquisitions and control leading to monopoly, would it not be correct to assume that General Motors is about the largest corporation in the world?

Mr. LOEVINGER. No, sir. A.T. & T. is.

Chairman PATMAN. A.T. & T. Would you say that General Motors is the largest manufacturing concern?

Mr. LOEVINGER. General Motors is the largest industrial corporation.

Chairman PATMAN. The automobile industry is as highly concentrated, I suppose, as any industry. Is that correct?

Mr. LOEVINGER. I suppose it depends on how you figure industries. I do not think that is quite correct, Congressman Patman. General Motors has been manufacturing in the neighborhood of 50 percent of the American automobile production. In 1961 it was just under 50 percent. This year it is up to about 56 percent, so far.

Chairman PATMAN. Fifty-six percent. You mean of all automobiles?

Mr. LOEVINGER. Of domestic automobile production; yes, sir. There are industries that are more highly concentrated.

Chairman PATMAN. What percent does Chrysler and Ford have?

Mr. LOEVINGER. Last year Chrysler had about 10 percent. This year they have about 8½ percent. Last year Ford had about 32 percent; this year Ford has about 28 percent.

Chairman PATMAN. I assume General Motors has attained this position principally by acquisitions of other automobile concerns over the years.

I have a chart here—I will give you a copy of it—which gives a long list of acquisitions made by General Motors since 1908, which, without objection, I would like to have included in the record.

(Chart referred to follows:)

*Acquisitions of General Motors Corp. since 1908*

Passenger cars and trucks:	Year
Buick Motor Co. (automobiles), Flint, Mich., stock-----	1908
Olds Motor Works (automobiles and patents), Lansing, Mich., stock-----	1908
Rainier Motor Co. (automobiles), Saginaw, Mich., stock-----	1908
Oakland Motor Co. (automobiles), Pontiac, Mich., stock-----	1909
Cadillac Motor Car Co. (automobiles), Detroit, Mich., stock-----	1909
Rapid Motor Vehicle Co. (trucks), Pontiac, Mich., majority of stock-----	1909
Cartercar Co. (automobiles and patents), Pontiac, Mich., stock-----	1909
Ewing Automobile Co. (automobiles), Geneva, Ohio, stock-----	1909
Reliance Motor Truck Co. (trucks), Owosso, Mich., stock-----	1910
Elmore Manufacturing Co. (automobiles), Clyde, Ohio-----	1910
Randolph Motor Car Co. (commercial vehicles), stock-----	1910
Welch Motor Car Co. (automobiles), Pontiac, Mich., stock-----	1910
McLaughlin Motor Car Co., Ltd. (automobiles), Oshawa, Ontario, Canada, stock (49 percent in 1910; rest in 1918)-----	1910
Chevrolet Motor Co. (Delaware) (automobiles), Flint, Mich., assets-----	1918
Chevrolet Motor Co. of Canada, Ltd. (automobiles), Oshawa, Ontario, Canada, stock-----	1919
Chevrolet Motor Co. of California (automobile assembly plant), Oakland, Calif., assets-----	1920
Scripps-Booth Corp. (automobiles), stock-----	1918-24
Yellow Cab Manufacturing Co. (trucks and coaches), reorganized as Yellow Truck & Coach Manufacturing Co. in which General Motors acquired a 57-percent stock interest, Pontiac, Mich-----	1925

*Acquisitions of General Motors Corp. since 1908—Continued*

	<i>Year</i>
<b>Auto bodies:</b>	
Plant of W. F. Stewart Co. (automobile bodies), Flint, Mich.....	1908
Fisher Body Corp. (automobile bodies), 60 percent of stock (assets in 1926).....	1919
Plant of Martin Parry Corp. at Indianapolis, Ind. (truck bodies), assets.....	1930
<b>Parts and accessories:</b>	
Northway Motor & Manufacturing Co. (motors and parts), Detroit, Mich.....	1909
Michigan Auto Parts Co., Detroit, Mich.....	1909
Seager Engine Works.....	1909
Weston-Mott Co. (axles), Flint, Mich., stock.....	1909
Dow Rim Co., New York, N.Y.....	1909
Michigan Motor Castings Co., Flint, Mich.....	1910
Jackson-Church-Wilcox Co., Jackson, Mich.....	1910
Champion Ignition Co. (succeeded by AC Spark Plug Co.) (spark plugs), Flint, Mich., stock.....	1910
Novelty Incandescent Lamp Co.....	1910
Heany Co., included following subsidiaries: Heany Lamp Co. (electric lamps), Heany Fireproof Wire Co. (magnet wire), Tipless Lamp Co., York, Pa., stock.....	1910
United Motors Corp. (parts and accessories), New York, N.Y., assets.....	1918
Michigan Crankshaft Co. (crankshafts), Saginaw, Mich.....	1919
Saginaw Malleable Iron Co. (malleable iron castings for autos and trucks), Saginaw, Mich.....	1918-20
T. W. Warner Co. (gears), Muncie, Ind., assets.....	1921
Brown-Lipe-Chapin Co. (differential gears), 20 percent of stock acquired in 1910 and remainder in 1922, Syracuse, N.Y.....	1922
Armstrong Spring Co. (auto and truck springs), Flint, Mich., assets.....	1923
Guide Lamp Co. (auto lamps), Cleveland, Ohio.....	1928
North East Electric Co. (electrical equipment), Rochester, N.Y., assets.....	1929
McKinnon Industries, Ltd. (gears and castings), St. Catherine, Ontario, Canada, stock.....	1929
Liberty Starter Co.....	1932
Packard Electric Co. (automobile cables), Warren, Ohio.....	1932
<b>Fire engines:</b> Ahrens-Fox Fire Engine Division of Cleveland Automatic Machine Co. (fire engines and appliances), Norwood, Ohio.....	1951
<b>Road machinery:</b> Euclid Road Machinery Co., off-highway earthmoving equipment; component parts, accessories therefor.....	1953
<b>Aircraft:</b>	
Dayton Wright Airplane Co., Moraine (near Dayton), Ohio, part of assets.....	1919
Allison Engineering Co. (aircraft engines), Indianapolis, Ind., stock.....	1929
Engineering Projects, Inc. (development of airplane propellers), Dayton, Ohio, assets.....	1940
<b>Diesel engines:</b>	
Winton Engine Co. (diesel engines), Cleveland, Ohio, assets.....	1930
Electro-Motive Co. (railroad diesels), Cleveland, Ohio, assets.....	1930
<b>Mechanical refrigerators:</b>	
Guardian Refrigerator Co., Detroit, Mich., assets.....	1919
Meterice of America, Ltd. (meter device for refrigerators), assets.....	1932
Sunlight Electrical Manufacturing Co. (small electric motors), Warren, Ohio, assets.....	1933
<b>Radios:</b>	
Day-Fan Electric Co. (radios), Dayton, Ohio.....	1929
Plant of Crosley Radio Corp. at Kokomo, Ind. (automobile radios).....	1936

*Acquisitions of General Motors Corp. since 1908—Continued*

Miscellaneous:	Year
Plant on Jefferson Avenue in Detroit, Mich.....	1909
Plant of Imperial Wheel Co.....	1916
Samson Sieve Grip Tractor Co. of California (tractors), Stockton, Calif., stock.....	1917
Domestic Engineering Co. (light and powerplants), Dayton, Ohio, stock.....	1919
Dayton Metal Products Co. (including subsidiary Dayton Securities Co.), Dayton, Ohio, stock.....	1919
General Leather Co., 50 percent of stock.....	1919
Janesville Machine Co. (farm implements), Janesville, Wis., stock.....	1919
Lancaster Steel Products Co. (cold drawn wire and bar steel), Lancaster, Pa., stock.....	1919
Plant of Interstate Motor Car Co., Muncie, Ind.....	1919
Plant of Hastings Consolidated Press & Tool Co., Hastings, Mich.....	1919
Property of Reliance Engineering Co., Lansing, Mich.....	1919
Saxon Plant of Industrial Terminal Corp.....	1919
Plant of International Arms & Fuze Co., Bloomfield, N.J.....	1919
Plant of Flint Motor Co., Flint, Mich.....	1926
Heat Transfer Products Corp.....	1934
Plant of Durant Motors Corp., Lansing, Mich.....	1935
Plant of LaFrance-Republic Corp., Bloomfield, N.J.....	1935
Plant of Ryan-Bohn Foundry Co., Lansing, Mich.....	1940
Foreign acquisitions:	
Bedford Motors, Ltd., European distributor, London, England, stock.....	1911
Vauxhall Motors, Ltd. (automobiles), Luton, England, stock.....	1925
Adam Opel Aktiengesellschaft (automobiles), Russelheim, Germany, 80 percent of stock.....	1929
Holdens Motor Body Builders, Ltd., Australia, assets.....	1931
Affiliates:	
Doehler Die Castings Co., 40 percent of stock.....	1918
Ethyl Corp. (tetraethyl lead), 50 percent of stock.....	1924
Bendix Aviation Corp., 25 percent of voting stock (stock resold in January 1948).....	1929
Fokker Aviation Corp. of America (airplanes), 48.58 percent of stock (assets merged into North American Aviation in 1933; successor company dissolved in 1934).....	1929-33
Kinetic Chemicals, Inc. (Freon), 49 percent of stock (sold in December 1949 to E. I. du Pont de Nemours & Co.).....	1930
North American Aviation, Inc. (aircraft), 29.1 percent of stock (stock resold in May 1948).....	1933-34
International Freighting Corp., Inc., 83.3 percent of stock, New York, N.Y. (sold in October 1956 to E. I. du Pont de Nemours & Co.).....	
National Bank of Detroit, Detroit, Mich., 50 percent of stock.....	1933

Chairman PATMAN. As you read down the list you see a lot of the important names of automobiles that are still manufactured by General Motors: for example, Buick, Oldsmobile, Cadillac, Chevrolet. These were all independent automobile companies at one time, until General Motors bought them out.

Yellow Cab was another company bought out by General Motors. Then there was Fisher Motors and Champion Sparkplug. General Motors has bought all kinds of firms through the years, passenger cars and trucks, parts and accessories, aircraft, diesel engines, radio. It has bought English and German and Australian firms.

Do you not think, Judge Loevinger, our country would be much better off if we had a lot more automobile companies spread out throughout the Nation with local people in management and operation?

Mr. LOEVINGER. This is a very complicated and difficult question to answer, Congressman Patman.

We are, as is well known, maintaining a number of antitrust suits against General Motors at the present time, and we have a continuing investigation of certain other aspects of its operations.

I would not want to appear to prejudice the conclusion of our investigations; and indeed it is only fair to say that were I to do so, this would not be a reliable judgment, since I am not intimately familiar with the evidence that has been gathered by the staff.

It will require bringing together a very large mass of detailed evidence, and a very careful appraisal of this evidence, to reach a wholly fair conclusion as to this, I believe.

Chairman PATMAN. Well, I do not want you to be persuaded to say something that you should not say, in view of these suits that you have pending against General Motors.

Now, to save time, I will read a number of questions and ask you, when you get your transcript, to answer those that you can.

After the question I just asked you: Would we not have a lot more competition in the industry if we had a lot more automobile companies? Of course, obviously, the answer is in the affirmative, there.

I know that General Motors, being a great big company, claims to be one of the most efficient and progressive companies in the world. But if they are so efficient and progressive, why did they not anticipate all this demand for small foreign automobiles that we have seen in this country during the postwar years?

It does not seem very efficient to me when they miss a big marketing opportunity like that? Does it to you?

Do you not think that some of our balance-of-payments problem has been aggravated by the fact that all of these foreign automobiles have been imported?

Take the steel industry. That is another of the so-called administered price industries. We have heard complaints about a lot of steel imports in recent years, and our steel companies seem to have lost a lot of their foreign markets for steel.

Does this not reflect on the industry and its failure to be competitive and reduce its prices so as to be competitive? Is this not another source of our balance-of-payments difficulty?

I have some figures which were worked up by Senator Kefauver's economics staff, which indicate the effect of the increase in steel prices on our adverse balance of payments. I would like to read these into the record.

#### STEEL PRICE EFFECT ON EXPORTS

During the period 1954-56, U.S. steel exports represented 20 percent of the world total steel exports; by 1960 they had fallen to 12½ percent.

Had American exports held at the 20-percent figure in 1960, American steel exports would have been \$400 million greater.

In addition, some \$300 million of additional imports to the United States of steel products occurred. Thus, some \$700 million of our adverse balance of trade in 1960 may be traced directly to steel losses in the world market, to say nothing of the indirect losses incurred in

steel-consuming industries because of the steel price rise. This \$700 million represents a very substantial proportion of our \$1,100 million adverse balance of trade.

That was last year, of course.

Mr. LOEVINGER. I will certainly say this. These are very challenging questions, Congressman Patman.

Chairman PATMAN. Yes, sir. Answer all of them you can, if you will, for the record, when you get your transcript.

And I am going to read some questions about foundations I will ask you to answer, too. I will not have the time to get your answers, because we alternate, here, and my time will expire before you could answer all of them, but I will read them into the record.

Senator SPARKMAN. Mr. Chairman, I am going to have to leave here in about 5 minutes. I have an appointment down in one of the departments. Since we are at a good breaking point, I wonder if you would let me interject for a few brief questions.

First, I want to apologize to Judge Loevinger for having to leave, but it is one of those things that I cannot help. I did want to be here and hear a part of your presentation.

I want to say that I think you have been doing a very fine job in your work. I think that you enjoy the confidence of all of us.

Mr. LOEVINGER. Thank you.

Senator SPARKMAN. But there is a question that sometimes worries me, and this has to do with the field of small business.

My friend, the chairman, here, is chairman of the Small Business Committee on the House side, and I have the privilege of serving as chairman on the Senate side.

I often say that the greatest concern to small businesses in this country is not financing, as important as that is. Nor is it management, as important as that is. It is being able to compete in a fair market. I am sure the chairman of the House committee would agree with me on that.

Now I believe it to be a true statement that you do not have a force for policing these matters, and suits are rather slow. Court actions are usually long drawn out. Many small businesses can be ruined while waiting for court actions to take place.

Now, I know the Federal Trade Commission does have some policing powers, and you may have some powers. But I have often wondered just what could be done or what should be done in order to get quick action in cases in which there are unfair practices that may ruin small businesses before action can be taken.

Now, I will give an example. Just recently I had a friend in my State call me on the telephone. He was the operator of a small bakery operating just in one town. He told me that a chain bakery, a big one, had reduced the price of bread by 3 cents a loaf in his town. In another town 6 miles away, there had been no change.

All of the circumstances he gave indicated that it was a move to freeze him out. And he told me he could be frozen out very quickly, and that it could have disastrous results.

May I say that I took this matter up with your office, and also with the Federal Trade Commission, and both of you moved in quite promptly, and the matter was cured quickly.

That is a case that worked out all right. Many other cases do not work out that way.

I may give another instance, not quite as clear cut as that. I had a case one time where a small business became involved in hearings. The hearings were really directed against big businesses but the small business became involved. And in order to protect their rights, they had to move around to many different places in the country in connection with their hearings.

And again I was told by this particular small business that they simply could not bear the expense of that, and therefore their rights, they felt, were not protected.

I may say that I took that matter up with the Federal Trade Commission, and later our Committee on Small Business made a recommendation that the practice be changed; and I believe there were some rules put into effect changing it.

Now, the question that I will put is this: What is being done, or what can be done, to assure to small business prompt and reasonable action in order to protect them against practices of the kind that I have mentioned?

Goodness knows, there are hundreds of different practices that could be used as an example, but I just use those two to illustrate my question.

Mr. LOEVINGER. This is one of the very important problems with which we are concerned, Senator Sparkman. In a sense, this is merely an aspect of a similar but broader problem, which is how to reconcile the demands of due process with the necessity for expedition in the administration of justice. It is not only in antitrust laws or in aiding small business, that this problem arises.

Just yesterday I was reading an article in the New York Times magazine about indigent defendants who were sometimes held in jail for sometimes as long as a year, awaiting trial, at which time they might be acquitted. And yet, they would have been imprisoned for a year because they could not raise bail money and because there was no method of disposing more expeditiously of their cases. This is a general problem.

The converse of it, of course, is that of criminals who remain at large on bail for extended periods, although they are flagrantly guilty and are ultimately convicted.

In the business field, the problem is more difficult, because we are dealing with more complex phenomena, and therefore the gathering and the presentation of evidence becomes more difficult and takes longer.

There is within the Antitrust Division a procedure that we call our small business procedure, which involves an attempt to dispose of some of these problems simply by writing to the parties concerned.

Frequently, an inquiry by the Antitrust Division will dispose of the problem by calling the attention of the predatory business to the fact that the Government is interested. It may cause the predatory practice to cease.

We believe that improvement of the enforcement means afforded the antitrust agencies will help. We have hopes that Congress will at this session enact the civil investigative demand bill, which will give us a more flexible tool for enforcement and for prompt action.

I predict that the problem is not going to be wholly and satisfactorily solved in my generation or yours. We will keep on trying, and we will keep on expediting our procedures as much as we can, consistent with due process.

The difficulty is that of course there is always the necessity for careful investigation and weighing of the evidence, if we are not to short-circuit our basic constitutional principles. There just is no quick, ready answer that I have to give to you.

This does to some extent, however, suggest the point that I tried to make earlier. It is not merely the antitrust policy that is involved. There are many other Government policies that are involved.

We find problems connected with Government procurements. The same complaint is sometimes made in relation to some of the Government contracting practices. It is sometimes said by small business that it is easier for big business to wade through the mass of paperwork that is required in contracting with the Government, and to wait for payment, than it is for small business to do this.

Practices have been undertaken to alleviate this complaint, and I believe they are being somewhat successful. There is no single answer across the board. We simply must be conscious of this problem, and keep working at it.

Senator SPARKMAN. Thank you.

And again I express my regret at having to leave.

Chairman PATMAN. I think I have just about enough time to read these questions, with the understanding that you will answer them when you look over your transcript.

Over at the House Small Business Committee we have been making a study of the tax-free foundations. I wonder if you have had an opportunity to consider those foundations that are engaged in business enterprise? Do you see anything contrary to the spirit and objectives of the antitrust laws in a situation where a corporation accumulates a large amount of funds, tax free, and then borrows those funds back to finance expansions of the corporation, or to finance the acquisition and merger of other corporations?

I can see some merit in giving tax exemptions for an individual or a family who want to establish a foundation for charitable purposes. But I am really wondering if it is proper for a business corporation to have a foundation. When a business corporation sets up its own foundation to carry out its own education programs or its own charities, or both, does it strike you that the corporation is beginning to take on the scope of a private government?

Do you have any recommendations to make for improving the effectiveness of the antitrust laws and the other laws intended to help maintain competition, and to prevent practices which tend to lessen competition or create monopolies?

Back in June I noticed a report of an interview that you gave to Anthony Lewis of the New York Times. In that piece Mr. Lewis quoted an official of the Antitrust Division as saying that—

It is probably true that we are affected by business uncertainty to the point where we are holding up cases with a novel or uncertain legal approach. We are sticking pretty much to the precedents, to the established lines.

Does that not mean, Mr. Loevinger, that we are simply following a mild program of antitrust enforcement, punishing the conspirators but leaving the big firms which are dominant in their industries untouched, as long as they do not get mixed up in obvious collusive arrangements?

No case has been brought in recent years, to the best of my knowledge, that really had as its purpose divestiture of dominant firms in a major industry. The GM-DuPont litigation, in spite of all of its complexities, still leaves each of those giant companies No. 1 in their respective industries.

What program do you have for dealing with this sort of situation?

If you will answer those for the record, it will be appreciated very much, Judge Loevinger.

Mr. LOEVINGER. Yes, sir.

(The response to this inquiry appears in the appendix at p. 952.)

Chairman PATMAN. Now I shall yield to Mr. Reuss of Wisconsin.

Representative REUSS. Judge Loevinger, where are we, nowadays, in terms of the Supreme Court decisions on what is called conscious price parallelism?

I am under the impression that the Supreme Court has thereby rather effectively put you out of business, unless you can prove that a Gary dinner occurred at which time there was worked out an agreement to fix prices.

Mr. LOEVINGER. I do not think so, Congressman Reuss. The only decision that I am aware of that has seemed to back down somewhat from the so-called conscious parallelism doctrine is the *Theatre Enterprises* case.

Now, this was a private lawsuit by a theater owner against a number of large distributors who had formerly been engaged in conspiracy as established by the Government in the *Paramount* case.

The jury in the district court found a verdict for the defendants. The court of appeals affirmed. The plaintiff appealed to the Supreme Court, claiming that if full effect were given to the prima facie significance of the *Paramount* decree and to the fact that the defendants acted uniformly in denying the plaintiff the particular exhibition rights that he sought, there would have been a case that would have required the jury to find in favor of the plaintiff.

The Supreme Court simply said that the lower court gave the *Paramount* decree all the effect to which it was entitled; and then it said that—

Although we have referred to the doctrine of conscious parallelism in the past, this has not altogether read conspiracy out of the Sherman Act.

This was said, however, in the context of affirming a jury's verdict in a private suit.

Representative REUSS. There is no magic in the fact that it was a private suit. The distinction, if any, is that it was a jury verdict; and I suppose the Supreme Court was saying that included within that finding was almost anything.

Mr. LOEVINGER. Yes, sir.

Well, there is no magic in the fact that it was a private suit, except that it appears that courts, possibly including the Supreme Court, tend to lean a little more toward vindicating the antitrust policy in Government cases than in private cases.

In private cases, you not only must prove your conspiracy, but you must prove its focus in an impact causing damage on a party; and, therefore, there is a much narrower range within which to operate.

Representative REUSS. Let me ask you this: Suppose there are four producers of X commodity, and suppose, over the years, with uncanny precision, they raise their prices in the same amount at about the same date, but that that is all you can prove. No Gary dinner, no collusion, no letters, no telephone calls, no Hotel Barclay, no nothing. Where are you? Have you got a lawsuit there, or do you not?

Mr. LOEVINGER. Well, you have a lawsuit there. This was somewhat similar to the *Tulsa Oil* case. Of course, lawsuits never come with facts as starkly stated as this. You get identical price behavior over a period of time, but then you also get economic testimony on behalf of the Government that economic conditions are not such as to produce price identity, absent collusion, and economic testimony by defendants that the price identity was the result of other economic circumstances, or of common responses to similar circumstances.

The Supreme Court has not yet, so far as I am aware, passed on a case of precisely this sort. It is, it seems to me, quite permissible for a court to find conspiracy from facts of this sort, but I do not think that it is necessarily compulsory.

Representative REUSS. You think, then, that a court or a jury could, even in the stark case that I have presented, find circumstantial evidence of conspiracy which would stand up?

Mr. LOEVINGER. Yes, sir, I believe it could; although frankly, in a case in which the facts were as starkly stated as you have suggested, and where there were not a great many additional facts, I would be inclined to test it out in a civil case, in which case, of course, there would not be a jury.

One of the difficulties with the *Tulsa Oil* case, I believe, was that it was brought as a criminal case. Thus, when Judge Savvage dismissed, at the conclusion of the Government's case, the Government was all through.

There was no possibility of testing whether or not, giving full range to all of the inferences which the Government at that point in the procedure was entitled to, it might not have been possible to spell out conspiratorial or collusive action.

Representative REUSS. The next step in point of difficulty after price parallelism, is what has been called "administered pricing," that which is said to have occurred or did occur in concentrated industries—steel, automobiles, and heavy engineering—particularly in the 1955 to 1960 period.

And there it is true, is it not, that most antitrusters give up? This is not an area reached by the Sherman or Clayton Acts.

Mr. LOEVINGER. Well, as you are probably aware, the work of Chamberlain and other economists following him has shown pretty clearly that as markets become more oligopolistic, price behavior tends more nearly to resemble monopolistic pricing. That is, the fewer and fewer enterprises there are in a market, the more nearly their price behavior is likely to resemble monopoly pricing, even without conscious collusion.

The antitrust laws do not reach this economic tendency. I believe that is true. The antitrust laws go only to conscious collusion or phenomena of that character.

Representative REUSS. Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Judge Loevinger, I want to pursue something that Senator Sparkman started talking about.

The New York Times the other day had an article entitled "Small Businesses Declining in Area." Now, these figures I think are really sensational, and I was struck by them. Although I knew small retail businesses had been declining, I had no idea it had reached these fantastic proportions.

Let me read you this paragraph:

New tabulations of the 1960 Federal Census show that there are now 66,000 managers, corporate officials, and proprietors in retail trade in the New York metropolitan area. In 1950, there were 153,000 such shopkeepers.

In other words, a decline from 153,000 down to 66,000; so that there are less than half as many retail outlets, establishments, today, in New York, as there were only 10 short years ago.

Now, I am struck by this, because, at the same time, the population in the area increased very substantially, and the number of sales clerks increased very substantially; sales themselves increased far more than population did.

I would like to just read the following paragraph, before I ask you to comment.

The little store tended by a neighborhood shopkeeper has been replaced by a section of a large store. With exceptions becoming rarer, the butcher shops are departments in giant chain supermarkets; the bakeries are shelved walls and cases in the markets, and candies, and candles, mostly the product of automated factories, are sold in markets, variety stores, and gift shops.

Now, I am one of those who is sponsoring legislation to provide for a kind of retail price maintenance or fair trade, and I recognize the opposition which your Department has had for this kind of thing.

But I think when we see the impact of concentration, in retail trade, especially, and the fact that these individual stores, which provide very, very useful social values, of independence and initiative and so forth, particularly in small towns, but even in the big cities, are declining with such fantastic rapidity, I am just wondering if there is not some concern on the part of the Department of Justice and some willingness to reconsider the long-range habitual kind of dogmatic opposition to any legislation which will give small business an opportunity to have a fighting chance to survive—small retail business.

Mr. LOEVINGER. I think, Senator, if I may say so, you overstate the position of the Department of Justice. I do not think the Department of Justice has ever taken a dogmatic position against legislation that would seek to give small business a chance to survive.

However, I would like to take just a minute, if I may, to comment.

Senator PROXMIRE. Well, it is obvious that more than half the individual firms in New York did not survive. They have failed.

Mr. LOEVINGER. I have seen this article, and I agree with you. It is quite sensational. I do not believe it represents national figures, since the national figures that I am familiar with tend to show that there has been some increase in the number of businesses.

Senator PROXMIRE. Oh, yes. I would like to interrupt right there.

For example, what it showed in New York was that there was a decline in the number of managers and so forth in New York, from 618,000 to 569,000. And that included retail trade. That was a decline of 49,000; where the decline of individual retail proprietors was 87,000.

This means that other businesses increased. But I am talking about the retail area. Here is the area where we have had devastating impact of the supermarkets.

Mr. LOEVINGER. So far as I am aware, the argument of most of the supporters of resale price maintenance is that it is necessary to insure the survival of small business, particularly retail business.

However, nobody has attempted to analyze and examine the figures to determine whether or not in fact this is what such laws do.

Now, we have had as many as 45 out of the 48 States having fair trade or resale price maintenance laws in the past, as you know. The number now has declined to about 25. But over a long period of time we have had a very good laboratory-type experiment with these laws.

The Department of Justice has undertaken an analysis of the figures, and we have found that without variation, year by year, over a more than 10-year period, the business rate failures for business generally, and apparently for retail businesses, are higher in those States with resale price maintenance than they are in those States without resale price maintenance. And the difference is a very marked statistical difference.

Now, the analysis suggests why this may be true. The complaint is that small business is having a difficult time competing with large business and holding its own with chainstores and manufacturers.

However, the resale price maintenance approach puts it entirely within the power of the large manufacturer to control the price, and to establish the conditions which are supposed to help small business.

In fact, these manufacturers are mostly interested in the large retailers, and the chainstores, and in many cases are affiliated with chainstores.

Under the pending bill, in fact, there is a specific provision that permits manufacturers with their own retail outlets, their own factory stores, their own chainstore affiliations, to engage in resale price maintenance.

To say that this is a bill that will protect small business seems to me to be like saying we will deputize all of the robbers that we catch and make them part-time policemen in order to protect citizens against robbery. This just makes no sense at all.

On the other hand, the argument that is made most frequently by the very sincere, very articulate, and very well informed advocates of such legislation, is that the things that they must really guard against are so-called loss leader pricing.

It is said, and quite properly, that we cannot make the pricing system too inflexible, but that we must prevent the long purse of big business from being used to drive small business out by loss leader pricing.

I think it is significant, however, that Senator Humphrey has had a bill in the Senate, if I recollect correctly, S. 2120, specifically directed against loss leader pricing, in which all of these very vocal advocates of resale price maintenance have shown almost no interest.

Such a bill as that by Senator Humphrey, without commenting briefly on—

Senator PROXMIRE. He is the author of both bills.

Mr. LOEVINGER. I understand he is a coauthor.

Senator PROXMIRE. He is the principal sponsor of the stabilization bill.

Mr. LOEVINGER. But I have talked with Senator Humphrey, and I believe Senator Humphrey is behind both bills.

The significant thing is that the lobbies, the people who are advocating laws of this sort, are pushing the resale price maintenance, exhibiting not the slightest interest, as far as I can determine, in the loss leader bill.

Now, the loss leader bill is a bill that would cut clear across the field, that would attack directly the evil sought to be remedied. It would establish a uniform rule of law. It would not leave the protection of small business to the tender mercy of large business. It would not establish any of these very questionable situations in which it is not at all clear what the rule is going to be, because it depends upon the private action of particular businesses.

It is a relatively clear-cut and a relatively clean approach to the problem, which does establish a uniform legal rule that has some chance, at least, of achieving the objective sought.

I think that the quality stabilization bill or resale price maintenance bills have no chance of achieving the objectives to be sought, and in fact would work in reverse, as our statistics indicate they have to date.

Senator PROXMIRE. First let me say that I support both bills enthusiastically, and let me say also that the statistics I have seen—and I would be very anxious to see your statistics—the statistics that I have seen have given exactly the opposite picture.

For example—and there are many, many examples—the maintenance of prices for gasoline in New Jersey was a clear demonstration, it seems to me, of the possibility of eliminating price wars which are destructive of the small businesses and do very little or nothing for the consumer.

As a matter of documented fact, when the small dealer was wiped out, prices had gone up in the past very sharply before retail price maintenance came in, and after it the situation of stability at a moderate price had prevailed pretty consistently, so that consumers and small business both gained greatly.

I would like to ask you about something else.

Has the Department of Justice expressed an interest in the identical bid situation, which concerns us very deeply, concerns this Senator, at least, and, I know, other members of this committee?

The fact that we have had over a past year or so one example after another of firms, as many as four or five firms, bidding—and these are all the firms that do bid—and every bid being exactly identical on a pretty big contract, down to the fourth or fifth decimal point?

This has been a matter of real concern, and I know that Senator Lausche has offered several examples to the Senate, and I have had several in my State, and I am wondering if the Department of Justice has gotten into the situation at all.

Mr. LOEVINGER. Yes, sir. We have been very interested and very active. As you are undoubtedly aware, following the suggestion of this committee and of Congressman Patman and Senator Douglas, the President issued an Executive order calling for the reporting and collating of identical bids.

Senator PROXMIRE. What has happened on that? What is the situation now?

Mr. LOEVINGER. This has been implemented and undertaken.

Following the Executive order, in order to do this properly, we had extensive conferences with representatives of the Defense Department and GSA. What was sought was to get a form of report and standard regulations that will provide for the report, so that they would come in in useful form, that could be manipulated, and that would permit the data to be worked with. If we simply had miscellaneous reports coming in, without any uniformity, of course, it would be impossible to work with such a mass of data.

These regulations were promulgated, and if I recollect correctly, reports started to come in around September 1 of 1961, from the Federal agencies. Subsequently, extensive conferences were held with representatives of State governments, and analogous forms were promulgated for the States.

The States, of course, could not be required to report, but the States, the larger municipalities, school districts, and similar governmental units, were invited to report.

Senator PROXMIRE. The larger municipalities? I know that several of the complaints I received were from small municipalities in Wisconsin.

Mr. LOEVINGER. There are a total of 102,000 governmental units engaged in purchasing in the United States. We concluded it would be physically impossible to handle reports from this many.

Therefore, invitations were sent to larger municipalities, school districts, counties, and purchasing groups, and in addition we have plans for a random selection of the others in order to give a cross section that is representative of the entire local and State governmental purchasing operation.

We think that the reports that are being secured will cover 75 to 80 percent of the purchasing and of the population.

In addition, anyone else who wishes to report, of course, is invited to do so. But we have simply felt that the circulation of over 100,000 governmental units for this purpose was a burden that was just a little too great to handle.

Reports have been received since this program was initiated, and the initial report of the Attorney General has been prepared by the staff and is now being examined by the Attorney General. I believe this committee will have it within a relatively few days.

(Discussion off the record.)

Senator PROXMIRE. I just have one other question, Judge. That relates to what I think is an unfortunate lack of advertised competitive bidding in procurement in our Government.

I am particularly concerned with the space budget, where as I understand it, only \$1 out of less than \$10—actually it is, I think, \$9 out of \$100—represents procurement based on advertised competitive bidding.

Congress has established advertised competitive bidding as the preferred method of procurement. We all recognize the enormous benefits from advertised competitive bidding, not only to the taxpayer, which are obvious—costs are bound to be lower, it would seem to me—but particularly for the opportunities for all business people to compete on an equal and fair basis without special privilege. And small business does a lot better, as you know, on advertised competitive bidding.

I know that this is something that may be a little delicate, because it has to be within the purview to a considerable extent of the particular agency involved. But I wonder if the Department of Justice expresses an interest and a concern to the Defense Department, the Space Agency, and so forth, with regard to advertised competitive bidding.

Mr. LOEVINGER. Well, we do where we have a legitimate opportunity to do so. It is not the function of the Department of Justice or of the Antitrust Division to supervise the activities of NASA or the Department of Defense, and we do not undertake to do so.

Occasionally, we do have some function to perform which gives us an opportunity to comment on a particular practice. We have gone over certain contracts and have commented on various provisions in them, and suggested on occasion modifications that we thought would encourage competition.

The Department of Justice has the duty of commenting on surplus property disposal. You may have seen a little story in the papers recently about the disposition of a plant on Long Island where the Department of Justice said that it could not approve the proposed disposition as being consonant with the statutory standards, because it was disposed of under conditions that did not permit competitive bidding.

In general, however, Government procurement is an activity that does not come within the jurisdiction of the Department of Justice, and which the Department of Justice does not importantly influence.

It is, as I have suggested earlier, one of those other policies that does have to do with the competitive character of the economy in addition to antitrust.

Senator PROXMIRE. In view of your expertise in competition, and your tremendous experience in this area—I am speaking both of you and the Department of Justice—and its responsibility for competition and antitrust action with regard to competition, I think that any observations, any study, any recommendations, which you might have, either to Congress or to the agencies, would be enormously helpful, because this is something that we feel pretty helpless about in Congress.

Our Government has been losing out on competitive bidding, and we are told by the top Government officials that they cannot do it,

that it is easier to negotiate, or more in the national interest to negotiate. But it is hard for us to challenge that.

And we have instances where we are just positive that this is not the proper procedure. So that any opportunity which the Department of Justice might find in the future to urge competitive bidding would be, I think, very helpful.

Mr. LOEVINGER. Yes, sir.

Chairman PATMAN. Thank you.

Judge Loevinger, we will resume with you, then, Wednesday morning, at 10 o'clock, if it is all right with you.

Thank you kindly, sir, for your appearance, and your answers to the questions, your comments, and your statement.

Mr. LOEVINGER. Thank you, Congressman.

Chairman PATMAN. Tomorrow morning at 10 o'clock, here in this room, we will have as witnesses Edwin J. Nourse, former Chairman, Council of Economic Advisers, 1946-49, Alfred E. Kahn, professor of economics, Cornell University, Walter Adams, professor of economics, Michigan State University, and Richard J. Barber, professor of law, Southern Methodist University.

The committee will stand in recess until 10 o'clock tomorrow morning.

(Whereupon, at 11:15 a.m., the committee was recessed, to reconvene at 10 a.m., Tuesday, August 21, 1962.)



# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

TUESDAY, AUGUST 21, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representative Patman; Senators Proxmire and Bush.

Present also: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will please come to order.

Dr. Nourse, will you come around, please?

The committee continues hearings on the state of the economy and policies for full employment.

This morning we are concentrating on competition and monopoly problems and the question of how to strengthen and maintain competition, which is our historic national policy for trying to achieve full employment and growth and progress in our economy.

Our first witness this morning is Dr. Edwin G. Nourse, the first Chairman of the Council of Economic Advisers and a distinguished educator and economist.

Dr. Nourse, I see you have a prepared statement. You may proceed in your own way. If you would like to, you can file a statement, and it will go in the record at this point, and then you can summarize it and comment on the parts that you think are necessary.

I mention that in view of the fact that we have a panel coming on after you, and it looks as if we will just have this morning to do the whole thing. And then we would like to have you, if you desire to do so or are willing to do so, join the panel. Then we will ask all of you questions.

Whichever you prefer, sir. We are indeed glad to have you.

## STATEMENT OF DR. EDWIN G. NOURSE, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, 1946-49

Dr. NOURSE. Mr. Chairman, it is a pleasure to be back here testifying before this committee, which I have done several times over the years.

My paper is only five pages, and I think, I probably would not be able to pick out its highlights very well.

Chairman PATMAN. You may proceed in your own way.

Dr. NOURSE. It seems a good augury for the continuing intellectual leadership rendered by the Joint Economic Committee that the chair-

man and his fellow members were not satisfied to conclude this series of hearings on the state of the economy and policies for full employment with attention focused so exclusively as it has been thus far on fiscal and monetary processes and policies. I deplore the exaggerated emphasis that professional economists have in recent years been giving to this "macroeconomic" part of the total economic process, important as it undeniably is *per se*.

I would suggest that the situation is broadly comparable to that in the field of medical thinking and practice. There, the relatively recent emergence of radical surgery as a corrective and preventive technique has often led to overweening reliance on these procedures, to the partial eclipse of medication, diet, and other traditional methods in the whole regiment of health maintenance and restoration. Fortunately, the "internist" has now appeared as a medical specialist, devoted to treatment of "the whole man" by coordinating medication, surgery, physical therapy, and even psychosomatic techniques into a comprehensive and well-balanced pattern of health care.

The internist of economic health is commonly referred to—sometimes with condescension—as a generalist. But I submit that such generalists or economic internists should be included along with fiscal, monetary, and private-sector specialists on whatever panels this or other committees of the Congress consult and likewise on such advisory staffs as are used by the executive branch.

Obviously, with the flow of funds through the Public Treasury, with Federal spending and taxing now covering operations which amount to about one-sixth of the gross national product, the fiscal policy area is one of very great importance. Likewise, the administration of a national currency that is to be flexibly responsive to business needs and be suitably geared to the investment process through interest rates is of vital consequence. But in the last analysis, the problems emerging with reference to both these functions and the burdens that devolve on both these organs of the national body economic are kept manageable or are rendered insuperable by the way in which the private sector of the economy is functioning. Even fiscal and monetary policy cannot be adequately analyzed and formulated in isolation from the processes of the private business world—collective wage bargaining, administrative price setting, capital formation, and investment.

To make our basically private enterprise system operate so well in the use of national resources and the satisfaction of human wants that its shortcomings will not have to be "compensated" by frequent and massive fiscal and monetary manipulation (with their threat of advancing statism), our business structures—primarily of the corporation and the union—and the policies and practices of their executive officers and their lesser participants must maintain a dynamic balance between saving investment and labor inputs (including technical and managerial skills) on the one hand and such disbursements of purchasing power as will result in promptly clearing the market of the varied and voluminous product of comfortably full capacity operation.

This is a sweeping, highly generalized, even pompous statement of ideal operation of our everyday bread-and-butter, free enterprise, producer-meets-consumer business world. In proportion as actual performance falls below that ideal or a reasonable approximation of it, our ambitious and impatient populace will demand that their demo-

cratic Government fill the gap or attempt to fill it through fiscal and monetary devices, however drastic and hazardous as to their foreseeable side effects. Of these harmful consequences, inflation, impairment of private enterprise, and loss of operational flexibility are outstanding.

There is much in evidence today (and strong in influence at policy-making centers) a cult of economic magicians, who claim that fiscal and monetary action alone can, in any time of business sluggishness, so stimulate the private economy that a desired rate of acceleration will be induced. They regard this response as bankably certain. Tax abatement or enlarged Government spending, they argue, can be undertaken in magnitudes great enough to insure effectiveness, with confidence that prompt growth in the volume of national production, multiplication of jobs, fattening of profits, and easing of credit will preclude a budget deficit and indeed create a Treasury surplus as well as a rise in the level of general consumption.

This consummation, so devoutly to be wished, entails also, in that philosophy, an upward spiral of continuing national economic progress, but seems to me to rest on oversimplified assumptions about the fundamental nature of free enterprise, business motivation, consumer behavior, and collective wage bargaining. In an article several years ago, I attempted to portray the difference in two major schools of economic thought among businessmen as well as economists in these terms:<sup>1</sup>

The divergence of views concerning goals espoused in the Employment Act (and means of reaching them) grows out of two basic concepts of the nature of our enterprise economy. One may be called the filling station philosophy; it is concerned primarily with a fuel supply poured in from the outside. The other may be called the service shop approach; it is concerned primarily with optimum adjustment of the working parts internal to the machine.

The filling station approach is external to the policy and action of individuals, of firms and organized groups, and even of Government except in its fiscal role. It is concerned with aggregate magnitudes on both the supply and demand side of the labor market—total labor force and total job offerings. It conceives our economy as an integrated mechanism having a rated productive capacity expressed in numerical manpower comparable to the horsepower of a machine. If output falls below theoretical capacity, the sovereign remedy is to "turn on more juice" in the form of total monetary demand \* \* \*.

In contrast to the filling station approach, that puts all or most of its policy eggs in one statistical basket, the service shop approach does not start from a unique theory of cause and cure (or even an attribution of categorical dominance to any one line of causation). The policymaker proceeds to make comprehensive diagnostic studies of the economy to discover any possible source of low performance or a combination of many small maladjustments or functional derangements. His objective is to see what small or local lapses from maximum or optimum use of labor power add up to enough unemployment to become a cause of general concern and the initiation of public action. This approach centers its diagnostic techniques and remedial prescriptions on matters internal to the business process such as income incentives and purchasing power of households, firms, and communities—the modernized refinement of Say's law. Like medical therapy, its prime concern is to locate organic flaws or functional derangements (physical, chemical, biological, or psychosomatic) which are responsible for disability, pain, or malfunctioning. For these the physician seeks specific remedy though he finds the temporary stimulation of alcohol, adrenalin, or benzedrine pills useful on occasion. \* \* \* It is obvious that the two philosophies are not mutually exclusive, but the difference in emphasis is so great as to amount to a difference in kind when it comes to sharp issues of employment policy, or, more broadly, economic stabilization policies.

<sup>1</sup> "Defining Our Employment Goal Under the 1946 Act," *Review of Economics and Statistics*, May 1956, p. 196.

Developments in technology in business structures and practices, in the culture patterns of our people, and in the international complex of which we are a part have made terrific demands for revamping of our free enterprise system since World War II—the life span of this committee. Your committee's record of recognizing the challenges within the private sector as well as the public sector of the national economy is admirable. I need cite only your special studies of automation and of small business and your comprehensive examinations of employment, growth, and price levels, and of the relationship of prices to economic stability and growth.

I read the present signs as portending failures in the reciprocal adjustments among wages, prices, profits, and capital formation in the years just ahead that threaten to show a performance of the private economy far below the goals set in the Employment Act of 1946 under which this joint committee was set up. Such shortfalls in the private sector would throw burdens on fiscal and monetary policy so far outside their normal scope as to upset a sound division of labor between the two branches of the national economy—private and public.

It would appear to me in this connection that the economic statesmanship of the President has shown a better balance than the policy line of his professional economic advisers. In the early months of his administration, he established a continuing Advisory Committee on Labor-Management Relations as a sort of summit conference between the Departments of Commerce and of Labor and the prime ministers from organized labor and big business. The Executive order of February 16, 1961, setting up this Advisory Committee stated that its purpose—

is to help our free institutions work better and to encourage sound economic growth and healthy industrial relations. \* \* \* It will bring to the great problems of collective bargaining, industrial relations, wage and price policies, and productivity the experience and wisdom of labor, management, and public experts in these fields (and) help restore that sense of common purpose which has strengthened our Nation in times of emergency, and generate a climate conducive to cooperation and resolution of differences.

Obviously, what this Advisory Commission can accomplish will be in no small part the mutual education of these leaders in strategic posts and in effecting some rapprochement among them. It should serve as a seminar in which the issues that divide our two great business classes and that retard the progress of the economy may be formulated in realistic terms by the men most intimately aware of and most deeply involved in the results of their solution or their impasse. This very fact of deep personal involvement, however, is a difficulty of the summit conference as well as a condition necessary to effective treaty-making.

And so, in May 1962, the President convened a White House conference of larger membership, embracing more executives of individual companies, lesser labor officials, lawyers expert in economic affairs, and academicians of the real world, not the ivory tower.

In response to a question at his next press conference about results of this meeting, President Kennedy said:

The meeting, of course, had two phases, one with public speeches [and one with private round-table meetings]. I wished in the public meetings that we could have discussed what I feel are some of the newer problems that the

economy faces and which labor-management faces. I understand that in the private meetings there was much more willingness to forget some of the old basic arguments between labor and management and to consider some of the new challenges.

As I said in my opening, what I would like to hear them talk about is how the Government, labor, and management can function so as to provide for a steadily increasing economy, how we can prevent periodic recessions every 2 or 3 years, how we can maintain full employment, what is the proper relationship between Government and business and labor. These are all matters which concern us today and about which we must do something. I would like to have their views on it, not so much their views on questions which have been debated, about which we are fully informed of the points of interest of each of the parties, but rather these new and rather sophisticated technical problems. I hope we will have another conference quite soon, so that we can continue to talk about these things.

I understand that not only another single conference but a continuation of conferences of somewhat different pattern is being planned for.

It seems to me evident that a succession of such conferences on a topically specialized seminar basis, that is, taking up separate problems intensively, might really do something toward consensus as to causes and develop competent and searching criticism of proposals to effect a breakthrough from what threatens to become a stalemate in our economy.

The nature of this challenge suggests to me an opportunity of unique service for this Joint Economic Committee. It was set up under an almost revolutionary statute declaring "a continuing policy and responsibility" of the Federal Government to promote maximum employment, production, and purchasing power.

While the role of this Committee was first defined as review of the Economic Report of the President, it has fortunately developed on much broader lines. It has become, in effect, a continuing research center for the Congress. Much comparable work is done by older committees, such as Ways and Means, the Judiciary, with its Subcommittee on Antitrust and Monopoly, Money and Banking (or Currency), Agriculture, and the like. But their investigations have a relatively narrow frame of reference, generally on an ad hoc time span.

It is this Committee, with its continuing and comprehensive mandate, that might collate the work of the various congressional committees in the economic area, as well as that done by the executive branch through its Labor-Management Committee and White House conference and special study committees of other departments and the President's Council of Economic Advisers.

Particular attention should be given to scrutinizing all promising but novel proposals for dealing with the private economy in ways as imaginative and forward-thrusting as those which our "opposite numbers" in the field of natural sciences and technology are bringing to practical fruition in the very years when our economic performance yields to the drag of hard-bitten prejudices and dogmas and of unyielding group interests.

Chairman PATMAN. Thank you, sir.

Dr. Nourse, I know you are a wise man, and you have had a lot of practical experience. Are you really very optimistic about what may come out of the President's Labor-Management Conference?

In other words, what do you think it is possible for them to agree on?

Dr. NOURSE. Well, it is pretty hard for them to agree in the Labor-Management Committee, there, on anything. As I said in the paper, they can educate each other somewhat. They can clarify their separate positions with reference to the total economy to some extent.

Now, I think what is latent in your mind is a feeling that they cannot budge very much. They are locked into their particular interest groups. And that is why I stressed the possibility of these conferences of broader character defining particular issues in more objective terms.

In answer to your question, I would say that I think in the use of the White House conference, or something else of that sort, there is some real possibility of progress.

Chairman PATMAN. Senator Bush, would you like to ask some questions?

Senator BUSH. Dr. Nourse, did you see the editorial in the Washington Post this morning, by chance?

Dr. NOURSE. No, I did not. I was hurrying down to this meeting.

Senator BUSH. It is entitled "Federal Reserve Policies." I wondered whether you had had a chance to look at that.

Dr. NOURSE. No, I have not.

Senator BUSH. The general question raised in the editorial is: If private business can be financed through the banking system, why cannot the Federal Government be just as effectively and properly financed through the banking system?

Dr. NOURSE. Well, of course, that is a very long controversy, and I have consistently taken the opposite position, that the Federal Reserve System is a unique system of a national federation of still private banks, and that they have a function there in dealing with the business community, being elastic, meeting the needs of the community, and they cannot dictate conditions from their side. As Mr. Martin's expression runs, they have to roll with the punch or "lean with the breeze."

Now, there is a very strongly held view among some economists and political scientists that this separation between the functioning of the public Treasury and the functioning of the commercial banking system, as headed up in the Federal Reserve, should be merged. And of course that goes back to "the accord" and the independence of the Federal Reserve System.

I simply can state my position categorically, that I believe that the separation is most compatible with our traditions and is most compatible with sound economic reasoning, as I understand it.

Senator BUSH. You had left Washington when the accord came into being?

Dr. NOURSE. I have never left Washington, Senator. My roots are too deep, here. I had left the Executive Office of the President.

Senator BUSH. That is what I mean.

Dr. NOURSE. But I was very happy at that accord, because as Chairman of the Council of Economic Advisers, I felt locked in by the policies that had to be incorporated in the President's Economic Report, before that unpegging of the interest rate took place.

Senator BUSH. It says in this editorial, in the next to last paragraph :

According to Dr. Martin, it is perfectly proper for the banks to finance private indebtedness by creating money, but when one suggests that public debt be handled in the same manner, he alludes to the dark dangers of printing press money. Is he suggesting that the banking system should discriminate against the Federal debt? It is of course true that reckless use of bank-financed public debt would lead to inflation, but the very same stricture may be placed against bank-financed private debt.

Dr. NOURSE. Well, that is perfectly true.

Senator BUSH. I want to ask you a question about that. My impression is that these two cannot be compared, for one principal reason. In the first place, when a private borrower goes to the bank, his credit is carefully scrutinized, his profit and loss statement is scrutinized. Presumably he has to have a record of earnings which shows that he is in the black and able to stay there and get there. His balance sheet is examined.

And his whole credit position is examined and then established; whereas when the Federal Government goes—

And also, he is borrowing on a short-term basis, because the banks do not lend on a long-term basis.

Dr. NOURSE. Yes.

Senator BUSH. Now, while he is doing that to establish his credit and make a loan, somebody else is paying one back. In other words, you have a constant pay-back going on, which deflates the inflationary force of bank borrowing.

In other words, as new money is created, it is also being retired by those who are paying back.

Is that not so, so far?

Dr. NOURSE. Yes.

Senator BUSH. The difference, then, with the Federal Government, is that when it goes in, the record does not show that it pays back. The money is created by the establishment of a deposit for the credit of the Secretary of the Treasury, but it stays there, and when the time comes, it is renewed. New notes are sold; new loans are made; and the increase in the money supply remains. This has been going on over the years.

Dr. NOURSE. Yes, sir, though Federal bonds can be paid off and the national debt reduced.

Senator BUSH. So that the effect of the Government borrowing through the banks in that way is to increase the money supply and keep it increased. Is that not so?

Dr. NOURSE. Yes. I think that there is a basic difference and that is why I believe that two unlike things should not be mixed in the same system.

Now, on the other hand, they are not water-tight compartments. As the Fed says—I remember Randolph Burgess particularly saying this: "While we are free of subservience to the Treasury, we have to be aware of their problems and responsive to them."

But the distinction that you make, that they are two very different ways of handling financial matters, is the basis of my feelings that we should not merge.

Senator BUSH. Therefore I take it that you would endorse Mr. Martin's stand when he spoke of the deficit which is impending for the 1963 fiscal year, and which was then in prospect of being considerably enlarged by a tax cut.

Dr. NOURSE. Yes.

Senator BUSH. Now, we do not intend to have that, apparently.

But he said that he could not be counted on, that the Fed could not be counted on, to finance the deficit. You would approve of that position?

Dr. NOURSE. I would, decidedly.

Senator BUSH. Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Dr. Nourse, I would like to join the chairman in saying you reflect your wisdom in this paper. I am delighted to see that you feel that there has been much too much emphasis on fiscal and monetary policy to the disregard of other policies which can be very helpful and significant in improving our economy and enabling us to move ahead. This is a very strong statement of that position.

I would just like to say, though, carrying on for a minute longer, on this point that Senator Bush so ably raised: Dr. Hansen, of Harvard University, has pointed out that over time we have had almost identical relationship between total debt and the gross national product; that is, the proportion has been about the same.

There have been times when the national debt has been very low, but when private and local debt under those circumstances, State debt and so forth, has been high in relationship to gross national product. It is a very steady relationship.

Therefore, if you follow a dogmatic position of saying that under no circumstances will the Federal—and, incidentally, Mr. Martin has never taken that position; he was very clear here the other day in saying that he would not take it—if you take the position, however, that seems to be advanced, that you will never finance the Federal deficit to any extent through the banking system, then it would seem to me you are saying: At times, when the Federal Government is expanding its deficit and private debt seems to be declining, regardless of what economic conditions seem to call for, you will contract the money supply.

Now, the President of the United States has indicated, and his economic advisers have indicated, that they think we need to expand our economy.

I am inclined to disagree with some of their methods. I do not think that we should have the kind of a super deficit which we seem to be about to have in 1963.

But if they do intend to do that, and Chairman Martin tightens money as he says he might, it would seem to me that we have the two instruments of economic policy clashing; with fiscal policy trying to expand, and move the economy ahead and provide more employment, and monetary policy putting on the brakes and slowing down the economy.

Now, I would feel that it might be wise, under some circumstances, although certainly not under all, for the money managers to expand the money supply by financing part of the deficit through the banking system.

And I would like to give you just one example of this. Supposing that we have no tax cut, we have no increase in Government expenditures. Suppose under these circumstances that the economy begins to turn down. We still have a deficit. The deficit, because the economy is turned down, begins to grow.

Now, under these circumstances, why would it not be wise for the Chairman of the Federal Reserve Board to finance that deficit through the banking system, thereby having less contracting influence on the economic system than if bonds were sold to the public?

Dr. NOURSE. Well, I would say it would be wise, and they manifest that kind of wisdom. The remark was made that they cannot be unaware of Treasury needs. As stated, in this instance I cited, they had seven refunding operations coming up within the remainder of the year. It was then about midsummer, I think.

Now, they must make so tight a money market as to defeat the funding operations of the debt management of the Treasury. That is what I think "leaning with the breeze" means in that connection.

On the other hand, to simply say, "We go along with whatever there may be," if we follow a loose-money policy in the time when the financing is jeopardizing the health of the economy—I think that is another position more extreme than they have been willing to take, and they are right at the present time following a somewhat tighter money policy than certain factors in the economy think is desirable.

In other words, that simply is using the brake in the system wisely, not freezing the brake and, as they charged one time, throwing the passengers through the windshield. But it is keeping the system under control with a deference of one branch for the other, I think that is the essence of wisdom, there.

You have used the expression "dogmatic policy." I think that dogmatic policy would be fatal. And yet, the absence of any policy would be just as fatal.

Senator PROXMIER. Well, I would just like to conclude by asking you if it is not right that when we have a situation of substantial unemployment, and unemployment is serious now, and we have a situation of a lack of full utilization or nearly full utilization or even optimum utilization of our industrial facilities, and when we have a stable price level—we have a very stable wholesale price level and a nearly stable retail price level—and when the international payment situation is improving, as it has been, and when the experts come up and tell us that interest rate differentials are not a significant factor in the international payment situation, anyway, under these circumstances it would seem unwise, at least, to follow a policy of monetary tightness.

Is that not correct? Or is it correct?

Are these not the criteria that should be considered, primarily?

Dr. NOURSE. Well, you say "tightness." But tightness is not one categorical concept. It is a question of degrees of tightness. And that is the point I was trying to make. That to throw all control away is just as bad as to have a rigid control.

Senator PROXMIER. I am not talking about pegging the Government bonds, or returning to anything of that kind. I am not talking about very low interest rates. I am just saying that in the future—

the past is finished—in the future it would seem to me most unfortunate, if the conditions remain about as they are, if we are going to follow a policy of not increasing the money supply with the gross national product.

We would have rising interest rates and some restraint on the economy moving ahead, at a time when we need to do so. And we suffer this restraint because of monetary policy. If we get into an inflationary system, that is quite different. We are not in that now.

Dr. NOURSE. Yes. We are not in a crisis situation. I agree on that.

Senator PROXMIRE. I want to apologize for having done just exactly what you say we have mistakenly done, that is, put so much emphasis on monetary policy, or fiscal policy, because I do think that your contribution this morning has been extraordinarily helpful, and I agree with it quite fully.

Chairman PATMAN. Dr. Nourse, you made one statement, that the Federal Reserve should not defeat the debt management policy of the Federal Treasury. I would like to invite your attention to the fact that when the last issues were put out recently, one issue was  $4\frac{1}{4}$  percent, due in 30 years, I think, and the Treasury expected to sell about \$750 million worth. Well, they actually sold about \$316 million worth.

That is an instance that occurs to me. When the Federal Reserve was sitting idly by and permitting the Treasury to lose, the Federal Reserve could have purchased those bonds one way or another, without any inconvenience or trouble or cost, without any possibility of loss, and finally have fed them back into the market when the market was better and when the climate was more suitable.

But the Federal Reserve did not help the Treasury at all on any of those issues, so far as I know. And I think that is a dangerous trend.

Of course, the Federal Reserve, if they want to carry out a hard-money policy, and leave the impression and have the psychological weight behind it that it would have, that interest rates are going up, and therefore convince the people that a  $4\frac{1}{4}$ -percent Government bond issue will not sell, they have made a point, there. But the point I think is against the public interest.

What do you think about it?

Dr. NOURSE. Well, I do not claim to be privy to all the issues that were involved in that situation. In a general way, however, it would seem to me that the Treasury, in its debt management, was trying to lengthen the maturities and feel out the market for longer maturities; and the Fed could follow two policies:

(1) We let you perform this experiment in the existing state of the commercial market. We let the market tell you what this debt management possibility is.

(2) They could have, on the other hand, followed the course which you suggest, of making an artificially favorable situation for the sake of making that offering fully successful.

Now, I may be an old-fashioned conservative, but it seems to me—

Senator BUSH. They would have to buy the bonds. They could not create a situation. Banks do not buy 30-year bonds.

Chairman PATMAN. Well, if they want to, they buy them; they have been buying tax-exempt bonds lately.

Senator BUSH. No; they buy shorts. You do not advocate buying long-term bonds with short-term deposits, do you?

Chairman PATMAN. No; I do not. I do not think the banks belong in the long-term Government bond market, and certainly not in the tax-exempt market. But, the Fed can always carry them. All they have to do is create more money. They could buy up the entire national debt, if they wanted to. There is no restriction on it.

That is correct, is it not?

Dr. NOURSE. That is a rather dangerous power.

Chairman PATMAN. I am not advocating it, and no one else is advocating it. But it could be done?

Dr. NOURSE. Yes. That is why discretion is so important.

Chairman PATMAN. The fact of the matter is that I have been keeping up with the payments of the Federal Reserve into the Treasury. Every month they are paying in about \$68 to \$70 million into the Treasury. That money, of course, is there because they bought Government bonds without paying anything for the bonds, on the Government's credit, and they collect the interest from the taxpayers through the Treasury, and then the surplus goes back into the Treasury. That is part of the surplus every month, \$70 million, approximately \$840 million a year.

Now, it is my contention that when the bond sales and the price of the bonds justify it, the Federal Reserve should be allowed the privilege, and encouraged through the open market operations, to buy bonds, so long as it does not upset the market, and accumulate them; in that way the Government would save the interest expense on them.

I would not do it to the extent of causing inflation or destroying our monetary system. Certainly not. But it is possible for the Federal Reserve to acquire a portion of the national debt that way. Not quickly, not suddenly, but over a period of years, when the climate is right, to acquire those bonds and let the interest flow back into the Treasury—reduce the interest burden on the budget.

Now, of course, some people will throw up their hands and say, "That would cause inflation." But there are ways to put the brakes on inflation.

Take the reserve requirements of banks, for instance. You could change them, if you wanted to. There is nothing sacred about them. I know one time when they were doubled, to keep people from getting adequate purchasing power. So certainly they could increase the reserve requirements of banks and prevent any type of inflation.

So do you not think it would be in the public interest if we had a policy like that, where the Fed could more and more accumulate Government obligations, when it would not upset the economy, and it would not be inflationary?

Dr. NOURSE. Mr. Chairman, if I may make a respectful comment, I would say that the intricacies of this matter are almost endless, and unfortunately it seems to me that we have lapsed back into a discussion of fiscal policy, here, whereas I thought the purpose of this hearing and the testimony to be given by the members of the panel is to explore forces of the private market.

Chairman PATMAN. Well, of course, we have broad jurisdiction, you know.

Dr. NOURSE. But again, it is a question of balance.

Chairman PATMAN. I doubt that a point of order would be good on almost anything asked for before this committee. But, in any event, I will not pursue that further, except to ask what you consider to be the paramount subject today; monetary policy, or monopoly?

Dr. NOURSE. Well, monopoly; except more broadly stated. That is to say, I think that we have canvassed more fully the situation on fiscal policy, and we have not gone adequately into the question of market relationships, not merely monopoly, unless you interpret monopoly very broadly in terms of the concentration of labor power, as well as the concentration of managerial power.

Chairman PATMAN. Well, thank you very kindly, Dr. Nourse. We appreciate your testimony. It will be helpful to us.

I understand that Dr. Nourse is unable to be with us this afternoon. He has asked, however, that we include in the record a reprint of an article that he published in 1960 on "Some Questions Emerging Under the Employment Act." It contains his views on the issues with which we are concerned in this phase of the hearings.

(The matter referred to follows:)

[The American Economic Review, May 1960—The Journal of the American Economic Association]

#### SOME QUESTIONS EMERGING UNDER THE EMPLOYMENT ACT

By Edwin G. Nourse, Joint Council on Economic Education

##### I

There is a striking disparity between the grand national purposes declared in the Employment Act of 1946 and the paralyzing squabbles that have erupted in the steel industry and that impend for the automobile and railway industries in 1960. As setting for an analysis of causes of this disappointing development and for promising means of combating or, if possible, reversing it, I submit several all-too-categorical propositions.

The Keynesian dialectic for a high-production economy sustained by the grace of compensating fiscal policy and stabilizing monetary policy has proved inadequate for dealing successfully with the postwar problems of our economy. We have been confronted with many operational dilemmas in trying to adapt particular pricing and income-determining institutions and practices to the higher price level which had been, in a very irregular pattern, induced by the tumultuous wartime developments and improvisations. Alvin Hansen admirably previewed the complex nature of the Employment Act problem in his Economic Policy and Full Employment (1947). Referring to inflation as "the immediate danger," he said: "In our modern, highly complicated economic order we are continually in danger. It is not easy to keep the system in balance. That involves not only fiscal and monetary controls, but also, among other things, a balanced *wage-and-price policy, control of monopoly, promotion of high productivity, technical progress and, above all, social unity and cohesiveness.* [Italics added.] Stability, maximum production, and full employment are not easily achieved goals. We are perhaps out of the kindergarten, but we still have a long way to go." (Page vii.)

Unfortunately, neither Hansen nor any great number of our fad-following profession felt moved to explore the private market prerequisites for full employment symmetrically with their explorations of the public control aspects. But thirteen years of experience, during which conditions have been very favorable and performance of the economy on the whole quite gratifying, have shown that, under the institutions and the mores of our enterprise economy, "opening the money spigot" wide enough to get full employment results in dangerous

inflation and "reversing the money pump" drastically enough to prevent inflation produces intolerable unemployment. The continued rise in industrial prices and service rates during the 1937-38 recession while unemployment persisted or even mounted has now caused attention to shift to this field. This has given us the catch phrase "cost-push" inflation. I myself have been moved to label the phenomenon "institutionalized" inflation; that is, an inflationary trend built into the market process through the institutions of the large corporation, the big union, and big government sensitive to the political pressures of special-interest groups. This institutionalized inflation embraces not only the conditioning structures of business, labor, and government but also personal attitudes and group practices—the mores or ideologies of the elite groups which, as corporation executives, union leaders, Administration and Congressional officials, constitute our effective cadre of policymakers.

To grasp the complex realities of institutionalized inflation and gauge the possibilities of achieving sustained high production without periodic disruption of price-and-income alignments, our American "mixed" economic system may be visualized as a global process comprising a hemisphere of private business administration and a complementary hemisphere of public economic administration. This public hemisphere is divided into quarter-spheres of credit administration and spending-taxing administration. The private hemisphere is similarly divided into quarter-spheres of capital administration or price-investment policy and labor resource administration and wage negotiation. These four quarter-spheres of the economy, though separable for many purposes of analysis, are intricately intermeshed in actual operation. Thus, there cannot be an effective demand-pull that is independent of the cost-pushes of speculative business enterprise and resource-owners' opportunism. Nor can there be an effective cost-push that gets very far in defiance of the power of appropriation committees and credit agencies to "advise and consent." Fiscal policy is a powerful initiating and guiding force as it injects funds here and drains them off there. But also it is strongly conditioned by the price or cost situations brought about by the speculative and innovating activities of management and by the offensive and defensive strategies of organized labor.<sup>1</sup> For example, cost of government payroll and procurement and the yield of any tax structure are markedly affected by the level and structure of prices and of incomes brought about by the administrative policies of management and of organized labor and their articulations through collective bargaining.

To a very important extent, therefore, both fiscal policy and monetary policy are the captives of market policy or, stated more precisely, captive to market behavior, with its decisive administrative component. To recognize this fact of our economic life today is to realize the sterility of the aggregate demand formula in the unique causative, explanatory, and correctional sense in which it has been so freely used in recent years. The tough questions ultimately raised by the Employment Act are not primarily or dominantly those of public action to compensate for failure of the private economy to effect sustained high production. They are basically questions of how to forestall such failure by improving the institutions of the market—for goods, for services, and for funds—and how to raise the mores of individual and administrative responsibility<sup>2</sup> to a level compatible with the character of modern industry and trade. While permitting and indeed facilitating such concentrations of private economic power as are needed for efficiency in handling our fast-advancing technology, we need also to effect disciplines (i.e., group behaviors) in a domain that we have debauched into but by no means mastered. Our objective should be to preserve that "free competitive enterprise" premised in the Employment Act, not as a mere abstract ideal, but to make that freedom and the competition among larger operating units that results therefrom achieve the high economic goal of maximum consumer real purchasing power better than atomistic competition ever served the much less ambitious objectives of Smith's, Ricardo's, and Malthus' time. Big-

<sup>1</sup> While recognizing the withering of the Invisible Hand and moving to repeal Say's Law, we should take some care not to throw out realism's baby with the theoretical bath water. Labor's wage advances and management's markups are income generating, and pro tanto demand creating or fortifying—so long as the Fed and/or the fisc continue to put up the chips—and productive capacity is not allowed to breach the dam of price maintenance.

<sup>2</sup> I do not say social responsibility because I believe that the economist qua economist should keep his analysis on the operative or technological rather than the moralistic plane.

unit competition must find an optimum blend of internal constraint, that achieves discipline in its own ranks, and such cooperation among special interests as will promote a constellation of private prosperities as integrated parts of maximum national prosperity.

## II

Concentrations of private economic power are a perfectly normal manifestation of the economics of enterprise. Under our traditional principle of free private enterprise we have permitted the ambition, the ingenuity, and the daring of business leaders to develop the industrial and the commercial corporation to the point where a single firm may hold assets, develop money flows, and control personnel to an extent that exceeds the economic power of any one of perhaps a quarter of our sovereign states or of many a foreign country. The right of both horizontal and vertical integration permitted under the law (despite occasional curbs) has contributed powerfully to the stimulating of production, the enlargement of employment opportunities, and marked rise in the real purchasing power of consumers. Its impact on national stability has been more equivocal.

Paralleling the development of the giant corporation, we have, under our traditional principle of free private enterprise, permitted the ambitions, the ingenuity, and the daring of labor leaders to build up unions of size and power in many regards approaching and in some regards surpassing those of the largest corporations. Much as the "infant industry" argument in the manufacturing area in time became an absurdity, so the "underdog" justification for public policy further enlarging the rights allowed to, and the benefits conferred upon, organized labor has become obsolete.

The workability of a system of free competitive private enterprise under modern conditions pivots on the institution of collective bargaining, and it had seemed an almost axiomatic proposition that all that was necessary to give bargaining between units of unlimited size the same beneficence as that traditionally ascribed to atomistic bargaining was for private action to promote and public authority to permit structures that would achieve "equality of bargaining power." It would be hard, however, to concoct a phrase more elusive in interpretation and more untoward in its application than this one—unless it be "bargaining in good faith." Instead of promoting market equilibrium through rational juxtaposition of supply realities against demand realities, each side sought to maximize its fire power to force a decision which would be to its financial advantage. The consequences of this line of development seem now to have brought us to the distressing alternatives of inflation or return to the cold war of the class struggle.

Rather than countervailing against each other to achieve high production and price stability, great concentrations of economic power become a prime initiating and aggravating force of inflation. Instead of an apparatus of wholesome adjustment, we get a continuing race for more power on both sides and impasse when the summit is reached. Neither party is willing to admit that collective bargaining fulfills its role as balance wheel through "equality of bargaining power" if it has to accept contract terms below the level of its demands. Paraphrasing George Orwell's brilliantly satirical phrase in *Animal Farm*: Both pigs must be equal, but each pig must be more equal than the other.

Success of the industrial union tactic of striking that oligopolistic employer who appeared at the moment to be in the most vulnerable position or to have a recognized position of policy leadership moved the steel companies this year to confront the solidarity of the United Steel Workers union with the matching solidarity of the twelve major steel producing companies. But this strong riposte in the game of bargaining power promptly engendered a countermove toward a still larger solidarity among unions as a whole. Several of them passed resolutions to support the United Steel Workers in their strike, and the AFL-CIO and several individual unions not only gave unequivocal moral support but also voted substantial cash subsidies to increase the defensive power of the United Steel Workers.

Do we not here see the race for countervailing power generating a trend toward cartelization of industry by the back door that we have persistently turned back at the front door under our antitrust principle? Whether or not the Department of Justice will challenge this development remains to be seen. Thus far the monolithic labor suzerainty has been able to maintain substantial immunity from the antitrust laws. Something radical or at least showing sparks of inventiveness now needs to be done to check the erosion of that competitive

flexibility that is essential for an enterprise economy to deal with real operative situations.

Our traditional theories of competition were developed long before these modern complexities had emerged. Edward Chamberlin's pioneer study of monopolistic competition took a long stride forward into the realities of today's commercial and industrial life. But the focus was on maximization of the profits of the business firm. There needs to be—and to some extent there has been—an enlargement or elevation of this type of theory to encompass maximization of the productivity and distributive dynamism of the whole economy. Public inquiries and private studies are now vigorously underway (notably those sponsored by the Joint Economic Committee and the Senate Subcommittee on Antitrust and Monopoly) to see if we can arrive at some actionable consensus as to what concentrations of economic power now permitted by law and administrative rulings are inimical to the intentions expressed in the Employment Act, and what steps we should take to validate those intentions. Never before has the practicing economist been vouchsafed so adequate and competent a body of analytical and empirical material for his professional synthesis. We should now be near a break-through on both the juristic and the educational front.

### III

Both the analyses of economists and the attitudes of the business world and general public divide rather clearly into two broad schools of thought as to the market phase of our current national economic problem. On the one hand are the radicals or pessimists, who despair of getting really full employment and avoiding inflation without superseding the free market or substantially limiting the present scope of freedom in the product, labor, and money markets. They would resort to extensive price, wage, and interest rate controls. This defeatist position seems to me premature, though it follows not unnaturally on the heels of disenchantment with the oversimplified belief that the purposes of the Employment Act were to be achieved through the wonder drugs of fiscal and monetary policy alone. It reflects an impatience with the slow and difficult process of progressively improving our market institutions in the light of larger experience and changing conditions and of progressively improving the performance of private administrative agencies in those markets in the light of research and a broadening viewpoint. The proponents of price and wage controls look for quick and decisive results from resort to centralized decision making.

But such shortcuts lead seductively to a fully authoritarian system. Experience with OPA, OPS, AAA, and indeed even much of public utility regulation seems to me to furnish ample evidence of both the theoretical shortcomings and the administrative difficulties of government control in the market process. No comprehensive rule book of price setting can be devised in advance by even the most competent team of market experts and economic professionals. However well conceived are the prices initially set at strategic spots, they impose unforeseen disturbances on major and minor commercial relationships. These immediately clamor for compensating adjustments. Control of the price structure creates demand for control of the processes of production and distribution. (See the "rake's progress" of agricultural "adjustment" acts.) Hope that market controls can be rationalized under a few broad principles or limited to a few strategic points proves illusory, and the system rapidly bogs down in a morass of detailed regulations, exceptions, grievances, and evasions. As for a standby apparatus, it is sure to grow costly during periods of inaction and be found obsolete when need for action arises.

The milder proposal that intended new prices or rates be posted and then held in abeyance while the public scrutinizes their justification and impact nominally substitutes the intellectual approach for the power approach to economic adjustment. But those whose critical judgment would be competent in the appraisal of proposed action cannot in any real and important instances become adequately informed as to the complex factors involved. The mere form of the price or wage proposal and the conditions of compliance present insuperable practical difficulties. If the steel companies were to make such an advance declaration of intention, it would not be sufficient for them to state a single price on basic steel because there are many grades and types of steel and specifications as to "extras," fabrications, terms of sale and delivery, and the like. These could not all be set out in the price proposal, and whatever base price was finally set by the company in the light of public reaction could be

materially modified in application through skillful manipulation of these escape possibilities. Similarly in the case of automobiles, is it conceivable that the companies could, months in advance of the introduction of a new model, inform the amateur public and enlighten their professional rivals as to the precise character of vehicle to which any specific price was to apply? The companies themselves are, up to the last moment of announcing the new models, uncertain as to what prices they can, must, or will name.

The labor aspect of the notice-and-waiting proposal is in some ways simpler than the price aspect. But with all the skill differentials, seniority rights, fringe benefits, and grievance procedures by which the basic hourly rate is intertwined, the practical use of this approach to wages (and work rules) seems slight. Nor does recent experience in the steel impasse encourage the hope that either management or labor would be responsive to public opinion even if it could be captured, measured, and weighed as to its internal variations.

But there is a more fundamental theoretical reason for eschewing the idea of a change of venue from the market to the government regulatory agency. The underlying premise on which the proponents of government intervention must rely is that the official pricemaker possesses a magic touchstone for the performance of this task, whereas such prescience is not available to private price setters or price negotiators. The first of these premises, in my judgment, constitutes an overestimate, the latter an underestimate.

The plea for radical government regulation was presented vigorously before this Association a year ago by Ben Lewis. Burlusquing the economic sophistication required, and in considerable measure attained, by some executives of big business units, as "corporate conscience \* \* \* marinated in goodness \* \* \* as benevolent individuals construe goodness," he laid down the dictum that such managerial policymaking "has nothing to do with economizing"; i.e., getting good allocation of productive resources:

"It is neither the privilege nor the responsibility of any individual, however conscientious or statesmanlike, voluntarily to render economizing decisions in the name of society. \* \* \* Economizing is society's job. \* \* \* Economic decisions must be right as society measures right. \* \* \* An economy is a mechanism designed to pick up and discharge the wishes of society in the management of its resources. Sometimes we seek through government to make the market itself operate more effectively as an economizing instrument; sometimes we move positively into the market with our sleeves rolled up and force the economic verdicts which, collectively, we want. \* \* \* Through government we supplement the market; we also supplant the market. \* \* \* The years ahead will see a great increase in conscious, collective, governmental controls and of governmental enterprise. \* \* \* The conviction that great power over the economy must reside only in a government of the people will be acted on relentlessly, bluntly, and with force."

Passing over Lewis' fast semantic shuffle between "society," "the economy," and "government" and the socialist implication of his prediction, I find myself in considerable disagreement with his dichotomy between big business purblind to what the public wants by way of allocation of resources and big government suffused with full understanding of these wants, full wisdom in resolving conflicts among them, and an adequate apparatus for implementing its "right" answers. The anthropomorphic idea that either society or government can know, discover, or formulate "the public interest" is a figment of the imagination since "society" does not and cannot have an official spokesman, and the officials of government bring their own limited empirical knowledge and very considerable personal biases and special-interest affiliations into their vocation as policy makers. Congressional action is not based merely on honest debate among informed statesmen; it also reflects ruthless pressures of interest groups and sordid trades among "practical" politicians. This voice of the people is in only the most Pickwickian sense the voice of God. Though it is the only workable alternative to authoritarianism that democracy has found for the shaping of fiscal policy and the institutional framework of the market, it is thoroughly unacceptable as a substitute for profit-seeking, responsible, ad hoc decision making of and within business firms and labor unions.

#### IV

**If, then, we reject the deceptively simple device of cutting the Gordian knot of our full employment versus inflation dilemma by the use of direct government price and wage controls, what positive program can we adopt? My answer**

to this challenge begins with a caveat. Zeal in attacking the problem of linking maximum production with dollar stability should be tempered with careful discrimination. "As prudent men we should not take hasty steps to alter an institutional system so deeply grounded in our traditions and so successful in meeting immediate postwar demands and opportunities. At the same time we should not be tardy in taking well considered steps toward correcting such deep-lying or slowly developed shortcomings as time has revealed in our modern system of free but highly organized industrialism."<sup>2</sup>

Within such an interpretation of the needful role of the Federal Government in the private market, our positive program should be a vigorous implementation of the policy explicitly stated in the Employment Act; namely, "to foster and promote free competitive enterprise." This clause was not a mere political gesture toward threadbare tradition, but rather was a correct reflection of a basic principle of American and Western European economic science—that free competition among the complex thrusts of supply forces and the diverse pulls of demand forces furnishes the optimum condition for attaining maximum productive use of the economy's resources and maximum consumer satisfactions. Four ingredients of a free enterprise program seem to me to be indicated: (1) integration of our sprawling and confused antitrust statutes under a basic policy law or Joint Resolution that declares a comprehensive principle of free competitive enterprise; (2) pressure for vigorous and consistent enforcement of this principle both through the Department of Justice and also the ancillary agencies of the Federal Trade Commission, the National Labor Relations Board, the Secretary of Agriculture (Capper-Volstead and Marketing Agreements Acts), and several independent commissions; (3) realistic studies by the economics profession of the fundamental theory of large-scale competition, and the use of this enlarged understanding for the guidance of courts in applying general statutes to particular situations; of Congress and of administrative agencies in perfecting our competitive institutions and current practice under them; and (4) systematic but nonpropaganda campaigns of general education of the various functionaries and the general public in the operative requirement of a free competitive economic system.

The integration of a consistent and comprehensive procompetition legal structure should begin with a clear-cut declaration that all parties and interest groups shall stand equal before the law of the land, that no segment of the economy—industrial, commercial, agricultural, labor, or financial—shall be immune from safeguards set up to prevent the abuse of concentrated economic power. This unification of our institutions of big-unit competition would then require careful re-examination of our many special regulatory laws to see that their provisions are in strict conformity with the general declaration of policy as well as recognizing the operative needs and peculiarities of the several business areas. Even so, the definitions and rules embodied in these special statutes can hardly be more than a skeleton of generalized statements of principle and intent which must have flesh put on its bones by enforcement authorities—who must exercise a considerable margin of discretion in interpreting a given state of facts in a complex and changing economy and in aligning regulatory action with declared policy.

To say this emphasizes the close interrelationship among all four of the ingredients I have proposed. For the selection of cases to be examined and acted upon by the Department of Justice or the independent commissions and the findings made by them must be guided by economic analysis as much as by legal technicalities or by ease of handling or prospect of a successful outcome. It is cause for congratulation that there are today a considerable number of professionally competent economists in the staffs of these several agencies, that they draw upon the skills of brother economists in academic and business connections, and that the variegated wisdom of all three groups is made available to our lawmakers and amenders through the intellectualized apparatus that has been introduced into our Congressional system—and that is still growing. This is all the more important because so many vital questions of both corporation and labor practice are still in so ambiguous and indeterminate a state.

We do not have any economic pope who is in a position to give us any infallible answer, for instance, as to the competitive or noncompetitive impact of conglomerate mergers or the lush proliferation of big companies into lines re-

<sup>2</sup> Excerpted from the writer's testimony before the Senate Subcommittee on Antitrust and Monopoly Hearings on Administered Prices, pt. I, p. 18, July 9, 1957.

lated only remotely if at all to the company's original business. Similarly on the labor side, it appears that outlawing the national wage contract would be found highly disadvantageous by some employers and a statutory "right to work" inequitable by many workers. Until we have something more closely approaching scientific demonstration in numerous cloudy areas, we will do well to limit the law to statements of principle and purpose and rely on judicial or quasi-judicial procedures to articulate declared policy with ad hoc puzzlement. In discharging this vital role, some courts now avail themselves of economic counsel in balance with their use of legal counsel; others prefer, in the bright blue yonder of the economic stratosphere, to "fly by the seat of their juridical pants."

While my emphasis on the usefulness of the economists as expert witness in litigation and as staff member or consultant in the legislative area may seem to be in the nature of a commercial for our craft, in fact it is a sober challenge to us to foreswear a good deal of academic boon-dogging in the name of research and come up with some illuminating answers or at least well-grounded and stimulating hypotheses as to the nature and potentialities for both good and harm of price and non-price competition between large economic units and some inventive proposals for capturing the benefits and avoiding the abuses of such massing of private power.<sup>4</sup>

v

In thus seeking to devise a model of privately administered price-making and wage negotiation compatible with the purposes of the Employment Act, can we discover any hard core of theory as to the basic nature of our problem which might furnish theoretical keys to its situation? I venture to suggest two hypotheses.

First, I am persuaded that a basic reason why an irresistible force of union cravings meets an immovable body of managerial prerogative is that the scope of decision making on wages and work rules has become too wide and its situs too far removed from the core issues that need to be resolved. This proposition, however, must not be mistaken as the premise for a sweeping proposal for corporation-busting or union-busting; it simply points to a discriminating realignment of functions. The issue as to centralization versus decentralization in the private hemisphere of our economy runs closely in parallel with the same issue in the public hemisphere. While certain functions such as defense, international relations, and fiscal policy must be and remain the functions of government, in the great body of operational matters, both civil and criminal, we find it better to let local autonomy decide upon patterns of life which free citizens find best adapted to their peculiar circumstances and values. They may invent, experiment, learn by doing, and profit by the experience of other autonomous groups. Similarly, certain financial and related investment and technological policies of the modern corporation can most efficiently be centrally determined. Wage bargains and detailed work rules seem to me to fall in a distinguishably different category and to call for serious effort by all parties to discover principles and shape practices of local autonomy that would promote serviceable reconciliation of conflicting alternatives on both sides rather than creating a widespread, even national, impasse by trying to extend a single formula to quite unlike situations. Instead of the sort of centralization marked by the intrusion of AFL-CIO and its Industrial Union Department and by the industry-wide coalescence of major companies in the national wage bargaining which tied up the steel industry and the economy, we need more flexible differentiation of local situations and variety of accommodation through initiative, experimentation, and natural selection.

Of course any such suggestion will be greeted by the union hierarchy as a proposal to "weaken the unions" and evoke the real, and in its time, legitimate

<sup>4</sup> But even under the institutions we now have and with the understandings we have already gained, we should be able to recognize and act upon a few extreme situations where concentrations of economic power are so massive—and still growing—that government should proceed actively, not merely to check, but to reverse them. On the corporate side, I would nominate the General Motors Corporation; on the labor side, the Teamsters Union (quite outside the issues of shady practices now under attack). Exemplary action in each of these extreme cases would serve as a warning to others who have not yet stretched so far the tolerances of our free enterprise doctrine. And, even more significantly, the size and importance of these cases would assure such thorough discovery proceedings and such appeal to economic analysis by outstanding experts by both prosecution and defense as would define national policy over the whole area and for a considerable time into the future. The logic of action in the two cases is not identical, but it is equally compelling—though it is not possible to elaborate it here.

dread of the "company union." But note that I am not proposing the abolition of the national union or the multi-union federation—simply a restoration of powers of choice lost to the operational groups through the growth of union hierarchies. The national union will still have a centralized role of general policy making, promotion, and enterprise leadership—including legitimate lobbying. It may formulate general policies as to work rules (as it now does) and propose wage levels and differentials, but with these tailored by the local to its own peculiar (environmental) conditions, and state of the employing company (as textile workers have done). The main point is that any strike vote shall be taken independently for itself by each union without constraint by others. This would not be a departure from practices which now obtain sporadically within the union movement, but would regularize and generalize the principle and would allow "the show to go on," recognize difference in operational requirements, assure self-determined values, and raise the dignity of local leadership. It would not have to rubber stamp central policy or seek promotion to the national hierarchy via such subservience. Union members who have felt they had to support the national leaders even in an "unpopular" strike might ponder whether their own interests would not be served better by contributing to the making of differentiated adjustments than by accepting authoritarian decisions.

Note, too, that my proposal includes a similar restitution of powers of decision making by the centralized corporation to its component operating units.

This diagnosis is not based on the negative proposition that bigness must always suffer from bureaucratization, but on the positive concept of economic statesmanship and promotion of the common good, about which there is such ambiguity. Much as officials of the national government should and, to a not always recognized extent, do have a national or statesmanlike outlook even amidst the practical necessities of reflecting local and interest-group pressures, so top executives of national corporations and top officers of national unions have a similar opportunity (and duty) to learn of the national process within which their management must function and of practicing two-way statesmanship: backward for the enlightenment of their constituent parts and forward to the enlightenment of government agencies as to the needs and response of their "factor" group and its underlying parts.

A second impediment in the path of fundamentally workable adjustments is the refusal of management almost universally to admit that the price of product (in its relation to volume of sales, number of jobs, and rate of profits) should be considered as an integral part of the wage problem. If management were to admit the functional inseparability of these issues, it should expect labor similarly to treat wages in their relation to volume of employment, productivity, and actual rather than formulated living costs. This issue goes to the very heart of the proposals currently being made in various forms for dealing with labor-management deadlocks by means of "fact-finding" committees, compulsory arbitration, Presidential pressure for some "recommended" terms of settlement, or legislation providing for "a third chair [the public's] at the bargaining table." The simple fact is that corporation orthodoxy clings to the huckstering philosophy of early proprietary capitalism even in our new day of trustee capitalism. The progress of science and engineering has, in the area of technology, eroded the province of "trade secrets" almost to the vanishing point, and industrial executives have found that patent licensing is a practicable way of competitive life. We now need a counterpart development under which rational determination of critical cases within the price-income process could be approached by arraying the pertinent factual material and applying to it the best of professional expertise (with such fruitful variants of interpretation as economists would offer—even as scientists and engineers do). In a word, our society is now laboring under a serious cultural lag, and will continue to do so until we can bring ourselves to substitute scientific method for "muscle" in the conduct of big-unit industrialism.

In the fourteen years since the war we have demonstrated only a very precarious kind of control over the built-in or institutionalized inflation that has evolved and only dubious and adventitious capability for full and sustained use of our national resources for production. We are now, very properly, probing into a variety of local and more or less discrete manifestations of this unsatisfactory performance, in the hope of improving economic structures and elevating economic practice. Along with these activities, and as a guide to them, we should also ponder deeply what are the over-all impli-

cations of the maximum production policy or doctrine to which we give lip service. Both Sir William Beveridge as the British prophet Isaiah of the full employment gospel and Alvin Hansen as its American John the Baptist stated the postulates in quite explicit terms.<sup>5</sup> These prerequisites were: widespread economic sophistication and a pervasive spirit of social cohesiveness or national unity.

Reverting to Hansen's comment that, in terms of economic sophistication and social unity, we were, in 1947, "out of the kindergarten but still have a long way to go," what can be said of progress made since then? The record seems to me to be seriously disquieting. The most charitable estimate is that we have moved on to the stage of teenage turmoil, with its undisciplined aggressiveness, adolescent frustrations, and intellectual confusions. There was a flash of economic insight in the steel companies' statement of the need to get the cost-price mechanism under control if we are to attain a competitive stance in world markets and competitive dynamism among domestic industries. But there was egregious economic stupidity (and even business stupidity) in their bland assumption that price and profit factors should be immune from any part in the readjustment process, while wages and volume of employment took the full brunt. There was a flash of economic perspicacity—even precociousness—in the argument of the vice-president of AFL-CIO that our basic problem is that of "learning how to distribute abundance" and in his reasoning that wages cannot be adequately analyzed—and adjusted—in isolation from price and profit information and analysis. But I do not find equal or even minimal grasp of the global economic process in his supposition that money wages can be advanced by larger and larger amounts on each contract renewal date, that those with the highest rates should get the largest new gains, and that each of the leaders get more than any of the other front runners.

I have already stressed the responsibility of our profession to provide clearer analyses of the complex problems of this real world and more cogent and practical proposals for positive devices for meeting them. But a means of selling as well as producing such intellectual merchandise is needed. This over-all factor or condition necessary to the successful practice of economic democracy is referred to by its proponents as the educational approach or "intellectualism on the economic front." It is tagged by its detractors as the hortatory approach, admonition, or the "jawbone attack." Only at our peril do we sneer at "creeping admonitionism" and declare that "statesmanship is for the statesmen" and thus that private statesmanship is "for the birds"—even in the day of multi-billion-dollar corporations and multi-million-member unions and the still more powerful solidarities of both.

It should be remembered that admonition is an art widely practiced by many who ridicule it when practiced by the professor or by the President. Business organizations carry on an elaborate campaign of admonition to their workers, their shareholders, and the public against the economic fallacies of labor, or government, and of "liberals" generally. The unions conduct a parallel crusade to educate the public as to the errors of capitalist practice and theory. They are now embarking on even more ambitious plans to admonish voters against endorsing measures or electing men who fail to understand the role and needs of labor in a full-production economy. And, of course, the political campaign, the legislative process, and the executive branch of government reek with admonition. As I told a meeting of business executives while I was on the firing lines from the colonial town meeting to the modern business convention and the Congressional hearing, the endlessly wagging jawbone has been one of our best devices for making progress both in common understanding and in the mutual tolerance essential to a self-regulating society.

This is the distinctive economic weapon of a free society in its battle against authoritarian imperialism. If we allow it to rust or use it but feebly, we shall not have validated the inherent potentialities of a self-disciplined enterprise system and of economics in the public service.

<sup>5</sup> Beveridge stipulated "a coordinated attempt, not a blind groping and pressing by numerous groups each of which sees only its own sectional interest and tries to exploit its particular strategic advantage"; voluntary arbitration of wage disputes; and both prices and wages "determined by reason, in the light of all the facts [employers opening their books to public scrutiny] and with some regard to general equities." Hansen gave us the admirable generalizations already quoted: "a balanced wage-and-price policy and, above all, social unity and cohesiveness."

Chairman PATMAN. Now, for our next witnesses this morning, we have a distinguished panel of economists, one of whom is a professor of law and a former staff member of the Joint Economic Committee.

Our panelists are Dr. Walter Adams, professor of economics, Michigan State University; Dr. Alfred E. Kahn, chairman of the Department of Economics, Cornell University; Dr. Robert F. Lanzillotti, head of the Department of Economics, Michigan State University; and Dr. Richard J. Barber, professor of law, Southern Methodist University.

Gentlemen, we are glad that you have come. Our procedure is to have each member of the panel make a brief opening statement, then members of the committee may wish to put some questions to the panel.

We usually take you alphabetically, Dr. Adams, so we will start with you.

#### STATEMENT OF DR. WALTER ADAMS, PROFESSOR OF ECONOMICS, MICHIGAN STATE UNIVERSITY

Dr. ADAMS. Thank you, Mr. Chairman.

May I ask that my statement be inserted in the record at this point?

Chairman PATMAN. Yes, sir. Without objection, your statement will be inserted at this point.

(Statement referred to follows:)

#### STATEMENT OF DR. WALTER ADAMS, PROFESSOR OF ECONOMICS, MICHIGAN STATE UNIVERSITY

It is reported that when Galileo made his telescope and discovered the satellites of Jupiter, his findings were disputed by the head professor of philosophy at the University of Padua. "We know," he said, "that there are seven planets, and only seven, because there are seven openings in the human head to let in the light and air: two eyes, two ears, two nostrils, and a mouth. And the seven metals and various other examples also show that there have to be seven. Besides, the stars are invisible to the naked eye; therefore they do not influence human events; therefore they are useless; therefore they do not exist. (*Quod erat demonstrandum!*)" (Quoted in Frank H. Knight, *Intelligence and Democratic Action*, p. 57.) The event occurred in 1610, long after man had supposedly emerged from the darkness of the Middle Ages to the light of the Renaissance.

That type of reasoning has not yet disappeared. It has survived in fields other than astronomy, in lands other than Italy, and times even more enlightened than the 17th century. Today, for example, one can still find economists who argue as follows: (1) Monopoly power exists in theory but is rare in practice; (2) it cannot be measured with elegant precision; (3) being unmeasurable, it cannot possibly be widespread; (4) even if it were widespread, it would be held in check by interindustry competition, the corporate soul, the gales of creative destruction, countervailing power, congressional investigations, and presidential admonition; (5) in any event, there is no urgency for public action until further research has unearthed the final answers.

I do not happen to share this Pangloss view of things. Conceding the fact that monopoly power is never absolute—that no system of price administration is ever foolproof—I submit that concentrated economic power is a fact of American life. It exists; it is pervasive; it is dangerous. It poses what I consider the No. 1 domestic problem of our time—the prevalence of private socialism in what we like to think of as a free enterprise economy.

Let me explain the different types of market power—conglomerate, vertical, and horizontal—by using the General Motors Corp. and the auto industry as an example. (1) Conglomerate power: This means that a firm's operations are so widely diversified that its survival no longer depends on success in any given product market or any given geographical area. Its absolute size, its sheer bigness, is so impressive that it can discipline or destroy its more specialized competitors.

General Motors, of course, possesses conglomerate power. Until recently part of the giant Du Pont empire, this corporation is not only the largest automobile company in the world, but also a significant factor in diesel locomotives, buses, trucks, refrigerators, electric ranges, auto financing, batteries, earth-moving machinery, etc. This corporation could decide to enter the ice cream industry—intent on capturing 20 or 40 or 100 percent of the sales—and succeed in this endeavor. It would matter little whether GM was indeed an efficient ice cream manufacturer or whether its ice cream was indeed tastier than more established brands. By discreet price concessions, saturation advertising and attractive promotional deals, it could commit its gargantuan financial power to the battle until only so much competition as GM was prepared to tolerate would be left in the industry. Remember that, in good years, the annual profits of General Motors are roughly as big as the combined assets of Borden and National Dairy.

Put differently, in a poker game with unlimited stakes, the player who commands disproportionately large funds is likely to emerge victorious—regardless of ability, virtue, or luck. He has the one asset the others lack, viz., the power to bankrupt his rivals. Given the laws of probability, his power alone tends to be decisive.

(2) Vertical power: This means that a firm engaged in successive stages of production and distribution can squeeze its suppliers by denial of access, or its distributors by denial of supplies, or both by manipulation of price. In the case of General Motors, congressional committees have received ample evidence of the corporation's power over automobile parts manufacturers and automobile dealers. The record on this score requires no elaboration here.

(3) Horizontal power: This is market control in its pristine, classical form. It consists of dominance over an industry (in relative, percentage terms), and is manifested in entry controls, price leadership and followership, and other assorted forms of oligopolistic cooperation.

General Motors, with its more than 50 percent control over the automobile industry, is a prize example of horizontal power. Its decisions what to produce, where to produce, how to produce—what price to charge, what target profit to aim at, what means of raising capital to employ—these and similar decisions have a profound impact not only on its fellow oligopolists, but the whole automobile industry, the American businessman, the American consumer, the American worker, and the American economy. These are decisions which affect the general public, but they are made by a private government—subject to only the loosest public control and involving only the remotest participation of our democratic citizenry.

(a) Pricing.—General Motors sets its prices so that—over the long run and assuming "standard volume" (operations at roughly 80 percent of capacity)—they will yield an average profit (after Reuther and after taxes) of 15 to 20 percent on invested capital. This is called target-rate-of-return pricing. It is the same cost-plus system of pricing used in the regulated industries—with this difference: the rate of return allowed a public utility is determined by a government regulatory commission, whereas the General Motors rate is determined by the company itself. It is not imposed by the autonomous forces of the market place as in a competitive industry; it is not imposed by a public regulatory commission; it is the private exercise of discretionary power by a corporation with dominant control of the market. Not only does General Motors possess this market control, but as the Kefauver committee hearings showed, it has been amazingly successful since World War II in exercising such control and achieving its self-determined and predetermined target rate of profit.

That it was able to do so is partly due to the slavish pliability of its major rivals. The latter have simply not chosen to challenge General Motors' price leadership and contented themselves to follow, within rather narrow limits, the lead of the industry's giant. One dramatic illustration revealed by the Kefauver hearings involved the pricing of the 1957 models: Ford had announced an average 2.9 percent price increase—"no more than our actual costs for materials and labor have gone up;" General Motors 2 weeks later announced an average 6.1 percent increase on comparable models; whereupon Ford quickly revised its price list upward—no doubt to meet the higher price of a competitor. When Chrysler later fell in line, the traditional pattern in the low price field was maintained. The deleterious effects of such conduct, I trust, will become apparent later in my presentation.

(b) *Product design.*—While the automobile industry in the days of Henry Ford I was an arena of price competition—with companies reaching out for “the other 95 percent of the market” by competitive price reductions, the rise of General Motors ushered in a diversion of the industry’s competitive energies into nonprice rivalry. Whereas Henry Ford told his customers that they could choose any color automobile as long as it was black, the industry by 1960 was offering more than 300 different passenger models and the manager of General Motors’ Chevrolet Division boasted that his factories were turning out a custom-made car for almost every buyer. Chevrolet, he said, offers the buyers so many combinations and permutations of body styles, color, trim, and equipment options that (without counting accessories) Chevrolet could have produced its entire 1960 output of 1,850,000 passenger cars without making any two of them exactly alike. Price cutting to tap new layers of domestic or foreign demand had become an anachronism, only to be replaced by advertising outlays, annual model changes, and the horsepower race. The automobile, no longer a mere vehicle for transportation, was made a complex and luxurious amalgam of superengines, tailfins, quadruple headlights, and a cornucopia of chrome. Inevitably, its cost of production and price increased steadily and alarmingly.

For the Big Three, according to the Kefauver committee, depreciation and obsolescence costs rose from \$183.2 million in 1950 to \$679.8 million in 1957; selling and administrative expenses from roughly \$450 million to \$1,200 million; and the annual cost of special tools from \$182.3 million to \$762.0 million. (It should be noted that production volume in 1950 and 1957 was 7 million cars which makes these comparisons especially relevant.) At Ford, the dollar cost of major model changeovers increased more than 6½ times between 1948 and 1957, and at an increasing rate: in 1957 these costs were more than 3 times as high as in 1953. Since sales increased at a much slower rate, the ratio of styling costs to sales (and production costs) increased significantly—doubling between 1948 and 1957. In economic terms, the effect of this nonprice rivalry was to raise overhead costs and exert an upward pressure on price; this in turn, given the elastic demand for automobiles, tended to depress volume and raise unit fixed costs even further. The consequences, as we shall see presently, were far from gratifying.

(c) *Export policy.*—How should American automobile companies supply their overseas markets? Should they utilize and expand their domestic facilities or rely on their foreign subsidiaries? Should General Motors supply its overseas markets from Detroit, Flint, and Lansing, or from the Opel factory in Germany, the Vauxhall factory in Great Britain, or the Holden factory in Australia? Should Ford turn to River Rouge or to Dagenham, England, and Cologne, Germany? The choice that is made has an obvious impact on the volume of private investment at home, on employment, on purchasing power, on economic growth—and even on Government tax receipts.

Shortly after World War II, according to press reports, General Motors was contemplating the marketing of a new small car to be produced at a new plant built somewhere in the United States. This was the Holden, and its production facility was eventually located in Australia. This decision apparently became a policy trend in the industry. In 1958, J. Wilner Sundelson, manager of facilities and operations planning, Ford International Division, openly said: “\* \* \* in our planning, we have taken the view that vehicle exports from the United States, which are playing a declining role in Europe, will virtually vanish \* \* \*. Given the geographic penalty of the U.S. exporters in the European market \* \* \* it will readily be understood why we do not anticipate selling many U.S.-made cars in 1970 in the Common Market. Not only vehicles and vehicle components but parts and accessories will be exported from the United States in limited quantities.” In 1961, Frederic G. Donner, chairman of the board of General Motors, echoed these sentiments: “\* \* \* we will build cars and trucks in the United States for the home market and for those markets that want American-type cars, and we will continue our longtime policy of building cars abroad for sale in our overseas markets.” No wonder that American automobile exports between 1950 and 1959 declined from 120,000 to 104,000 while General Motor’s Opel exports from Germany increased from 25,000 to 169,000, the German Ford exports rose from 8,000 to 65,000, and Chrysler’s Simca exports from France rose from 7,000 to 121,000. No wonder that the percentage share of American automobile exports declined radically not only in Europe and the world at large but also (and significantly) in the Latin American market at our back door.

Again I say that the effect of these decisions by American companies had an obvious effect on domestic production, employment, payrolls, growth, tax receipts, and the U.S. balance of payments.

(d) *Market results.*—What then are the effects of these corporate decisions with respect to pricing, product design, and exports on the economic performance of the automobile industry—and, indirectly, the levels of production and employment in the American economy? To approach an answer, let us first examine the domestic automobile market, and then the world market.

In the domestic market, European imports became a significant factor between 1955 and 1959. Their number increased from 57,000 to 668,000, and their relative share of the American market rose from less than 1 percent in 1955 to more than 10 percent in 1959. The reasons, according to a survey of the National Automobile Dealers Association, was that the imports were cheaper to operate and gave better gas mileage; that the original purchase price was lower; that they were easier to park; and that they were easier to handle in traffic. In other words, the American consumer was in open revolt against the Big Three's price policy and product design. While the price of the standard six-cylinder two-door Ford increased from \$1,707 in 1955 to \$2,261 in 1961, the comparable Plymouth from \$1,738 to \$2,260, and the comparable Chevrolet from \$1,685 to \$2,230, the European makes effectively held the line. The Volkswagen went up from \$1,495 in 1955 to \$1,565 in 1961; the Fiat 600 from \$1,298 in 1957 to \$1,398 in 1961; and the Renault Dauphine actually reduced its price from \$1,645 in 1957 to \$1,385 in 1961. (These are all delivered prices in the United States, after payment of transport costs and import duties.)

The reason for the success of the European imports obviously was not that American producers were incapable of turning out a competitive model, but rather that they had chosen not to do so. They had become sufficiently insensitive to consumer desires—persuaded by their own propaganda that they could foist ever larger gas-guzzling monsters at ever higher prices on the hapless American public. Once the oligopolists were brought back to reality by the marginal competition of the European imports, they proceeded to bring out the compact cars which quickly terminated the import threat. Since 1959, both the number of imported cars and their percentage share of the American market has decreased steadily. A different price and product policy by the Big Three—forced on them by "outside" competition—had obviously turned the trick.

In the international arena, too, there is dramatic evidence that the Big Three's price, product, and export policies have caused the United States to lose out in world markets. In motor vehicle exports to the world at large (excluding the United States), according to the Department of Commerce, the U.S. share has declined from 41 percent in 1954 to 26 percent in 1960. At the same time, Germany's share rose from 16 to 24 percent, and that of the other OEEC countries from 15 to 25 percent. Even in Latin America, an area in which we enjoy massive advantages and which by geography and tradition is so closely tied to the United States, the U.S. market share declined from 81 percent in 1954 to 65 percent in 1960, while the United Kingdom's share increased from 5 to 7 percent, Germany's share from 8 to 15 percent, and the other OEEC countries' share from 7 to 12 percent. Put differently, the shortfall in U.S. automobile exports between 1954 and 1960 amounted to some \$656 million; that is, if American exporters had been able to command the same share of world markets in 1960 as they held in 1954, the United States would have earned an additional \$656 million through automobile sales abroad. (This, incidentally, is the largest shortfall of any manufactured commodity group—followed by a \$395 million shortfall in iron and steel, a \$335 million shortfall in industrial machinery, and a \$108 million shortfall in agricultural machinery and tractors.)

Clearly, the Big Three have priced and designed themselves out of world markets, on the one hand, and have made a conscious decision to supply overseas markets from their foreign subsidiaries, on the other. The impact of these private corporate decisions on domestic production, employment, and growth require no elaboration.

By using General Motors and the Big Three in the auto industry as an example—and no more than an example—I have tried to illustrate the existence of the vast discretionary power in the hands of some large corporations. "That power," as Justice Douglas once said, "can be used with lightning speed. It can be benign or it can be dangerous." In a democracy, dedicated to free competitive enterprise, such power should not exist. It should be decentralized. "It

should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men." The fact that they are not rapacious robber barons, but respectable and social minded, is irrelevant. The fact that they are imbued with the "corporate soul"—a sense of social responsibility—may qualify them to decide what is good for General Motors; it does not entitle them to determine what is good for Detroit or for the United States. Such decisions, in a democratic economy, are the function of the competitive marketplace. And when a corporation or group of corporations become so big that they are immune from the regulation of competition—so big that they constitute what amounts to a private government—then those corporations are too big for their own good and certainly too big for society's good. They then become an instrument of private socialism which is incompatible with both free enterprise economics and political democracy.

Dr. ADAMS. Thank you.

It is reported that when Galileo made his telescope and discovered the satellites of Jupiter, his findings were disputed by the head professor of philosophy at the University of Padua, who said:

We know that there are seven planets and only seven, because there are seven openings in the human head to let in the light and air: two eyes, two ears, two nostrils, and a mouth. And the seven metals and various other examples also show that there have to be seven. Besides, the stars are invisible to the naked eye; therefore they do not influence human events; therefore, they are useless; therefore they do not exist. (*Quod erat demonstrandum.*) Quoted in Frank H. Knight, "Intelligence and Democratic Action," p. 57.)

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That type of reasoning has not yet disappeared. It has survived in fields other than astronomy, in lands other than Italy, and times even more enlightened than the 17th century.

Today, for example, one can still find economists who argue as follows: (1) Monopoly power exists in theory but is rare in practice; (2) it cannot be measured with elegant precision; (3) being unmeasurable, it cannot possibly be widespread; (4) even if it were widespread, it would be held in check by interindustry competition, the corporate soul, the gales of creative destruction, countervailing power, congressional investigations, and Presidential admonition; and (5) in any event, there is no urgency for public action until further research has unearthed the "final answers."

Now, Mr. Chairman, I do not happen to take this rosy view of things. Conceding the fact that monopoly power is never absolute—that no system of price administration is ever foolproof—I submit that concentrated economic power is a fact of American life. It exists; it is pervasive; it is dangerous. It poses what I consider the No. 1 domestic problem of our time—the prevalence of private socialism in what we like to think of as a free enterprise economy.

Let me explain the different types of market power—conglomerate, vertical, and horizontal—by using the General Motors Corp. and the auto industry as an example. And I will confine myself to that industry and that company for purposes of illustration.

(1) Conglomerate power: This means that a firm's operations are so widely diversified that its survival no longer depends on success in any given product market or any given geographical area. Its absolute size, its sheer bigness, is so impressive that it can discipline or destroy its more specialized competitors.

General Motors, of course, possesses conglomerate power. Until recently part of the giant Du Pont empire, this corporation is not only the largest automobile company in the world, but also a significant factor in diesel locomotives, buses, trucks, refrigerators, electric ranges, auto financing, batteries, earthmoving machinery, et cetera.

This corporation could decide to enter the ice cream industry—in intent on capturing 20 or 40 or 100 percent of the sales—and succeed in this endeavor. It would matter little whether GM was indeed an efficient ice cream manufacturer or whether its ice cream was indeed tastier than more established brands.

By discreet price concessions, saturation advertising, and attractive promotional deals, it could commit its gargantuan financial power to the battle until only so much competition as GM was prepared to tolerate would be left in the industry.

Remember that, in good years, the annual profits of General Motors are roughly as big as the combined assets of Borden and National Dairy.

Put differently, in a poker game with unlimited stakes, the player who commands disproportionately large funds, is likely to emerge victorious—regardless of ability, virtue, or luck. He has the one asset the others lack, viz, the power to bankrupt his rivals. Given the laws of probability, his power alone tends to be decisive.

Now, let me skip vertical power and move on to (2) horizontal power, which is market control in its pristine classical form. It consists of dominance over an industry—in relative, percentage terms—and is manifested in entry controls, price leadership, and followership, and other assorted forms of oligopolistic cooperation.

General Motors, with its more than 50-percent control over the automobile industry, is a prize example of horizontal power. Its decisions what to produce, where to produce, how to produce—what price to charge, what target profit to aim at, what means of raising capital to employ—these and similar decisions have a profound impact not only on its fellow oligopolists, but the whole automobile industry, the American businessman, the American consumer, the American worker, and the American economy.

These are decisions which affect the general public, but they are made by a private government—subject to only the loosest public control and involving only the remotest participation of our democratic citizenry.

This horizontal power is manifested in different forms:

(a) Pricing, for example. General Motors sets its prices so that—over the long run and assuming “standard volume” (operations at roughly 80 percent of capacity)—they will yield an average profit (after Reuther and after taxes) of 15 to 20 percent on invested capital.

This is called target-rate-of-return pricing. It is the same cost-plus system of pricing used in the regulated industries—with this difference: the rate of return allowed a public utility is determined by a Government regulatory commission, whereas the General Motors rate is determined by the company itself. It is not imposed by the autonomous forces of the marketplace as in a competitive industry; it is not imposed by a public regulatory commission; it is the private exercise of discretionary power by a corporation with dominant control of the market.

Not only does General Motors possess this market control, but, as the Kefauver committee hearings showed, it has been amazingly successful since World War II in exercising such control and achieving its self-determined and predetermined target rate of profit.

That it was able to do so is partly due to the slavish pliability of its major rivals. The latter have simply not chosen to challenge GM's price leadership, and contented themselves to follow, within rather narrow limits, the lead of the industry's giant.

I will skip the illustrations. I think this committee is familiar with them.

(b) A second manifestation of horizontal power is in the field of product design. While the automobile industry in the days of Henry Ford I was an arena of price competition—with companies reaching out for "the other 95 percent of the market" by competitive price reductions, the rise of General Motors ushered in a diversion of the industry's competitive energies into nonprice rivalry.

Whereas Henry Ford told his customers that they could choose any color automobile as long as it was black, the industry, by 1960, was offering more than 300 different passenger models, and the manager of GM's Chevrolet Division boasted that his factories were turning out a custom-made car for almost every buyer.

Chevrolet, he said, offers the buyer so many combinations and permutations of body style, color, trim, and equipment options that (without counting accessories) Chevrolet could have produced its entire 1960 output of 1,850,000 passenger cars without making any 2 of them exactly alike.

Price cutting to tap new layers of domestic or foreign demand had become an anachronism, only to be replaced by advertising outlays, annual model changes, and the horsepower race. The automobile, no longer a mere vehicle for transportation, was made a complex and luxurious amalgam of superengines, tailfins, quadruple headlights, and a cornucopia of chrome. Inevitably, its cost of production and price increased steadily and alarmingly.

Again I will skip the documentation of this proposition.

(c) Now, a third manifestation of horizontal power—and, Mr. Chairman, if I may underscore this, I think it is terribly important—the export policy of these companies:

How should American automobile companies supply their overseas markets? Should they utilize and expand their domestic facilities, or rely on their foreign subsidiaries? Should General Motors supply its overseas market from Detroit, Flint, or Lansing, or from the Opel factory in Germany, the Vauxhall factory in Great Britain, or the Holden factory in Australia? Should Ford turn to River Rouge, or to Dagenham, England, and Cologne, Germany?

The choice that is made has an obvious impact on the volume of private investment at home, on employment, on purchasing power, on economic growth—and even on Government tax receipts.

Shortly after World War II, according to press reports, General Motors was contemplating the marketing of a new "small" car to be produced at a new plant built somewhere in the United States. This was the Holden, and its production facility was eventually located in Australia.

This decision apparently became a policy trend in the industry. In 1958, J. Wilner Sundelson, manager of facilities and operations planning, Ford International Division, openly said:

\*\*\* in our planning, we have taken the view that vehicle exports from the United States, which are playing a declining role in Europe, will virtually vanish. \*\*\* Given the geographic penalty of the U.S. exporters in the European market \*\*\* it will readily be understood why we do not anticipate selling many U.S.-made cars in 1970 in the Common Market. Not only vehicles and vehicle components but parts and accessories will be exported from the United States in limited quantities.

In 1961, Frederic G. Donner, chairman of the board of General Motors, echoed these sentiments:

\*\*\* we will build cars and trucks in the United States for the home market and for those markets that want American-type cars, and we will continue our long-time policy of building cars abroad for sale in our oversea markets.

No wonder that American automobile exports between 1950 and 1959 declined from 120,000 to 104,000, while GM's Opel exports from Germany increased from 25,000 to 169,000, the German Ford exports rose from 8,000 to 65,000, and Chrysler's Simca exports from France rose from 7,000 to 121,000.

No wonder that the percentage share of American automobile exports declined radically not only in Europe and the world at large, but also (and significantly) in the Latin American market at our back door.

Again I say that the effect of these decisions by American companies had an obvious effect on domestic production, employment, payrolls, growth, tax receipts, and the U.S. balance of payments.

In commonsense terms, ask the people of Detroit. They understand the implications of this. The answer is jobs, payrolls, purchasing power, and the economic welfare of the State of Michigan.

(d) Market results: What are the results of these kinds of policies?

Let me try and approach an answer by talking first about the domestic effects, and secondly about the international effect.

Now, in the domestic market, the effect of this pricing and product design policy became obvious between 1955 and 1959, with the tremendous increase in imported cars. These imports from Europe increased in number from 57,000 to 668,000, and their relative share of the American market rose from less than 1 percent in 1955 to more than 10 percent in 1959.

The reasons, according to a survey of the National Automobile Dealers Association, was that the imports were cheaper to operate and gave better gas mileage, et cetera. Again, the record shows the relative prices of the European imports held the line, whereas, of course, the prices of American models kept going up. American cars became ever larger gas guzzling monsters sold at ever higher prices to the American public.

In the international arena, too, there is dramatic evidence that the Big Three's price, product, and export policies have caused the United States to lose out in world markets.

In the motor vehicle exports to the world at large (excluding the United States), according to the Department of Commerce, the U.S. share has declined from 41 percent in 1954 to 26 percent in 1960. At the same time, Germany's share rose from 16 to 24 percent, and that of the other OEEC countries from 15 to 25 percent.

Even in Latin America, again, an area in which we enjoy massive advantage, and which by geography and tradition is so closely tied to the United States, the U.S. market share declined from 81 percent in 1954 to 65 percent in 1960, while the shares of the other countries, like the United Kingdom, Germany, and the OEEC countries, kept going up.

Put differently, the "short fall" in U.S. automobile exports between 1954 and 1960 amounted to some \$656 million. That is, if American exporters had been able to command the same share of world markets in 1960 as they held in 1954, the United States would have earned an additional \$656 million through automobile sales abroad. This is the largest "short fall" of any manufactured commodity group—followed by iron and steel, industrial machinery, agricultural machinery, and tractors; again, highly concentrated industries.

Clearly, then, the Big Three have priced and designed themselves out of world markets on the one hand, and have made the conscious decision to supply oversea markets from their foreign subsidiaries, on the other. The impact of these private corporate decisions on domestic production, employment, and growth require no elaboration.

Now, Mr. Chairman, by using General Motors and the Big Three in the auto industry, as an example—and no more than an example—I have tried to illustrate the existence of the vast discretionary power in the hands of some large corporations.

That power—

as Justice Douglas once said—

can be used with lightning speed. It can be benign, or it can be dangerous.

In a democracy, dedicated to free competitive enterprise, such power should not exist. It should be decentralized.

It should be scattered into many hands, so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability, of a few self-appointed men.

The fact that they are not rapacious robber barons, but respectable and social minded, is irrelevant. The fact that they are imbued with the "corporate soul"—a sense of social responsibility—may qualify them to decide what is good for General Motors; it does not entitle them to determine what is good for Detroit or good for the United States.

Such decisions, in a democratic economy, are the function of the competitive marketplace. And when a corporation or group of corporations become so big that they are immune from the regulation of competition—so big that they constitute what amounts to a private government—then those corporations are too big for their own good, and certainly too big for society's good. They then become an instrument of private socialism which is incompatible with both free enterprise economics and political democracy.

I shall have specific recommendations what to do about that situation in the question period, Mr. Chairman.

Chairman PATMAN. Thank you, Dr. Adams.

Dr. Alfred E. Kahn is next, I believe.

**STATEMENT OF DR. ALFRED E. KAHN, PROFESSOR OF ECONOMICS,  
CORNELL UNIVERSITY**

Dr. KAHN. Yes, Mr. Chairman.

I will try to summarize my statement orally.

Chairman PATMAN. The statement of each one of you will be inserted in the record at the time of your appearance, and then you may comment as you desire.

Dr. KAHN. Thank you.

(Statement referred to follows:)

**STATEMENT ON MARKET POWER IN RELATION TO ECONOMIC GROWTH**

(By Alfred E. Kahn, professor of economics, Cornell University)

As I understand it, the Joint Economic Committee's present sequence of hearings is concerned principally with the current state of our economy, in particular with such questions as whether the recovery of the last 18 months is coming too soon to a halt, and what if anything can be done to sustain the expansion of economic activity and in so doing to make fuller use of a still too large volume of idle labor and plant. Such relatively immediate questions necessarily cause you to focus your attention principally on current issues of fiscal and monetary policy, because these are by far the principal instruments of policy for exerting relatively immediate and short-run influences on the pace of economic activity.

In contrast, the questions to which the committee has turned in the last day or so, concerning as they do the basic structure of our economy, the adequacy of the continuing stimuli it provides for expansion and of the limitations it imposes on the antisocial exercise of market power, are inevitably longer run in character. The policies it calls into question are not of a kind that can or should readily be varied with the stage of the business cycle, to sustain a halting business recovery or prevent a threatened recession. Indeed, they may even complicate the problems of economic stabilization: growth in a free society (perhaps equally in controlled economies as well) naturally proceeds in waves and spurts, and the institutions of free enterprise that promote innovation and expansion probably also accentuate short-run instability in some ways.

At the same time, I think there is a particular compatibility, here and now, in mid-1962, between the various goals of long-run growth, price stability, and reinforcing and extending the current, halting recovery, that makes it important for this committee to consider not merely our current monetary and fiscal policies but also the adequacy of our market institutions to the promotion of these various purposes. I say this for two reasons. The first is that somewhere in the mid-1950's the American economy apparently came to the end of a long boom—a 10- to 15-year boom, depending upon whether one includes the World War II period. The consequence of this relatively long-run change is that the remedy for the principal economic problems that have been troubling us since that time—sharply reduced rates of expansion of gross national product, a trend to a decreasingly full utilization of our human and physical plant, rising unit costs of production translated, at least at certain times and in particular sectors of the economy, into rising prices—is not in my opinion to be found merely in short-term stimulants for effective demand, important though I regard such stimulants to be at this time. Second, we have become sensitized in the last 5 years or so to the dangers of creeping inflation, a growing sensitivity forced upon us by our changed balance-of-payments situation, among other factors. It becomes important therefore to ask more fundamental questions of how and whether a sustained general expansion can within the framework of our present market institutions be rendered more surely compatible with stability in the general price level, with an improved rather than a deteriorated competitive position of American products in world markets.

It is not necessary for my purposes to examine at this point the important and controversial question of whether the private economy alone can in the next decade, even with the assistance of such stimuli as tax reductions and reforms, bear the major burden of this expansion, or whether, alternatively, the remedy for the termination of a boom powered primarily by private expenditures must be a corresponding expansion of public effort. Nor can I here enter

into the equally important controversies about the respective merits of devoting additional resources to the satisfaction of private market or public needs. It seems to me that in any event there can be no disputing the particular relevance at this juncture of considering the extent to which the structure of our private markets is conducive to long-term growth, and the ways in which their growth potential might be improved. This, it seems to me, is the relevance of the particular subject that I have been asked to discuss: does the existence of centers of market power in important areas of our economy, in both labor and product markets, impede economic growth?

The first possible connection between market power and economic growth is one that this Committee has already considered at great length in its enormously valuable hearings, studies and reports on "Employment, Growth, and Price Levels." This is the possibility, variously described and characterized, that market power may itself be responsible for a persistent tendency for costs and prices to rise, even when the level of aggregate demand in the economy at large falls short of what would be necessary to maintain adequately full employment.

The principal significance for economic growth of this tendency is of course that the goal of price stability tends in these circumstances to counsel monetary and fiscal policies restrictive of further expansion of aggregate demand, even though resources remain incompletely utilized; and if the experience of the 1940-55 boom shows anything, it shows that our economy grows most rapidly when it is subject to continuing pressures of demand on productive capacity.

There is no room for doubt that market power played a significant role in the disturbing increases in the general price indexes during the 1955-58 period. As I pointed out in a statement to this committee on February 3, 1959:

"It was an unmistakable sign of monopoly power that the steel industry could raise prices in 1957, with operations slumping, and again mid-1958, when it was working at less than 60 percent of capacity; it was equally a sign of monopoly power that the steel workers' wages (and the industry's unit labor costs) could have been boosted in those circumstances—in the second instance with well over 100,000 steel workers unemployed."

The continued increase in the price of new automobiles after 1955, when sales ran continuously below that 1955 peak, was, I averred, another "sign of ineffective price competition. The contrast between the behavior during the recent recession of the prices of aluminum and steel on the one hand and copper and zinc on the other, of crude oil on the one hand and of petroleum products on the other is simply inexplicable except in terms of the different degrees of market control over these groups of goods. I have no doubt either that some part of the rise in prices of services, which has played so important a role in boosting the cost of living, itself reflects wage and price administration, rather than the mere upward pull of demand."

The more thorough investigation and explanation by Prof. Charles L. Schultze of the inflationary tendencies of these years, expounded in a study prepared for this committee, which places heavy emphasis on the sharply increased demand for producers' durable goods in the 1955-57 period, likewise rests heavily on market power—a power reflected in the failure of prices and wages in other sectors of the economy to decline, in the tendency instead for wages elsewhere to rise in imitation of wage trends in the booming sectors, and in the so-called ratchet effect, resulting from the downward rigidity of prices and wages in producer durables after the booming demands subsided.

On the other hand, it is as yet not at all clear to what extent the 1955-58 experience was unusual, to what extent instead the tendency to market-power inflation is really chronic in our economy. As I pointed out in my earlier statement to this committee, there were bases for the former interpretation: witness, for example, the lingering inflationary influence in the steel industry of a 3-year labor contract, signed when demand was still strong and providing for annual increases in wage costs far greater than the historic growth of productivity, increases that went into effect in subsequent years when demand steadily declined. Moreover, while it is certainly clear why monopoly power in product markets would tend to produce levels of price higher than those that would prevail if markets were more competitive, it is less clear why monopoly power should be expected to produce prices continuously rising relative to the competitive. Monopoly power is the power to hold price above cost, however defined; it is not the power continuously, year by year, to raise prices relative to cost, or to exact perpetually widening profit margins.

Finally, the course of prices in the last 4 years no longer affords much support for the market power inflation thesis. The wholesale price index has been stable. The consumer price index and GNP deflator have continued to rise, but at a diminished rate, and it is doubtful that a cross sectional analysis of their components would show any correlation between price increases and concentration of market power.

I do not suggest that the market power inflation thesis should therefore be laid to rest. On the contrary, I believe that some such inherent tendencies exist, though I think they still await a wholly convincing explanation and demonstration. It hardly answers the market power inflation thesis to point out that wage and price increases have abated in a period when monthly unemployment has chronically exceeded a (seasonally adjusted) 5 percent of the labor force—entirely apart from part-time work and the withdrawals from the labor force that seem to occur when job opportunities diminish—and when the rate of utilization of our productive capacity has failed to break a long-run downward trend. That thesis does not deny that a sufficient constriction of aggregate demand can hold wage and price increases in check; on the contrary, it is its very essence that market power poses the dilemma for public policy of having to choose between the goals of price stability and full employment. The fact that we have apparently come close to achieving the former at the sacrifice of the latter does not prove, in contradiction of that hypothesis, that we can have both simultaneously.

In short, my suggestion about market power inflation is a modest one. First, the only verdict I am prepared to recommend at this stage is something like a Scotch one—"extent of guilt not proved." And second, I would like to see the committee reexamine the question in light of our experience during the 2½ years since it published its excellent staff report on "Employment, Growth, and Price Levels," to try to come closer to a determination of whether the 1955-58 experience was more or less unique, or the relative price stability we have had since reflects nothing more than our having chosen to impale ourselves on one rather than the other of the horns of the dilemma.

We can hardly take satisfaction from relative stabilization of prices in a period that witnessed one aborted recovery—the committee is in a sense trying to find out whether the number is now two—one recession, and a failure to break the long-run decline in the percent utilization of our productive plant. We might usefully remind ourselves that the original concerns about the behavior of so-called administered prices, tracing back to the 1930's, revolved not around any alleged tendencies to rise chronically, but around their resistance to downward pressures in periods of recession, declines in demand being reflected in reduced production rather than reduced prices. Those earlier controversies were never wholly resolved either, and I do not attempt to resolve them here. But they do suggest two relevant observations.

First, while I think most economists would agree it is highly doubtful that prices more flexible on the downside would prevent, cure, or even moderate general recessions, it is almost certainly true that if rigid prices in periods of excessive unemployment engender an understandable reluctance on the part of the Government to ease credit, reduce taxes, or expand its spending, in the fear that any such efforts would upset the precarious price balance, then recession price rigidity does, in fact, pose a definite obstacle to recovery. If prices went down in recessions, there would certainly be less hesitation on the part of the Government about trying to expand effective demand. And second, rigid prices may have quite a different overall significance in periods of general and widespread economic decline, when it is quite possible greater downward price flexibility might accentuate rather than moderate the general deflation, and in periods of merely inadequately rapid growth such as our economy has experienced in the last 5 to 7 years.

For if there is one point about the relationship of prices to growth on which I think most economists would agree, it is the point that Dr. Nourse has been expounding for the last 25 years: that one essential for economic progress in a private enterprise economy is the aggressive pursuit of price-reducing policies by its leading business firms. And this brings me to the second, and in my judgment more important, of the possible relationships between market power and growth that I wish to call to your attention today. I refer to the implications of market power with respect to the dynamic quest for new, cost-reducing processes and products, the unremitting probing of the longrun elasticity of demand by continuous price reductions over time, that are a prerequisite of satisfactory growth in a private enterprise economy.

Many words have been devoted to the general question of whether monopoly or competition is more conducive to economic growth. Much of this discussion has been illuminating, not because it has answered that question, but because it has demonstrated that it is unanswerable as stated. Everything depends on what kinds of monopoly or competition one has in mind, and where. To illustrate the latter, monopoly is probably a prime obstacle to economic progress in many underdeveloped countries of the world today—market power in the hands of entrenched, protected, quasi-feudal and entirely unaggressive, unprogressive, and unenterprising propertied classes. On the other hand, monopoly power was probably an important contributor to economic growth in late 19th century Japan and Germany; there monopoly power enjoyed by an emerging entrepreneurial class, intent on borrowing the best of foreign technology or developing and applying its own, probably conducted to higher levels of saving, capital formation and research than would have been achieved under more purely competitive conditions.

In the same way, the limitations on competition that give a successful innovator some protection against immediate imitation and deprivation of the fruits of his efforts, the prospect of temporary monopoly profits that result from successful, risk-taking innovations, and the business size, integration, and financial resources necessary for the conduct of continuing, longrun research efforts—all these elements and kinds of monopoly are, within limits, doubtless necessary for progress in the American economy today. But, it is equally true, the monopoly power that results from collusion and combination, from private or governmental restrictions imposed on competition, the market power that arises or is exerted precisely to ward off the profit- or wage-depressing effects of technological progress itself or of the entry of new, lower cost supplies, can only be obstructive of economic progress.

It is unnecessary to try to answer the general, and in my opinion meaningless, question of whether monopoly or competition is more conducive to economic progress in order to recognize that the cause of progress is not served by an industry that reacts to declining demand or to intensified competition from lower cost suppliers by raising or even just maintaining its prices, reducing break-even points, or seeking tariff protection. The same observations obviously apply also to unions that push up wages in the face of mounting unemployment, or pose unreasonable obstacles to the introduction of technological improvements. Economic growth in these circumstances requires instead more intensified competitive pressures and efforts, reductions in prices and unit wage costs rather than increases.

It is at this point that the obstacles posed by monopoly to the processes of economic expansion merge with the problem of market power inflation. Growth requires cost-reducing innovation and a passing on of some of those savings in lower prices to consumers. So does overall price level stability. If instead the benefits of above-average productivity advances are eaten up by wages and profits in the industries experiencing those advances, it is highly likely that the average price level will rise, and that a drag will be exerted on economic growth. Prices in the rapidly progressing lines remaining constant, there is no reason for consumers to buy more of their product; therefore labor will inevitably be displaced by the technological progress. Since the wages of the displaced workers have in effect been taken over in higher profits, rents and wages of the laborers that remain employed, the technological advance is not covered into the expanded purchasing power that would be required to absorb those workers in alternative employment.

Wages in other industries are unlikely to fall under pressure of these additional workers seeking jobs there, partly because wages are highly inflexible on the downside, and partly because the pattern of wage increases in the rapidly advancing sectors will operate instead to force them upward elsewhere as well, regardless of the state of employment there. Absorption of the technologically displaced workers will therefore require an expansion of aggregate money demand that can come only by some infusion of additional purchasing power from the outside, the failure of prices to decline in the rapidly advancing industries having eliminated the possibility of the required expansion of aggregate demand being generated automatically by the process of technological change itself. If such an infusion of additional purchasing power sufficient to absorb the displaced labor is, in fact, forthcoming, wages and prices generally are likely to rise rather than fall. So, once again, the economy faces the dilemma of having to choose between higher levels of unemployment or a general price increase.

The essential point is that given rigid prices in the rapidly progressing industries, there is no automatic tendency to reemployment of the technologically displaced workers in those very lines; to the extent instead that competition forces prices to fall as costs fall, the economy has an automatic tendency to absorb the unemployed in expanded output without the need for governmental or other external stimuli.

In light of these considerations, the fact that reported corporate profits declined in relationship to sales and to total national income in the 1950's does not necessarily absolve the limited price competition in many of our leading product markets of all responsibility for the inflation of 1955 to 1958 or the relative stagnation since that time. The price increases, as Professor Schultze pointed out, were in considerable part attributable to the attempt of our highly concentrated industries to recoup rising unit costs and to preserve accustomed profit margins as the percentage utilization of their capacity declined. The fact that the attempt was incompletely successful does not mean that it was healthy for the economy for it to have been made. Boosting or even maintaining prices, trying to get by on accustomed, conservative profit margins and low break-even points is not the way to restore profits as a percentage of sales or to promote more rapid economic growth in the presence of excessive productive capacity. Indeed, if made by many firms, the effort could well have been self-defeating, having had the net effect of reducing the buying power of the consumers' dollar and putting on Government a correspondingly greater responsibility for promoting recovery and fuller employment. The only possible cure for low profits, as this committee itself recently suggested in its annual report of March 6, 1962, is a fuller use of capacity; the price policies of the last several years have not contributed, but have instead detracted from the achievement of that goal.

It is much easier to expose the ways in which market power blocks economic expansion than to propose effective, practicable remedies. The available weapons of public policy are almost all indirect. All of them have inadequacies and limitations. But there is no reason to believe that together they would prove insufficient if—and this is the critical condition—they were resolutely applied, in recognition of the overriding public interest in economic growth combined with reasonable price stability. First, there are of course the antitrust laws. They are important; they do help. And, as is perfectly apparent, there are also important aspects of market power—notably noncollusive oligopoly pricing and union influences on wages—that they are presently incompetent to handle. The laws could of course be reframed to bring these kinds and manifestations of market power within their jurisdiction. But as I stated to the committee several years ago, I am frankly uncertain that there can be demonstrated either the efficacy or the need for such measures as could practically be adopted, or the practicability of such measures as might significantly reduce market power. Second, and more important, the Government should—whether it can find the will to do so is another matter—stop its all-too-prevalent practice of resolutely stepping in to prevent competition every time a price threatens to decline, a profit making to be squeezed, a job to be lost.

I refer to such steps—most of them uncomfortably reminiscent of NRA—as the mandatory quotas placed on the importation of crude oil in the last several years; the progressive cutbacks of petroleum production by State authorities in the name of conservation, cutbacks that hold up prices and protect marginal, high-cost producers from a deserved competitive extinction, and also encourage drilling of grossly excessive wells, the annual costs of which are estimated to run into hundreds of millions of dollars; the whole attempt to remedy the evils of rural poverty and agricultural income instability by supporting prices, a method that helps least the farmers that need help the most, while denying consumers at home and abroad the benefit of the astounding technological progress of our farms; the whole complex of controls by which the various regulatory agencies, most obviously in the transportation fields, keep the companies under their charge from competing with one another; the invocation of heightened barriers against imports under the escape clauses of our reciprocal trade agreements; the resort to fair trade; and so on. I do not suggest that the problems with which these various policies attempt to deal are susceptible of easy solution. But I do suggest that they are far too often resolved in the easy way from the standpoint of the interests directly involved—by protection and insulation—and the wrong way if the Government is to give adequate heed to the broader public interests in economic growth and general price level stability.

It is no less true of governmental than of private efforts that if the general price level is to be held stable, individual prices must be permitted to fall; and that if constantly new and better ways of doing things are to be introduced, then there must be permitted some injury to, or at least discommoding of, private parties who have an interest in the older and less efficient ways of doing things. If we truly want growth under private enterprise combined with price stability, then we must permit price competition fuller play, especially when it hurts. We must give the railroads greater freedom to compete with other transportation media; and, for exactly the same reason, it seems to me we must give the proposed coal pipelines the right of eminent domain that they require in order to realize the potential of this existing technological advance in competition with the railroads.

An important step in this task would be the enactment of the trade agreement legislation that the President has requested. Even with our present levels of import duties, probably nothing has been more effective in recent years in halting the wage-price spiral in automobiles—and to a lesser extent in steel—than imports. By exposing our industries to the competition of the burgeoning and aggressive industries of the Common Market, as well as giving them freer access to that growing market, we can supply not just a negative check on market power at home but a much-needed positive competitive spur to innovation and growth.

These proposals are essentially negative and permissive. As is appropriate in a private enterprise economy, the principal function of Government would be to release (and to refrain from restraining) the competitive energies and efforts of private individuals. This is especially true in the area with which my present statement is concerned, that is to say, in handling the problem of private economic power. I cannot conclude without setting forth my strong opinion, however, that there is much also that the Government can and must do on its own initiative to promote growth. I refer here not merely to the importance of reconsidering how tax, procurement, and monetary policies might better be adapted to assist rather than hamper small, growing companies. In addition, I would emphasize the desirability of growing governmental assistance to research, both pure and applied, and particularly to research in areas such as housing and the services, which have on the one hand made a disproportionately large contribution to price-level increases since World War II, and are on the other far too dispersed and small scale in their organization to be able to conduct research themselves; increased governmental efforts in the areas of education, in retraining and improving the skill of our growing labor force, and improving the mobility of displaced workers; and direct intervention in such areas as urban transport. All these would not only make a major direct contribution to economic growth, but would in my judgment also impose dynamic limitations on entrenched market power and improve the effectiveness with which our private, competitive economy meets the challenges of the 1960's.

Dr. KAHN. Before beginning my contribution of this discussion of the relationship of our market structures and the problem of monopoly in particular to economic growth, I wonder if I may suggest, at least as an expression of my own opinion, that, important though I regard this problem of market power, and in fact it is my professional function and area of specialization to regard it as important, I think it would be extremely unfortunate if at least my remarks—I cannot speak for the other gentlemen at the table—left the impression that our tax, our fiscal, and our monetary policies are not likewise of critical importance in affecting the rate of our economic growth both in long-run terms, and also at this particular juncture in the development of the American economy.

Nothing I will say here is intended to suggest, for example, that a tax reduction would not be desirable today.

And when I get to a very brief discussion of possible approaches to the problem of market power, I think it will be abundantly clear that there are not available, practically available, basic changes, basic reforms, of our markets, such as would solve the problem of the halting recovery in which I think we now find ourselves.

I do not see any incompatibility between saying, on the one hand, that we must continuously give emphasis to the structure of our economy, the functioning of our markets, the effectiveness of the competitive private enterprise system in contributing to economic growth, and on the other hand that we must emphasize the great importance of credit policy, of fiscal policy, in posing obstacles to growth, acting as a drag on growth, as the President has put it, and in the present juncture of the economy acting in my opinion as a definite drag on full recovery.

With that introduction, I will attempt briefly to summarize my remarks.

While this committee's principal attention this month is directed toward the question of the adequacy of our present recovery, the question of whether it is grinding to a halt, and whether, therefore, there ought to be changes in our monetary and fiscal policies, it seems to me particularly important today to consider also the adequacy of our market institutions.

I say this for two reasons.

First of all, I think it is fairly clear that somewhere in the mid-1950's—I do not care whether one dates it in 1955 or 1957; it cannot be any later than 1957, and I would suggest 1955—the American economy apparently came to the end of a long boom in economic activity.

That boom was a 10-year boom, or a 15-year boom, depending upon whether one wants to include the World War II period. This is a familiar cyclical phenomenon throughout American history, and I think we make a mistake if we regard the development since 1955 or since 1957 as simply a short-run inventory kind of phenomenon that can be very simply resolved by supplying short-term stimulants for effective demand.

The symptoms of this long boom on the one hand and of the termination of that boom on the other are very familiar. The President made most of those symptoms familiar to us in the campaign in 1960. We have since 1955 witnessed sharply reduced rates of expansion in our gross national product, a definite trend, which, incidentally, is clearly documented in the report of this committee issued in March of this year, toward decreasing full utilization of our human and physical plant, and a tendency to rising unit costs of production translated into rising prices.

The second reason why we must look to our market structure is, as this committee has become very much aware in the last few years, the threat that more satisfactory rates of growth may involve a renewal of creeping inflation. And we are increasingly sensitive to this danger because of the problems of our balance of payments, among other reasons.

In these circumstances I think it is very important for this committee to ask fundamental questions about whether a sustained and improved general expansion of our economy can, within the framework of our present market institutions, be rendered more truly compatible with stability in the general price level; with an improved rather than a deteriorated competitive position of American products in the world markets.

So, for this reason, it seems to me of particular relevance at this time to consider the extent to which the structure of our private mar-

kets is conducive to long-term growth consistent with reasonable price stability.

Now, there are two possible ways in which market power in our economy may bear unfavorably upon economic growth. And I document these at considerably more length in my prepared statement.

The first is the possibility, variously described and characterized, that market power itself may be responsible for a consistent tendency for costs and prices to rise, even when the level of aggregate demand in the economy falls short of what would be necessary to maintain adequately full employment.

The significance of this tendency for economic growth is of course that our goal of price stability tends, in these circumstances, to counsel monetary and fiscal policies that are restrictive of economic expansion.

Now, I think there is no room for doubt that market power did play a significant role in the disturbing increases in the general price level during the 1955 to 1958 period. I allude in my prepared statement to a statement that I made before this committee on February 3 of 1959, on precisely the subject. As I pointed out at that time, it was a clear evidence of monopoly power in product markets and monopoly power in labor markets that the prices of automobiles and steel continued to edge upward in the 1955 to 1958 period, even when the demand for both products peaked out in 1955.

The number of cars sold in 1956 was less than in 1955. It remained well below the 1955 level throughout all the remaining years. In fact, we have just this year come to a year that is not quite as good as 1955. Yet the price of an automobile by any test—I agree completely with Professor Adams—went up continuously in this period.

The case of steel is even more clear; 1955 was the peak steel year. There was less steel sold in 1956 than in 1955, less in 1957 than in 1956, and less in 1958 than in 1957. Steel wages went up, when we had over 100,000 workers out of work; and steel prices likewise continued to go up in these circumstances.

I refer also in my statement to the excellent monograph prepared by Prof. Charles Schultze for this committee in explanation of the inflationary tendencies of these years, in which he supplies a much more sophisticated and I think valid explanation of the phenomenon. But his explanation, too, relies very heavily upon market power.

Now, while still on this one subject, the relationship of market power to the possible danger of chronic inflation, I want to bring certain qualifications of the argument to the committee's attention.

One, we really do not know to what extent 1955 to 1958 was unusual. I pointed out in my own statement 3 years ago that there were many reasons to think that these years were in fact atypical: witness, for example, the effect of the 3-year labor contract in automobiles signed in 1955, which then carried over into increasing costs of 1956, 1957, and 1958. Or the 3-year contract in steel, signed in 1956, when demand was still high, which again carried over into wage and price increases in 1957, 1958, and 1959.

Second, I think the committee should recognize that prices have not increased in the last 4 years, at least wholesale prices have not increased, that the rate of increase in the deflator of the gross national product has diminished, the rise in the consumer price index has

slowly down, and I am quite certain that one would no longer find any clear relationship between the behavior of prices and concentration in product markets from 1958 or 1959.

I am not suggesting that the market power inflation thesis should be laid to rest. On the contrary, I think that there are such inherent tendencies in our economy. And I certainly do not think that it answers the market power inflation thesis to point out that wage and price increases have abated in the last few years, when we have had too much unemployment.

The whole point of the thesis is that we may face a dilemma of having to choose between very high unemployment, on the one hand, and price instability on the other. The fact that we have apparently come close to achieving price stability in a period when we have failed to sustain adequately high employment certainly does not disprove the hypothesis of administered price inflation, because what that hypothesis states is that we cannot have both simultaneously.

In short, my suggestion about market power inflation is a very modest one. The only verdict I am prepared to make is a Scotch verdict, or even a more academic verdict: "Extent of guilt not proved."

But I would like very much to see this committee carry on the really extraordinarily important work that it terminated about 2½ years ago in its various studies of "Employment, Growth, and Price Levels," to try to come closer to a determination of whether the 1955-58 experience was more or less unique, or whether the relative price stability that we have had since reflects nothing more than our having chosen to impale ourselves on one rather than the other of the horns of the dilemma.

I think it useful for the committee to remind itself that the whole controversy about administered prices started in the 1930's. And at that time what we were worried about was not any tendency to chronic inflation in administered price sectors of the economy, but the failure of those prices to decline in periods of business recession. The stability of prices in these sectors during the last four years, in a period when we have had a chronic underutilization of capacity, may be just as bad as the administered price inflation about which there has been so much more publicity in recent years.

There is one point about the relationship of prices to economic growth on which I think most economists would agree. It is the point that Dr. Nourse has been expounding for the last 25 years; that one essential for economic progress in a private enterprise economy is the aggressive pursuit of price-reducing policies by its leading business firms.

And this brings me to the second and in my opinion more important question about the possible relationships between market power and economic growth that I want to call to your attention today.

I refer to the implications of market power with respect to the dynamic quest for new cost-reducing processes and products, the unremitting probing of the long-run elasticity of demand by continuous price reductions over time, that are in my opinion a prerequisite of satisfactory growth in a private enterprise economy.

Now, there has been an enormous amount of discussion in the economic literature about whether monopoly or competition is conducive to economic growth. And I think it is a meaningless question.

There are certain kinds of monopoly that are useful for economic growth. I think that the kind of protection that the patent system gives, which is a kind of monopoly protection, while I would not at all accept all of the aspects of our patent law—I think the law needs reform in certain respects—still this kind of monopoly is conducive to growth within certain limits.

I think also to have firms that are large enough and stable enough and have a long enough perspective to engage in long-term research is conducive to economic growth. So certain kinds of monopoly in certain situations within certain limits are conducive to growth.

On the other hand, it is equally true that monopoly power that results from collusion, from combination of businesses, from private or governmental restrictions imposed on competition—the market power that arises or is exerted precisely to ward off the effects on profits or on wages of technological progress itself, or of the entry of new lower cost supplies, can only be obstructive of economic progress.

And I would say that the same observations obviously apply also to unions that push up wages in the face of mounting unemployment or pose unreasonable obstacles to the introduction of technological improvements.

In my statement I next present the thesis that the avoidance of inflation, on the one hand, and reliable, economic growth without Government infusions of purchasing power, on the other, both require this one phenomenon that we have not adequately witnessed in our economy in the last few years: declining prices in those of our industries that have experienced the most rapid expanding productivity.

Now, my explanation of this is rather lengthy and complex, and I think perhaps it would burden our time, since we have other gentlemen waiting, to bring it forth here. But the point is a very simple one.

If prices do not decline even in those areas in which we have had above-average rises in productivity, we are going to face a mounting problem of technological unemployment. These industries are not going to generate the increased consumer purchasing power necessary to absorb those workers. These workers are going to be a drag on the market. They might be absorbed, conceivably, if wages fell elsewhere. But wages will not fall elsewhere.

So the only way you can absorb these technologically displaced workers, if prices will not fall in these areas, is by turning to some such external source of stimulation as Government spending.

And here, I think, is the crux of the relevance of market power to the question that is posed before us today: Does our private enterprise economy have within itself a sufficient capacity to account for economic growth without turning continuously and in increasing degree to Government for assistance?

Incidentally, I am not satisfied that because corporate profits have declined in relationship to sales and to national income in the 1950's—I am not satisfied that this proves that there is no problem of administered prices.

The price increases of 1955-58, as Professor Schultze pointed out, were in large measure attributable to the attempt of our highly concentrated industries to recoup their rising unit costs and to preserve

their accustomed profit margins as percent utilization of capacity declined.

The fact that this attempt was not completely successful does not mean that it was healthy for the economy for the attempt to have been made.

This is precisely the kind of unenterprising, unaggressive, uncreative price policy, high margins at low volumes, that defeats the purposes of economic growth, and that defeats the purposes of having larger profits as well.

I will turn now to my concluding page, and say only a few words about what possible routes one may take to try to eliminate these impediments to economic expansion.

Let me say at the outset: I know of no simple answers. I know of no policies that can be suggested that promise both to be practicable and obviously and satisfyingly completely successful.

And it is for this reason, incidentally, that I emphasized at the beginning of my statement the importance also of monetary and fiscal policies. Sure, it would be wonderful if another White House Conference on Labor-Management Problems—and I attended the last conference and can speak with some knowledge about its limitations—it would be wonderful if another such conference or 10 more such conferences solved the wage-price problem. I think the conferences are useful. I think we must continue to have them. But I think we delude ourselves if we think that we can fundamentally change the processes of price and wage making in our economy by such conferences or indeed by anything that Congress can do. And for this reason I think it inevitable that this committee also give heed to what the Government can do, not merely with respect to market power, but by direct use of fiscal and monetary policies.

To come back to my text, there is no reason, however, to believe that the various kinds of policies that I will suggest, briefly, would prove insufficient if they were resolutely applied.

First, look at the antitrust laws. They are useful. I do not have anything very novel to say about them. The laws could be reframed to make them stronger in dealing with the things they cannot now handle, noncollusive oligopoly and union influences on wages.

But as I stated to the committee several years ago, and here I am sure I will disagree with Mr. Adams, I do not really believe we are going to get such a change in the antitrust laws. And I am frankly uncertain that we would get much better behavior of our economy if we did make the antitrust laws more stringent in dealing with oligopoly or with big unions. They might have the opposite effect. I do not believe one can really establish the efficacy or the need. And I do not want to waste my time tilting with windmills.

Second, and more important, the Government should—whether it can find the will to do so is another matter—stop its all too prevalent practice of resolutely stepping in to prevent competition every time a price threatens to decline, every time a profit margin threatens to be squeezed, every time a job threatens to be lost.

I refer to such steps, most of them uncomfortably reminiscent of NRA, as the mandatory import quotas put on crude oil in the last couple of years, and the cutbacks of production by State authorities. For month after month flowing wells in Texas have been producing

at 8 days a month, roughly at eight-thirtieths of their capacity, which has the effect not only of holding up prices, but protecting inefficient high-cost producers from a deserved competitive extinction, and also, by the way, encouraging the drilling of a grossly excessive number of wells, the costs of which are estimated to run to hundreds of millions of dollars each year.

I refer to the whole complex of controls by which our various regulatory agencies, especially in the transportation fields, keep the companies under their charge from competing with one another.

I refer to invoking heightened barriers against imports under the escape clauses of our reciprocal trade agreements.

I refer to fair trade, and so on.

I do not suggest that the problems with which these various policies attempt to deal are susceptible of easy solutions, but I do suggest that they are far too often resolved in the easy way, from the standpoint of the interests directly involved, by protection and insulation, and the wrong way, if the Government is to give adequate heed to the broader public interest in economic growth and general price level stability.

A third important step would be the enactment of trade agreement legislation that the President has requested. I refer, as Professor Adams does, to the fact that probably nothing has been more important and effective in recent years in halting the wage-price spiral in automobiles, and to a lesser extent in steel, than imports.

We must expose our industries to the competition of the burgeoning and aggressive industries of the Common Market, as well as offer them the opportunity of participating in the growth of that market.

Fourth, I do not want to conclude without mentioning an entire additional area of Government policies that seems to me of at least equal importance. And this is my last point. There is much also that the Government can and must do on its own initiative to promote growth. I refer here not merely to the importance of reconsidering our taxes, our procurement, and our monetary policies, and considering how they might better be adapted to assist rather than hamper small, growing companies.

In addition, I would emphasize the desirability of growing Government assistance to research, both pure and applied, and—let me emphasize this—particularly to research in areas like housing, and the services, which on the one hand have made a disproportionately large contribution to price level increases since World War II, and on the other hand, like agriculture, are far too dispersed and small scale in their organization to be able to conduct research themselves.

I refer to increased governmental efforts in the areas of education, in retraining and improving the skills of our growing labor force, and improving the mobility of displaced workers; and direct intervention in such areas as urban transport.

All these would not only make a major direct contribution to economic growth, but would, in my judgment, impose dynamic limitations on entrenched market power and improve the effectiveness with which our private competitive economy meets the challenges of the 1960's.

Senator PROxmire (presiding). Thank you very much.

The chairman unfortunately had to leave. He has asked me to take the chair.

Senator PROXMIER. Dr. Lanzillotti, we will hear from you next. I understand you are head of the Department of Economics of Michigan State University.

**STATEMENT OF DR. ROBERT F. LANZILLOTTI, PROFESSOR AND CHAIRMAN, DEPARTMENT OF ECONOMICS, MICHIGAN STATE UNIVERSITY**

Dr. LANZILLOTTI. Yes, sir.

Senator PROXMIER. We are very happy to have you with us. You may proceed.

Dr. LANZILLOTTI. I am very glad to be back here again, and to express my views on this particular subject.

As the other members of the panel have done, I would like to submit my statement for the record. I would like to summarize some of the important points that I have in here, and to underscore some of those statements.

Senator PROXMIER. Without objection, your statement will be put in full in the record.

Dr. LANZILLOTTI. Thank you, Mr. Chairman.

(Statement referred to follows:)

**STATEMENT BY DR. ROBERT F. LANZILLOTTI, PROFESSOR AND CHAIRMAN, DEPARTMENT OF ECONOMICS, MICHIGAN STATE UNIVERSITY**

**INDUSTRIAL CONCENTRATION AND THE OBJECTIVES OF THE FULL EMPLOYMENT ACT OF 1946**

During the past few years, there has been an increasing degree of agreement that continued high concentration in manufacturing industry persistently aggravates and undermines the ability of monetary, fiscal, and tax policies to maintain full employment and stable prices in the American economy. While the question of whether concentration is increasing, and how fast, is not regarded as settled among economists in this field, the recent report of the Antitrust and Monopoly Subcommittee of the Senate Judiciary Committee should serve to reduce uncertainty on the issue. Between 1947 and 1958 the share of industrial output held by our 200 largest companies rose from 30 to 38 percent; this change cannot easily be explained away as a temporary aberration. Nor can the fact that large companies with employees of over 2,500 account for over 50 percent of industrial output and pay 47 percent of the total salaries and wages in manufacturing industry. Even if one questions the data as an accurate measure of a trend, at the very least the data provide persuasive evidence of the persistent high degree of concentration in the industrial economy.

Increasingly the hard core of the problem of industrial concentration, and its impact on the realization of the objectives of the Full Employment Act, is showing through and can no longer be dismissed as uncorrectable. Concentration of industrial output and its logical and inevitable accoutrements—discretionary pricing power, administered prices, administered production, and collusive behavior—are the visible and inescapable bones of the problem. Since technical jargon and overabundance of words oftentimes may obscure meaning on a problem such as this, it is my intention to be as brief and specific as possible in developing the foregoing propositions.

First of all, permit me to emphasize and underscore what I believe to constitute basic economic and political considerations governing any useful discussion of the problem currently before the committee; namely, the overriding importance in our goals of economic management of full employment and operation of existing plants at or near capacity utilization.

Businessmen and economists alike today recognize high output as a fundamental inducement to investment, whereas low output and idle, or unused, ca-

capacity seriously dampen incentive to invest. I hope that we have also advanced to the point where it is no longer controversial to argue that high employment accompanying high output levels is importantly related to a high rate of economic growth, and vice versa.

One of the painful lessons of the past decade is that a national economic policy designed to promote the stabilization of prices by relying directly or indirectly on deliberately continued unemployment has little chance of permanent success. More important, pursuit of this policy has meant a reduction in the rate of economic expansion of the U.S. economy. The lack of wisdom in such a policy has been thoroughly exposed by the activities of this committee, which, if I sense matters correctly, have contributed to a wider general understanding of the problem we face.

But, you may ask, what does this have to do with the relationship between economic concentration and economic growth? Just this. In the aftermath of the exposure of the fallacy of a national policy for inflation control predicated upon reduction in the rate of utilization of industrial capacity, this very restrictionist approach has been instituted as a fundamental corporate policy by large, pace-setting firms in the concentrated sectors of industry.

In effect, what has occurred over the past decade is that a thoroughly discredited policy of national economic management has been adopted as an operational policy of business management in firms that are large and have a substantial measure of control over their price situation. Indeed, corporations following a restrictionist policy have been accorded a great deal of applause and acclaim in the business community for their soundness, and their business acumen in being better able to stabilize prices and profits over cyclical swings. This bit of irony has had unfortunate but nonetheless predictable consequences. The aggregative effect of private restrictionist production policies by economically powerful corporations has produced what we wish to eschew, a national restrictionist posture.

This policy incorporates the target-pricing-target-profits approach which uses a "standard volume" of plant utilization. "Standard volume" actually means leaving idle as much as 20 to 30 percent of plant capacity as a production "norm." Who are the firms that pursue such a policy? They are the really large manufacturing companies in the United States, which operate under conditions where entry of new competitors is difficult and concentration has persisted. These are the industries where, for technical reasons, large aggregates of capital are required, where patents are important, and economic and marketing advantages accrue from large-scale operations over and above the technical efficiencies of a single plant. Corporations of this type have a recognized latitude or discretionary power in price and production policy.

One of the important characteristics of corporate price and production policy that follows the above line is the planning of capital investment with some built-in or planned excess capacity as a normal operating policy. Predetermined profits targets become a kind of "fixed cost" in this policy, influenced by a predetermined return on capital to support longrun investment plans. The absolute size of the targets is not the important thing, though they tend to be relatively generous. Under the circumstances investment considerations calling for a specific profit rate becomes the basic determinant of price policy, to deliver the flow of funds to meet the desired rate of new investment. The impact on economic growth and stability of large firms freezing minimum profit rates in their pricing policy is shown in Professor Schultze's excellent treatise for this committee. You will recall that he uses the freezing of profit rates to help reconcile the phenomena in the 1950's of credit stringency, recession, and price advances.

My position so far is this: The industrial sector of our economy is becoming more and more rigid and inflexible in its pricing and investment decisions. In part, this is attributable, especially in the large concerns, to rigidities in costs, the "fixed" commitments to stockholders and employees, long-term arrangements with suppliers and customers, and tacit understandings with competitors, which increasingly bind and constrain pricing, production, and investment decisions. What emerges is a tendency for existing price structures, however arbitrary, to become self-justifying.

The effect of these tendencies, in turn, has been to induce the really big manufacturing companies to behave more and more like public utilities, which is a very distressing development for a free enterprise system. One is obliged to ask: Do frozen profit rates, based upon cost-plus pricing, restricted production, with market-sharing overtones, characterize a promotive and innovative policy? I think not. This kind of approach essentially means pricing to satisfy overt

existing and foreseeable demand. It is "accommodational" pricing not promotional. It is neither experimental nor creative. In brief, pricing along these lines is sterile as an inducement to higher consumption, production, employment, and rate of economic growth.

Another question to be asked is: How are our industrial concerns likely to behave under this approach in inflationary and recessionary periods? I believe the answer is that both at full or near-full employment, and also in times of falling demand, we shall experience inflation in concentrated industries. A monolithic policy like that described will lead to inflexible and even irrational economic behavior. At times it will unwittingly lead to a callous disregard of the impact of discretionary corporate power on the stability of the economy.

The recent abortive attempt at a \$6-per-ton increase by United States Steel in the face of falling demand and stiffened foreign competition illustrates the point. Mr. Roger Blough's explanation and justification essentially was: "We had to have the price increase if we were to meet our profits target."

A corporate policy of creating idle capacity and unemployment; that is, basing pricing decisions on a planned underutilization of capacity by upwards of 20 to 30 percent over the long run, in my view, collides head on with the higher national objective of full employment and full use of industrial capacity. Can we expect to have a higher rate of economic growth and full employment when corporations in the concentrated sector of the economy gear their own operations to a level substantially short of full utilization?

This situation points up a principal defect in our antitrust laws; that is, their inability to cope effectively with market power created by large corporations acting unilaterally and jointly. In particular, I have in mind those cases where 8 firms or less account for 50 percent of market supply, or the top 20 count for 75 percent. This situation characterizes approximately two-fifths of our national markets and approximately one-fourth of the value of shipments of all national manufacturing industries.

Industries that have become concentrated and calcified, and that tend to undermine the objectives of national economic policy, are also the administered-price industries. This committee examined this problem extensively several years ago, so it should not be necessary to repeat the findings of that inquiry. Suffice to say that there is a rigidity and lack of responsiveness of administered prices to changes in demand and economic conditions generally due to jointly acting dominant companies. More responsiveness in prices and costs in the concentrated industries, would, in my opinion, be conducive to a higher rate of plant utilization, higher employment, and higher rate of economic growth.

Instead, however, we find more and more evidence of collusive conduct among ostensible competitors, including some of our largest and best known corporations. The widely publicized conviction of a number of electrical equipment manufacturers and the imprisonment of seven corporate executives for what *Fortune* magazine calls "The Incredible Electrical Conspiracy," highlights the cogency of the problem. The executives of these firms decided that operations at substantially less than full capacity could be profitable if collusive agreements could be reached on prices, market sharing, and bid rotation.

Unfortunately, the electrical equipment conspiracy is not simply an isolated case of collusive conduct on pricing, market sharing, and production quotas. The 1961 study of identical bidding by this committee discloses suspect pricing in bids received by Federal agencies, which is almost pervasive in certain basic industries. I would expect that the report of the Attorney General to be released tomorrow will show just how widespread the practice has become. We should not be surprised at this development. Such behavior follows very logically and inevitably from highly concentrated industries. Identical bidding is simply another index—the sealed-bid version—of administered prices.

In order to demonstrate the logical chain of events flowing from concentrated industries, it is most useful to examine the structure and behavior of particular industries over time. I have not been able to make such an analysis for all of the industries included in the committee's report, but have analyzed the situation in one of the most important industries covered by the study—the chemical industry. (See E. F. Lanzillotti, "Pricing Chemical Products: Some Economic Considerations," Symposium on the Law and Economics of Pricing Chemical Products, American Chemical Society, March 1962, pp. 101-113.)

The situation in chemicals is roughly as follows: In 1958, in one-half of the subindustry groups (as classified by the U.S. Census of Manufacturers) the top eight firms accounted for over 75 percent of total industry output. (See the

forementioned concentration report of the subcommittee of the Senate Judiciary Committee, pp. 87-89.)

According to one of the most respected authorities on the economics of the industry, Prof. Alfred E. Kahn, a major reason for this degree of concentration is that "size breeds size." Historically, the fewness of sellers "has produced communities of interest among them," that has been "conducive to a kind of peaceful coexistence, with market relations friendly, if not collusive."

This collaboration among the few has followed several lines—the formation of joint ventures, marketing of products through established firms in the field, patent pooling, buying and selling raw materials at preferential discounts to one another, and active participation in a network of international cartel agreements. Very recently, the Chairman of the Federal Trade Commission disclosed also an important maze of joint ventures in various chemical and chemical-related industries which is very sobering indeed. The hoped-for rivalrous action in the petrochemical field is seriously weakened by these modern versions of the old trusts.

The basic questions raised by joint ventures are: What is the probable effect of joint ownership by competitors on the vigor of competition generally, and on pricing and production policies in particular? Is it reasonable to expect that partners in an industrial marriage at certain stages of the productive process will vie for business like strangers when they reach the marketplace?

It is little wonder that the chemical industry has come into conflict with the antitrust laws more frequently than any other industry. While overt cartels for dividing markets, limiting production, and agreements on prices have been dissolved, so far as the record goes, the habit of collaboration persists.

To illustrate, the committee's report on ostensible competitive, i.e., sealed bids, discloses that out of a total of 73 transactions, identical bids cropped up in all except 5 cases.

In the 65 transactions where identical sealed bids were turned in, in most cases most of the bidders tendered identical bids, including identical discounts and other terms of sales.

Close examination of the frequency of identical bids for particular companies discloses that certain firms made identical bids with one or more other bidders in a very high percentage of the time. For example, New Jersey Zinc, American Zinc, and Eagle-Pilcher, made 42, 38, and 34 identical bids, respectively, in as many bid attempts.

Also it is noteworthy that, with the curious exception of 21 identical bids on sodium fluoride, the larger the number of bidders, the greater the probability of differentials in bids.

Usually, when identical bid prices, even under sealed-bid procedures, are questioned, the defense offered is that "under competitive conditions, with fully informed buyers, the price of a standardized commodity will be a uniform price, since no well-informed buyer would pay more than another." This might be a valid explanation in a truly open, competitive market, at a given moment of time, with a given state of demand and supply, and given identical knowledge of the market by all sellers and buyers.

Take the situation of the chemical industries where concentration of production remains in the hands of a relatively few large firms. It is, of course, conceivable that under these circumstances each of the few large sellers might regard the present prices (or book prices) as his "best guess" or "safest guess" of what rivals would bid on future calls for bids. This is at least theoretically possible, especially if each of the bidders is content with his share of the market at last-bid prices.

How can we tell, then, if identical bid prices are due to competition or to collusion (tacit or overt)? A complete answer requires an examination of the history of the industry, including types of products, number of sellers, past conspiratorial behavior, importance of patents, nature of demand, supply, costs, and related factors.

An examination of the chemical industry on those counts discloses repeated efforts by leading companies to nullify competition through flagrant instances of monopoly pricing, collusion, and illegal use of patents. Given the persistent high degree of concentration, in chemicals and others with jointly acting firms, plus the increasing use of joint ventures (through which more subtle forms of cooperation are possible), is it reasonable to ask: How did past bid prices and book prices become identical in the first place? Were they driven to identity by the pressure of each firm attempting to gain a larger share of the market, to reach for new accounts, and greater profits?

Second, since sealed bids are called for opening at some future date, and for delivery at or during some future period, how then can sellers independently figure prices over periods of fluctuations in cost and demand conditions and persistently emerge with identical prices down to the nearest fraction of a penny?

Information theory, and good commonsense, suggest that data available to sellers and buyers on future market conditions are not that perfectly known to produce identical expectations all the way around. The probabilities of such identity due to chance alone is very low indeed.

It doesn't require sophisticated economic analysis to recognize that such cases of identical bidding are fairly conclusive evidence of some type of collusive arrangement that flows from highly concentrated markets. It is precisely the kind of rational behavior to expect under the circumstances. The fact that probative conspiratorial evidence, such as uncovered in the electrical cases, is not available, does not alter the finding of collusion in the economic sense, nor, indeed, should it in the legal sense.

In sum: restrictionist production, administered pricing, identical sealed bidding, and jointly acting sellers in highly concentrated markets, these are the cloth of which the monopoly problem is made. Only if we face the problem squarely can we put vigor into our antitrust program and restore viability to the marketplace.

Dr. LANZILLOTTI. During the past few years—and if I sense matters correctly here this morning, there has been an increasing degree of agreement that continued high concentration and all of the trappings of high concentration in manufacturing industry aggravates and undermines monetary policy, fiscal policy, and tax policies, in their efforts to maintain stability, to promote growth, and stable prices.

I think this would be a fair summary of the statements which we have had so far here this morning.

Now, we could argue endlessly this morning, I think, the question of whether economic concentration is growing or not. I propose that we do not get into any statistical arguments on that.

I do think, however, that the recent report of the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee discloses some rather sobering statistics. The 200 largest corporations, from 1947 to 1958, increased their share of U.S. markets from 30 to 38 percent.

I do not believe that this change can be easily explained away as a temporary aberration. Even if one questions the accuracy of these data as a measure of a trend in our economy, at the very least, the data provide very persuasive evidence, in my view, of a persistent high degree of concentration in certain sectors of our economy.

It is my view that the problem of concentration and its impact on the national objectives we have been talking about this morning, that is, growth and stability, is showing through. We cannot any longer consider this problem as uncontrollable.

Concentration of industrial output and the logical and inevitable accoutrements that you get with it—those that Professor Adams and Professor Kahn have alluded to—discretionary pricing power, administered prices, administered production, and collusive behavior—are part of the visible and inescapable bones of this problem.

I do not wish to get into a lot of technical jargon about this, nor an overabundance of words, because I think it may obscure the points I am attempting to make.

I would like, first, to underscore what I believe to be the basic and fundamental consideration, from the economic standpoint as well as the political standpoint, governing any useful discussion of this

problem—the overriding importance in our goals of economic management of full employment and the operation of existing plants at or near full capacity.

I think that businessmen, like economists, recognize today that high output is a fundamental inducement to investment, and low output or idle and unused capacity dampens that incentive to invest.

One of the painful lessons we learn over the past decade, and the one which was mentioned in the discussion here earlier this morning, is that a national economic policy designed to promote stabilization of prices by relying directly or indirectly on deliberately continued unemployment has little chance of permanent success.

More important, for the purposes of the subject before the panel and the committee this morning, it has meant a reduction in the rate of economic growth and expansion in the U.S. economy.

The lack of wisdom in such a policy has been thoroughly exposed by the activities of this committee; and, if I sense matters correctly, your hearings and reports also have contributed to a wider general understanding of the problems we face.

You may ask: What does all this have to do with the subject of concentration, monopoly, and growth? Well, just this: In the aftermath of the exposure of the policy I discussed a moment ago, as a national policy for inflation control, predicated upon the reduction in the rate of utilization of our capacity, and underemployment, this very restrictionist approach has been instituted as a fundamental corporate policy by large pace-setting firms in the concentrated sectors of our economy.

What I am saying, in effect, is that here we have a national policy that is being thoroughly discredited as promotive of stability, growth, at stable price level, and on the other hand, we have witnessed, developing along with this, corporations that have been able to adopt this restrictionist approach to production and price policies, as an operational objective, an operational policy, of these corporations.

Indeed, I think we have witnessed in the business press and elsewhere that these firms that follow what we might call a restrictionist production and price policy, have been accorded a great deal of applause and acclaim, for being better able to stabilize prices and profits over cyclical swings.

This is a bit of irony which I think has had very unfortunate, but nonetheless predictable, consequences.

Senator BUSH. May I just interrupt at this point?

We do not usually do that; but I would like you to define this thing called restrictionist production policy and national restrictionist policy. This is very interesting.

Dr. LANZILLOTTI. Yes, sir.

A little earlier, you were questioning Dr. Nourse about overemphasis on and overconcern about inflation, and about tax policies, fiscal policies, and monetary policies, as have been explained by this committee, and discussed by this committee in earlier hearings, that had an unemployment bias. They had a bias that amounted to underutilization of national production capacity.

What I am saying is that such a policy is a restrictionist approach—**for stability purposes.** We have been concentrating on the inflation-

ary problem, and in so doing we have ended up with a policy which embodied what I would call restricted output, or if you will, underutilization of capacity.

Dr. Adams and Dr. Kahn earlier referred to, in the private sector, a target rate of return approach—production policy set with 60 to 75 percent of capacity as the normal, as the target, as the optimum, if you will.

Now, what I am saying is that it is a rather curious bit of irony that what has been discredited as a national policy of restrictionism in terms of utilization of our capacity for the purposes of insuring stability, has been adopted by large, powerful corporations as a private policy. These firms, I think, have been important enough, and their impact on the economy has been sufficiently great, to bring about in the aggregate the very effect that we did not wish to bring about, as a national policy, namely, underutilization of capacity.

Senator BUSH. Just one question, there.

You are not suggesting, for instance, that in steel, let us say, which is running at a rate very short of capacity now—

Dr. LANZILLOTTI. Yes, sir.

Senator BUSH (continuing). That that is a deliberate restrictionist policy on the part of this industry or these corporations, are you?

Dr. LANZILLOTTI. Yes, Senator; I am.

Senator BUSH. You are?

Dr. LANZILLOTTI. Yes, sir.

Senator BUSH. That is what I wanted to bring out.

Dr. LANZILLOTTI. Yes, sir. I am saying that these firms are sufficiently large, they are sufficiently powerful, to be able to gear their operations, to tool up, and on the basis of statements made by steel executives, statements made by the General Motors Corp., they gear their operations to earn a target return, a profits return, on their investment, predicated upon a utilization of 60, 75, or 80 percent of capacity as the norm. This is precisely what I am saying, Senator.

Senator BUSH. And you are saying, really, then, that today they could be doing much better, could be turning out much more steel, than they are doing, because of the restrictionist policy that they employ?

Dr. LANZILLOTTI. Senator, you express it much more clearly than I do. This is precisely what I am attempting to put across.

Senator BUSH. Then I am much more surprised.

Senator PROXMIER. You are not saying the optimum rate is necessarily 65 or 70 percent. The break-even point for steel, Gardner Means testified to us—he has not been contradicted—may be 35 or 40 percent. Some say it will be a little higher. But the optimum rate might be up as high as 85 or 90 percent.

McGraw-Hill testified to us that in general in industry, and they are talking about manufacturing industry, the optimum operation is around 90 percent, that after that you get such a full utilization your marginal costs begin to rise.

So I would think that if McGraw-Hill is just roughly right, even though the steel companies operate at 65 percent of capacity and can be very happy and pay good dividends and make quite a bit of money, they would be a lot happier if they could maximize their profits and go on up.

Is that not correct?

Dr. LANZILLOTTI. Senator Proxmire, I admire your grasp of the economics of this problem.

I would like to return the question with the question: What do you mean by "optimum"? Are you speaking of an optimum in the sense of the least cost? Or that particular rate of operation which the firm's engineers would particularly like to see the plant operate at? Or are you speaking of an optimum in terms of higher national objectives?

Senator PROXMIRE. I am speaking of optimum in the technical way McGraw-Hill does, that point of operation at which you maximize profits. For most firms, according to McGraw-Hill, it is about 85 to 95 percent. This seems to be the average.

Dr. LANZILLOTTI. This emphasizes only the cost side of the picture, Senator. And even though, as you put it very well, marginal costs or incremental costs begin to rise beyond that, it does not mean, of course, that there are not profitable operations beyond what engineers may stipulate as an engineering optimum.

Senator PROXMIRE. I pressed McGraw-Hill on this. They said generally if firms went above 90 percent, they actually would reduce profits on the overall.

In other words, that you get to a point where your marginal costs exceed your marginal revenue.

Dr. LANZILLOTTI. Well, that I think is considerably beyond the point which you would term "optimum." I think what you are saying is that the per unit costs may be larger in that range.

But certainly not total profits going down, until you reach the point where, as you indicate, incremental costs exceed incremental profits; which is quite beyond that.

And I would merely submit that during the periods of the war and postwar periods, when plants were being operated, at what may seem to be an impossible rate of 104 and 105 percent of capacity, these corporations were very profitable indeed. I think the record is quite clear on this point.

So that the point which we are currently discussing, namely, "Would it be possible for these corporations to operate profitably at a higher rate of utilization?"—yes.

The basic point I am making is that they are able to set a lower rate at which they can make satisfactory profits. I do not know that they are intending to make what you would call maximum profits.

I would like to have them drive for maximum profits. But I would like to have them do that under the discipline of the marketplace, rather than, as Dr. Adams and Dr. Kahn have indicated, on the basis of their own private discretionary power.

Senator PROXMIRE. Well, now, Senator Bush and I have interrupted the usual procedure of the committee, which I think works quite well. And in fairness, I think, to the other members, why do you not go ahead with your paper, and we will come back to this?

I think this is extremely provocative. You finish up, and then come back, and we will all get into it.

Dr. LANZILLOTTI. Very well.

Senator, my position, so far, is this: That the industrial sector of the economy is becoming more rigid and more inflexible in its pricing, its production, and in its investment decisions.

I have pointed out, in the paper here, what I believe are the reasons why we have developed this inflexible and rigid posture in the private sector of manufacturing industry.

I think a point that Professor Adams has touched upon here is significant: In effect, what does the foregoing mean? These large corporations, in effect, are behaving in the nature of public utilities. I think this is a very distressing development for a free enterprise system.

I am obliged to raise the question: Do frozen profit rates that are a part of this target rate of return approach, standard-volume pricing, cost-plus pricing, restrictive production, and market sharing, characterize a promotive and an innovative policy, which is characteristic of a free enterprise system?

I think not. This kind of approach, it seems to me, essentially is pricing to satisfy the demand you can see, the demand which is foreseeable. It is what I call "accommodational" pricing.

It is not the kind of pricing that Dr. Kahn was alluding to earlier, that is going down the demand curve, and as Henry Ford I did, probing demands, trying to expand the market. It is neither experimental nor creative.

In brief, it is sterile as an inducement to higher consumption, to higher production, to higher employment, and a higher rate of economic growth.

In my paper, I have posed the question: How are firms following this kind of a policy, which I call a restrictionist approach, likely to behave under conditions of recession, under conditions of inflation, or under conditions which we now face?

I conclude, on the basis of the studies that have been made, that we shall experience, in these industries, inflation in the face of recession. We shall experience inflation in times of general inflation in the economy. And, at times, I am very distressed to point out, it will, albeit unwittingly, lead to what I consider a callous disregard of the impact of this power on the general stability of the economy.

As I noted, this may be unwitting. It even may be what you would call irrational economic behavior. Nonetheless, the results are what count. I would cite as an example that the recent abortive attempt at the \$6-per-ton increase in steel, in the face of declining demand and stiffened foreign competition, which, I think, proves the point.

What was President Roger Blough's, Chairman Roger Blough's, explanation and justification for the corporation's action? It was merely: We had to raise our prices in order to realize those target profits that we had set for ourselves.

He did not say that we are going to experiment with lower prices, attempting to increase the rate of production and increase the volume, and increase the employment. He said: We had to raise our prices in order to get the profits that we felt we needed.

I think that a policy of this type, creating idle capacity and unemployment, basing decisions on planned underutilization of capacity, upward of 20, 30, 35 percent over the long run as a norm, collides head

on with the higher national objective of full employment and the full use of industrial capacity.

I would raise the additional question: Can we expect to have a higher rate of economic growth and full employment when corporations in the concentrated sectors of the economy gear their own operations to a level substantially short of that?

The rest of my paper indicates the manifestations, if you will, of these particular policies, in terms of: How will they price? What will be their production policies?

I concentrate, in the latter part of the paper, on this question of pricing. The panel is emphasizing, today, the matter of more imaginative pricing, which I would stress.

I take as purely an illustration, the chemical industry. I have utilized some of the data of a report of this committee last year on identical bids, and have attempted to illustrate what results in an industry which, as Professor Kahn in one of his studies on the chemical industry has pointed out, is a very highly concentrated industry.

Concentration in this industry has persisted at a high level. You have in this industry today what you have had in the past—collusive behavior of various sorts.

The identical bidding that we have witnessed in the chemical industry persists. I have here a couple of tables which the committee staff have reproduced, if you are interested. The committee might like to have these available for the discussion period, since they show in detail the identity of bids by chemical companies under the sealed-bid procedures for a period of 5 years—1955–60.

Senator BUSH. On Government contracts?

Dr. LANZILLOTTI. Yes, Senator.

You will find that this industry, which I took as an illustration, because it happens to be one that is very important in the economy, and where we look for innovations of various types, has a long record of identical bidding. Specifically, this industry is characterized in sealed bid procedures (which are supposed to be competitive bids) of virtually identical prices over the period 1955 to 1960, as published by this committee. You will find that out of a total of 73 calls for bids, identical bids cropped up in all except 5 cases. I invite the committee to examine the tables in detail.

Could I request the chairman to have this exhibit inserted in the record?

Senator PROXMIER. Yes. Without objection, this will be printed in the record. It is only three pages.

(Tables referred to follow:)

TABLE 1.—Identity of bids on 73 chemical transactions, 1955-60

Item (1)	Date (2)	Number of bidders (3)	Number of identical bids (4)	Bid basis (5)	Unit price (6)	Total price (7)	Total price net of discount (8)	Percent of difference, identical and nonidentical (9)
Copper sulfate (10,000 pounds).....	Oct. 27, 1955	7	5	All f.o.b. destination..... (4) 1 percent 20 days..... (1) ¼ of 1 percent 20 days..... (1) 1 percent 30 days.....		\$1,734.00	\$1,716.66 1,729.67 1,716.66	(0.11 to 1.5 percent.)
Sodium fluoride (420,000 pounds).....	Sep. 24, 1957	21	21	All f.o.b. destination.....	\$0.143	60,060.00		No difference.
Solvent, electric equipment cleaner (2,400 gallons).	June 1, 1959	6	3	do.....	1.74	4,176.00		(-18.9 to +20.6 percent.)
Tetracycline hydrochloride capsules: Lot 1 (5,640 bottles).....	Mar. 20, 1955	5	5	do..... (1) 2 percent 10 days..... (4) 2 percent 15 days.....	19.58		19.29	No difference.
Lot 2 (6,084 bottles).....	June 6, 1955	5	5	All f.o.b. destination..... (1) 2 percent 30 days..... (1) 2 percent 15 days..... (3) 2 percent 30 days.....	19.58			Do.
Lot 3 (19,872 bottles).....	June 20, 1955	5	5	All f.o.b. destination..... (1) 2 percent 120 days..... (1) 2 percent 15 days..... (3) 2 percent 30 days.....	19.58			Do.
Lot 4 (3,000 bottles).....	June 27, 1955	5	5	All f.o.b. destination..... (4) 2 percent 30 days..... (1) 2 percent 15 days.....	19.58			Do.
Lot 5 (6,760 bottles).....	Dec. 7, 1955	4	4	All f.o.b. destination..... (1) 2 percent 15 days..... (3) 2 percent 30 days.....	19.58			Do.
Lot 6 (28,992 bottles).....	June 21, 1956	5	4	All f.o.b. destination..... (4) 2 percent 30 days.....	19.58			-2 percent. <sup>1</sup>
Lot 7 (29,962 bottles).....	July 30, 1956	6	5	All f.o.b. destination..... (5) 2 percent 30 days.....	19.58			Do. <sup>1</sup>
Lot 8 (50,400 bottles).....	Oct. 10, 1956	6	4	All f.o.b. destination..... (5) 2 percent 30 days.....	19.58			-9 to -2 percent. <sup>1</sup>
Detergent, laundry powder: Lot 1 (3,000 pounds).....	Nov. 15, 1957	6	3	All f.o.b. destination..... (3) 1 percent 20 days..... (2) ¼ of 1 percent 20 days.....	.1257		1.1245 1.1254	(-7 to +39.2 percent.) <sup>1</sup>
Lot 2 (17,000 pounds).....	do.....	6	3	All f.o.b. destination..... (2) ¼ of 1 percent 20 days..... (3) 1 percent 20 days.....	.1166		1.1155 .1163	(-8.2 to +41.5 percent.) <sup>1</sup>
Lot 3 (16,000 pounds).....	do.....	8		All f.o.b. destination.....	( <sup>2</sup> )			

Lot 4 (9,000 pounds)	do	8	(3) 1 percent 20 days					
			(2) 1/2 of 1 percent 20 days					
			(1) 1/4 of 1 percent 20 days					
			All f.o.b. destination	(?)				
Lot 5 (7,000 pounds)	do	8	(2) 1/2 of 1 percent 20 days					
			(3) 1 percent 20 days					
			(1) 1/2 of 1 percent 20 days					
			All f.o.b. destination	(?)				
Lot 6 (6,000 pounds)	do	7	(2) 1/2 of 1 percent 20 days					
			(3) 1 percent 20 days					
			(1) 1/2 of 1 percent 20 days					
			All f.o.b. destination	.1185				(-10.7 to +85.6 percent.)
			(2) 1/2 of 1 percent 20 days				1.1182	
			(3) 1 percent 20 days				1.1174	
			(1) 1/2 of 1 percent 20 days					
Lot 7 (89,000 pounds)	do	9	All f.o.b. origin	(?)				
			(2) 1/2 of 1 percent 20 days					
			(4) 1 percent 20 days					
			(1) 1/2 of 1 percent 20 days					
Lot 8 (88,000 pounds)	do	9	All f.o.b. origin	(?)				
			(2) 1/2 of 1 percent 20 days					
			(4) 1 percent 20 days					
			(1) 1/2 of 1 percent 20 days					
Zinc oxide (pounds)	Sept. 28, 1951	2	All f.o.b. destination	.1584	22,809.60	(?)		No difference.
Lot 2	Oct. 8, 1951	2	do	.1584	21,384.00	(?)		Do.
Lot 3	do	2	do	.1683	22,720.50	(?)		Do.
Lot 4	Dec. 24, 1951	3	do	.1742	43,898.40	(?)		Do.
Lot 5	Dec. 21, 1951	3	do	.1742	83,616.00	(?)		Do.
Lot 6	Jan. 21, 1952	3	do	.1742	62,616.00	(?)		Do.
Lot 7	Mar. 25, 1952	3	do	.1742	83,616.00	(?)		Do.
Lot 8	Jan. 18, 1952	3	do	.1841	99,414.00	(?)		Do.
Lot 9	Feb. 26, 1952	3	do	.1841		(?)		Do.
Lot 10	May 19, 1952	3	do	.1742	125,424.00	(?)		Do.
Lot 11	do	3	do	.1841	145,807.20	(?)		Do.
Lot 12	Apr. 29, 1954	3	do	.1336	38,476.80	(?)		Do.
Lot 13	do	3	do	.1435	8,610.00	(?)		Do.
Lot 14	Aug. 24, 1954	3	do	.1336	67,334.40	(?)		Do.
Lot 15	do	3	do	.1435	41,328.40	(?)		Do.
Lot 16	Nov. 16, 1954	3	do	.1336	33,667.20	(?)		Do.
Lot 17	do	3	do	.1435	30,996.00	(?)		Do.
Lot 18	Jan. 11, 1955	3	do	.1336	62,324.80	(?)		Do.
Lot 19	Jan. 10, 1955	4	do	.1435	51,660.00	(?)		Do.
Lot 20	Mar. 11, 1955	3	do	.1336	9,619.20	(?)		Do.
Lot 21	do	3	do	.1435	51,660.00	(?)		Do.
Lot 22	Sept. 28, 1951	2	do	.1584	22,809.60	(?)		Do.
Lot 23	Oct. 8, 1951	2	do	.1584	21,384.00	(?)		Do.
Lot 24	do	2	do	.1683	22,720.50	(?)		Do.
Lot 25	Dec. 25, 1951	3	do	.1742	42,898.40	(?)		Do.
Lot 26	Dec. 21, 1951	3	do	.1742	83,616.00	(?)		Do.

See footnotes at end of table.

TABLE 1.—Identity of bids on 73 chemical transactions, 1955-60—Continued

Item (1)	Date (2)	Number of bidders (3)	Number of identical bids (4)	Bid basis (5)	Unit price (c)	Total price (7)	Total price net of discount (8)	Percent of difference, identical and nonidentical (9)
<b>Kine oxide (pounds)—Continued</b>								
Lot 27.....	Jan. 21, 1952	3	3	All f.o.b. destination.....	\$0.1742	\$83,616.00	(9)	Do.
Lot 28.....	Mar. 25, 1952	3	3	do.....	.1742	83,616.00	(9)	Do.
Lot 29.....	Jan. 18, 1952	3	3	do.....	.1841	99,414.00	(9)	Do.
Lot 30.....	Feb. 26, 1952	3	3	do.....	.1841	86,158.80	(9)	Do.
Lot 31.....	May 19, 1952	3	3	do.....	.1742	125,424.00	(9)	Do.
Lot 32.....	do.....	3	3	do.....	.1841	145,807.20	(9)	Do.
Lot 33.....	Apr. 29, 1954	3	3	do.....	.1336	38,476.80	(9)	Do.
Lot 34.....	do.....	3	3	do.....	.1435	8,610.00	(9)	Do.
Lot 35.....	Aug. 24, 1954	3	3	do.....	.1336	67,334.48	(9)	Do.
Lot 36.....	do.....	3	3	do.....	.1435	41,328.00	(9)	Do.
Lot 37.....	Nov. 16, 1954	3	3	do.....	.1336	33,667.20	(9)	Do.
Lot 38.....	do.....	3	3	do.....	.1435	30,996.00	(9)	Do.
Lot 39.....	Jan. 11, 1955	3	3	do.....	.1336	62,524.80	(9)	Do.
Lot 40.....	Jan. 10, 1955	4	4	do.....	.1435	51,660.00	(9)	Do.
Lot 41.....	Mar. 11, 1955	3	3	do.....	.1336	9,619.20	(9)	Do.
Lot 42.....	do.....	3	3	do.....	.1435	51,660.00	(9)	Do.
Carbon dioxide gas (148,000 pounds).....	Dec. 14, 1955	4	4	do.....	.0435		(9)	Do.
Dry ice (280,000 pounds).....	Nov. 22, 1957	6	5	do.....	.035	8,750.00	(9)	Do.
Woods oil (140 gallons).....	May 27, 1955	9	4	do.....	1,104.60	1,104.60	(9)	(+6 to +8.4 percent.)
				(1) 2½ percent, 30 days.....				
				(1) 1 percent, 20/30 days.....				
Brush killer (200 gallons).....	June 25, 1956	9	2	All f.o.b. destination.....	1,306.00	1,306.00	(9)	(-21.5 to +11.7 percent.)
				(1) 1 percent, 30 days.....				
				(1) 2 percent, 20 days.....				
Soil sterilant, dry form (6,000 pounds).....	do.....	5	2	All f.o.b. destination.....	879.60	879.60	(9)	(-22 to +0.3 percent.)
				(1) 1 percent 30 days.....				
				(2) 2 percent 20 days.....				
Lot 2 (400 pounds).....	do.....	5	4	All f.o.b. destination.....	1,450.00	1,450.00		(-20.5 percent.)
				(2) 2 percent.....			\$1,459.60	
				(2) 2 percent 20 days.....			1,459.60	
Ammonium salt of dinitro secondary butyl phenol (500 gallons.).....	do.....	8	8	All f.o.b. destination.....	3,976.56	3,976.56	(9)	(-1.8 to +17.6 percent.)
				(1) 1 percent 30 days.....				
				(1) 2 percent 20 days.....				
Brush killer and soil sterilant (10,000 gallons.).....	Jan. 21, 1958	19	7	All f.o.b. destination.....	5.45	54,500.00		(-10.2 to +34.7 percent.)
				(10) 2 percent 20 days.....			53,410.00	
				(1) 2 percent 30 days.....				
				(1) 1 percent 30 days.....			54,005.00	
				(2) 1 percent 20 days.....				
				(4) 5 percent 30 days.....			51,575.00	
				(1) 5 percent 20 days.....				

Lot 2 (8,000 gallons)-----	Jan. 2, 1958	17	6	All f.o.b. destination-----	5.45	27,250.00	-----	(-10.3 to +34.6 percent).
				(8) 2 percent 20 days-----			26,708.00	
				(1) 1 percent 30 days-----			26,988.00	
				(4) 5 percent 30 days-----			25,890.00	
				(1) 2 percent 30 days-----				
				(2) 1 percent 20 days-----				
Lot 3 (2,500 pounds)-----	do-----	18	17	All f.o.b. destination-----	2.90	7,250.00	-----	(+19.4.)
				(17) 2 percent 20 days-----			7,105.00	
				(1) 2 percent 30 days-----			7,105.00	
Lot 4 (1,000 pounds)-----	Jan. 21, 1958	18	17	All f.o.b. destination-----	3.60	3,600.00	-----	(-19.4.)
				(7) 2 percent 20 days-----			3,528.00	
				(1) 2 percent 30 days-----			3,528.00	
Dinitro ortho secondary butyl phenol (600 gallons.)	June 26, 1958	14	7	All f.o.b. destination-----	5,608.00	5,608.00	-----	
				(1) 2 percent 20 days-----			6,223.40	
				(1) 1/4 percent 20 days-----			5,494.30	

1 Discount calculated on basis of unit price, where total price bid is not given.

2 No identical bids.

3 No discount.

4 No discount on identical bids.

Source: Compiled from "93 Lots of Bids Involving Identical Bids Reported to Department of Justice by Federal Procurement Agencies in the Years 1955-60." Joint Economic Committee, Congress of the United States (August 1961) pp. 18-39.

TABLE 2.—Frequency of identical bids by companies as published by the Joint Economic Committee of the U.S. Congress

Companies (1)	Number of bids made (2)	Number of identical bids (3)	Percent iden- tical bids (4)
New Jersey Zinc Sales Co.....	42	42	100.0
American Zinc Sales Co.....	35	35	100.0
Eagle-Picher Co.....	34	34	100.0
L. H. Butcher Co.....	8	5	62.5
Charles Pfizer & Co.....	8	5	62.5
Upjohn Co.....	8	8	100.0
Bristol Laboratories, Inc.....	8	8	100.0
E. R. Squibb & Co.....	8	8	100.0
Lederle Laboratories, Inc.....	8	8	100.0
Stauffer Chemical Co.....	8	3	37.5
Braun Knecht Helmann Co.....	7	1	14.0
Los Angeles Chemical Co.....	6	4	66.6
Allied Chemical & Dye.....	6	6	100.0
F. M. Speekman Co.....	6	4	66.6
Perf Products.....	6	3	50.0
Alex C. Fergusson Co.....	6	3	50.0
Plex Chemical Corp.....	6	3	50.0
Trio Chemical Works.....	6	0	-----
Consolidated Chemical Works.....	6	0	-----
The Clarkson Laboratories.....	6	0	-----
Standard Agricultural Chemicals, Inc.....	6	3	50.0
Van Waters & Rogers.....	6	5	100.0
Dow Chemical.....	5	4	80.0
California Spray Chemical Corp.....	5	1	20.0
Chilpman Chemical Co.....	5	3	60.0
Chicago Sanitary Products Co.....	4	0	-----
Pacific Guano Co.....	4	1	25.0
Oregon Agricultural Chemicals.....	4	4	100.0
Ben's Farm Store.....	4	2	50.0
Wilbur-Ellis Co.....	4	2	50.0
Norkem Corp.....	4	2	50.0
F. B. Gast & Sons.....	3	3	100.0
Blackson Chemical Co.....	3	3	100.0
Arthur S. Lapine & Co.....	3	3	100.0
American Agricultural Chemical Co.....	3	3	100.0
Beebeo Paint & Chemical Co.....	3	3	100.0
Sanditzer-Valentine Chemical Co.....	3	0	-----
Associated Lead & Zinc Co.....	3	3	100.0

Source: Listing from source given in table 1.

Senator PROXMIRE. In other words, there were identical bids in all but five out of how many?

Dr. LANZILLOTTI. Seventy-three, sir.

Senator PROXMIRE. I see. Thank you.

Dr. LANZILLOTTI. Now, as I was pointing out, I invite you to examine for yourself all the details on this bidding relationship for these commodities that were included in the Joint Economic Committee's report on identical bidding.

Senator BUSH. What types of commodities are these, here? Are they unusual chemicals, or are they more or less standard stock stuff?

Dr. LANZILLOTTI. A lot of it, I would say perhaps most of it, does represent what you would call stock stuff. Standardized commodities.

Senator BUSH. I mean zinc oxide I see down here. I do not know anything about chemicals, and very much less about zinc oxide. But it is a very common thing, is it not? I mean everybody makes it, and there is no secret about it, and it is sort of like salt, is it not?

Dr. LANZILLOTTI. It is, Senator.

Senator BUSH. It has those characteristics?

Dr. LANZILLOTTI. It does have those characteristics. And usually when the identical bids are questioned, you get a reply which takes off from that question: Well, aren't these really the "milk" business, the run-of-the-mill type of product, highly standardized? And would you not expect that the prices would be identical?

Well, my reply is this: When we call for sealed bids, the reason why we ask for sealed bids under Federal procurement procedures is precisely to provoke, to bring about, as low a price for the public as we can. And private industry does the same thing when it calls for sealed bids.

The point is this: Under what circumstances would you possibly get identical bids of this type? Well, they would only come about under what we would call competitive conditions that include all sellers guessing that every other seller is going to bid the next time around exactly what he bid the last time around; namely, the book price. All sellers have the same view of the way in which the demand is going. All sellers are faced with the same cost conditions.

I think that what you really conclude when you examine these is that you have to answer certain questions: How did these book prices that all of these firms say they are following become identical in the first place? There must have been some causal relationship, here, some background, some reasons why the prices were identical in the first instance.

Senator BUSH. Have you ever asked them, any of them, to explain it to you?

Dr. LANZILLOTTI. Yes, sir. I have.

Senator BUSH. What do they say?

Dr. LANZILLOTTI. On how they became identical?

Senator BUSH. Yes.

Dr. LANZILLOTTI. Their explanation is: We follow competition. I think it is an unsatisfactory answer.

Part of the answer on this identical sealed bid procedure, if we wish to get into it, is that we have a clash of laws which were designed to protect the public from unscrupulous public servants, and which require that the bids, after being made, under sealed procedures, be made public.

These firms have replied: If our bids could be kept secret and were not made public, we might be inclined to be more competitive in our bidding.

Senator BUSH. That is an interesting development.

Dr. LANZILLOTTI. It suggests what we know exists in the American economy, that if firms can discriminate in price and keep their price concessions secret, they will do so.

Well, I do not wish to take any more time. I merely would summarize with the statement that restrictionist production, administered pricing, identical sealed bidding, and jointly acting sellers, are the cloth of which the monopoly problem is made.

I feel that only if we face up squarely to the problem can we put vigor into the antitrust program, supplementing and complementing the policies of the monetary authorities and fiscal authorities and restore a general viability to the market place.

Senator PROXMIRE. Thank you very much, Dr. Lanzillotti.

Our next witness is Professor Richard Barber, of Southern Methodist University.

We are very happy to have you here, sir. You are a professor of law?

**STATEMENT OF DR. RICHARD J. BARBER, PROFESSOR OF LAW,  
SOUTHERN METHODIST UNIVERSITY**

Dr. BARBER. Yes, sir.

My statement is rather long, and I do not propose to burden the committee by reading it.

Senator PROXMIRE. Then, without objection, it will be printed in the record, and you can summarize it.

Dr. BARBER. Thank you, Mr. Chairman.

(Statement referred to follows:)

**STATEMENT BY RICHARD J. BARBER, ASSISTANT PROFESSOR OF LAW, SOUTHERN  
METHODIST UNIVERSITY**

My remarks are limited principally to a consideration of current public policies as they relate to the problem of industrial organization. In outline, these are my conclusions as I review the activity of the Federal Government in this area:

(a) That in spite of our professed interest in antitrust activity, the fact is that the antitrust laws have been and are being enforced with neither vigor nor imagination;

(b) That the administrative agencies, charged with the regulation of such key industries as transportation and communications, continue to flaunt the competitive standard and to encourage monopoly; and

(c) That in its transactions with the private sector of the economy, the Government, particularly the Department of Defense, aids and abets concentration and denies to smaller firms fair business opportunities, particularly insofar as research and development is concerned.

Each of these points will be developed more fully as this paper progresses.

**I. ECONOMIC ASPECTS OF CONCENTRATION**

Let me at the outset, however, comment very briefly on some of the economic implications of industrial concentration—matters which my fellow panelists have already discussed at greater length.

As I survey the domestic economic scene, I am struck by several features that are of immense significance in considering our public policy toward competition. Most important, in my estimation, is to note the simple fact that while few of our manufacturing markets are clearly dominated by a single firm, typically a very small number of firms account for most output in our key industries. The 1954 Census of Manufactures showed that of 426 four-digit product categories, in 112, 4 companies, or fewer, accounted for at least half of the total value of shipments. And actually this grossly understates the matter, for it fails to allow for the relative importance of the various products and segregates those which are really competitive (e.g., cane and sugar). In a recent study Professors Kaysen and Turner attempted to compensate for these kind of deficiencies; they concluded that of 147 manufacturing and mining industries with national markets, 104 were "concentrated" (in the sense that the 8 largest sellers account for at least 33 percent of total market sales). Included in this grouping, as the following list indicates, are such vital industries as autos, steel, most of the other metals, chemicals, rubber tires, flat glass, synthetic fibers, cigarettes, electrical machinery, computing machines, diverse other transportation equipment, etc.

*Percent of value of shipments accounted for by largest 4 companies, selected industries, 1958*

	Percent
Passenger cars.....	99
Synthetic organic fibers, noncellulosic.....	(1)
Telephone switching equipment.....	(1)
Sheet (window) glass.....	95
Locomotives and parts.....	92
Electric lamps (bulbs).....	90
Primary aluminum.....	82
Cigarettes.....	80
Metal cans.....	80
Power and distributing transformers.....	80
Computing machines.....	77
Wheel tractors and parts.....	72
Tires and tubes.....	71
Sheet ingots and semifinished shapes.....	71

<sup>1</sup> Withheld by Bureau of the Census to avoid disclosure. Concentration ratio very high.

Source: Report of the Senate Antitrust Subcommittee, "Concentration Ratios in Manufacturing Industry, 1958," 87th Cong., 2d sess. (1962).

What we have here then is an enumeration of our most basic industrial sectors—each dominated by a very few firms (and keep in mind that this listing excludes the regulated utilities).

Within these oligopolistic arenas only a very restricted type of competition prevails. As studies of various sorts have well demonstrated, price competition is uncommon, becoming more rare as the degree of concentration increases. What rivalry that does exist is confined to nonprice matters, like advertising, product design, the creation of a favorable corporate image, and so forth. Prices remain largely uniform among the rival sellers, with changes being effected from time to time in a coordinated fashion. For example, in 1956 the Ford Motor Co. initially announced an average price increase on its 1957 models of 2.9 percent. Two weeks later General Motors increased its 1957 model prices by an average of 6.1 percent. A week later Ford revised its prices upward to match almost dollar for dollar General Motor prices.

To the outside observer this sort of arm-in-arm conduct suggests that it must be the product of actual collusion between the managers of the respective organizations. Actually, as economic theory has indicated, this need not necessarily be the case. Where a small number of firms function in the same market, each accounting for a significant share of sales, a kind of "spontaneous coordination" can occur. Each firm, knowing that its fate is intrinsically intertwined with that of its principal competitors, learns that it cannot operate on its own and thus we come to have something like the circumstances of nuclear stalemate.

The longer that companies coexist under such conditions, the less likely they are to engage in anything approaching the price warfare that we have come to expect as the hallmark of a competitive system. Executives of these corporations are frank to admit that price manipulation is not an appropriate instrument of warfare, and indeed they speak more in the fashion of ministers of foreign powers than of aggressive businessmen. What they are interested in typically is preserving their position in the market and achieving over the long run what they feel is an acceptable rate of profit. Professor Lanzillotti, who along with others has done considerable work in this field, has concluded that a target return on investment is probably the dominant price goal of large corporations (e.g., in the case of General Motors, 20 percent on investment after taxes).

When it is recognized that target-return pricing is a longrun objective, it is easy to see why firms in a position to establish such an objective so rarely reduce prices when recession occurs. Their formula recognizes that there will be periods of inadequate profit, but seeks to compensate for this in periods of expansion. Instead of slashing prices in an aggressive manner to increase sales during periods of curtailed business activity, the dominant firms simply hold on, anticipating better days to come. As demand declines at the prevailing price, output falls and with it employment and corporate profits. The economic contraction hence is accentuated and prolonged and an undue share of the burden for accomplishing an upswing is shifted to governmental fiscal and tax

policies. Certainly greater price flexibility would assist, to some extent, in minimizing cyclical gyrations and in shortening their duration. Lower levels of concentration, and a greater degree of competition, thus would distinctly complement our other policies designed to achieve full employment and expanded productive opportunities.

No sensible person expects, of course, that antitrust intervention could achieve anything approaching the conditions of the classical competitive model. Modern technology requires large productive units and we cannot expect to atomize the economy and at the same time maintain optimal efficiency. But the fact is that we can have a great deal more competition, with many more companies of roughly equal size in the respective markets than is now the case—without sacrificing economies of scale. In the automobile industry, for instance, authoritative studies demonstrate that a firm supplying about 10 percent of total market demand can attain minimum production costs. This is not to say that an organization such as General Motors is not efficient; it is only to say that a company in this industry need not be anywhere nearly as large as General Motors to reflect maximum attainable efficiency. (I suggest that this is amply demonstrated by the performance of American Motors.) In the automobile context, this would suggest that we could have perhaps as many as 10 firms, about equal in size, rather than the present situation in which 2 firms (General Motors and Ford) together account for about 80 percent of new car sales. And a similar argument can be advanced in the case of most other industries.

The inquiring observer is entitled to ask at this point, though, whether it would really make any difference if we had 10 auto producers rather than the present 2-firm domination. No one can give a precise answer to this sort of question. Nevertheless there is much evidence to suggest that the larger the number of equal participants, the greater are the probabilities of something approaching full-scale competitive conditions.

This could at least mean a greater opportunity for product and service innovations (e.g., the compact car). And it could very well generate more open price competition. Where an industry is dominated by two large firms, the chances of widespread price cutting are very slim; but where there are 10 firms it is entirely probable that from time to time one of the group will decide that its fortunes can be improved with a price adjustment. There are many instances of this to be found, but a review of airline fares is illustrative. Here one finds that coach rates are typically placed in effect only when the carrier confronts a rival. Moreover, the most aggressive fare offerings have been along the east coast where many air carriers compete with one another. In most other parts of the country, where the number of participants is less, one finds that fares are commonly much higher and more stable. The implications of this for the economy as a whole are, I think, considerable.

In my estimation the extent of competition in the American economy could be greatly accentuated through vigorous antitrust action without necessitating any sacrifices in efficiency. The result would be more flexibility in prices and a better allocation of resources.

This sort of conclusion, I would hope, should not be at all surprising or startling to those who are familiar with our Nation's history. We have long professed our belief in competition as the best means of accomplishing our desired political and economic objectives. Our Federal and State antitrust laws reflect this attitude. The Congress has been particularly concerned with insuring fair opportunities for smaller business, and Presidents and major department heads have time and again assured us that competition should be encouraged, monopoly suppressed, and opportunities for smaller business guaranteed. In the remainder of this paper I propose to examine whether, in fact, our performance measures up to our declarations. On the whole, I think it does not.

## II. ANTITRUST ENFORCEMENT

Any adequate appraisal of the Federal Government's activities in relationship to competition and monopoly must consider three facets of the question. First, what is the character of our contemporary antitrust enforcement? Second, what are the effects of the work of the various regulatory agencies? And, third, what are the implications of Government procurement? I propose to turn to each of these matters in turn.

Let me first take a brief look at the work of the Antitrust Division of the Department of Justice. As you know, it is the principal enforcement agency in the field of antitrust, charged with the responsibility of enforcing the Sherman Act. Looking back over the last year and a half, one finds an extremely unsatisfactory performance. The cases initiated in number are many (60 cases were commenced in the calendar year 1961; in 1960, the comparable number was 90, but of these 39 involved the heavy electrical conspiracy). In character, however, they reflect little enforcement imagination and seem, by and large, unlikely to have any significant impact on reducing the level of prevailing concentration. I do not wish to imply that the work of the Division has been unimportant, certainly not. What I do suggest, however, is that the resources of this agency are not being employed to their fullest potential.

Of the 60 cases begun in 1961, 28 involved so-called per se violations (most notably price fixing, but also including allocations of territories, and bid rigging—the latter a variant of price fixing). Most of these were hard-core, overt conspiracies in which the Government usually possessed uncontradictable evidence of law violation. In many of these cases, the defendants did not dispute the charge, pleaded guilty or nolo contendere, and were fined. All too frequently, the fines constituted little more than a slap on the wrist. The firms were chastised, held up to modest public ridicule, and told to sin no more. Some of the major participants were fined, or jailed; and as the heavy electrical goods companies are learning, large money damages may be incurred. But even to the extent that prosecution of the per se offenses is a significant deterrent, we should not lose sight of the elementary fact that the most important problems stem from the highly concentrated industries, not those in which explicit collusion is usually found.

Let me again emphasize that I am not implying by the tone of these remarks that price fixing, bid rigging, and the rest of the offenses involved should go unpunished. The question I raise is whether more utility could not be obtained through the greater utilization of scarce enforcement resources in other kinds of cases.

The work of the Antitrust Division in suppressing corporate mergers is of much greater importance, although I think it deserves emphasis that this is essentially only preventive in nature: it does not usually reduce existing levels of concentration. In the calendar year 1961, the Department of Justice filed 19 cases, seeking to block or set aside corporate consolidations. Most of these were of consequence and involved firms of substantial size, whose affiliation promised reduced competition. Interestingly, however, two of the more important of these cases (one involving American Smelting & Refinery Co. and the other the Penn-Olin joint venture) were brought during the final days of the preceding administration. And actually as the year progressed one finds that the antimerger work of the Antitrust Division gradually slackened, a trend that persists to the present time (only six merger cases have been filed so far during 1962, well below the 1961 rate). What explains this curtailment in activity is not altogether clear. Nor is there any apparent explanation for the growing number of what strikes me as minor cases involving price fixing and other per se offenses. Among the "vital" product markets involved in recent cases alleging overt conspiratorial behavior, for instance, are ice show productions, venetian blinds, service station prices in Washington, and Kosher food products in New York City.

Increasingly it seems that the Justice Department, either for reasons of its own or because of larger political considerations, is confining its attention to less important issues and hence is contributing little to the achievement of a more competitive, less concentrated economy. In an interview in June with Anthony Lewis, a reporter for the New York Times, Assistant Attorney General Lee Loevinger admitted that his Antitrust Division was simply carrying on the enforcement policies of the preceding administration. He said "It just doesn't seem like the time to file any breathtaking, world-shaking cases—even if we were ready to." Another Department official was quoted in the same article as saying: "It is probably true that we are affected by business uncertainties to the point where we are holding up cases with a novel or uncertain character approach. We are sticking pretty much to the predictable, to the established lines."

Although I am aware, as we all are, of the criticism being leveled at the administration by business spokesmen, in part because of the recent steel price episode, I seriously question whether in shifting its policy emphasis and in disregarding major cases, the Department of Justice is living up to its legal and

moral responsibility. If the Antitrust Division is to perform a truly useful role, it must launch cases which have as their objective divestiture and other kinds of basic structural reorganization and relief that will reduce prevailing levels of concentration in our most important industries.

Until the Government seeks aggressively to obtain a more competitive climate in key industries, there will be room for participants in the less highly concentrated industries to feel they are the victims of a double standard. The gasoline station operators who agree upon prices at which they will sell their products are speedily brought within the criminal reach of the law. But the major oil companies which are able to achieve coordination in price, because of the concentrated character of the industry, go free. Both should be brought within the law.

While the Department of Justice is beset by administrative problems (its staff is too small for the job, and at the moment the Antitrust Division is operating far beneath authorized manpower levels), and while the law as written and interpreted is not nearly so clear as one would like, the fact remains that there is considerable room for improved enforcement that will lead to a more competitive market tone.

The situation is similar when one turns to the Federal Trade Commission. While this agency is possessed of considerable expertise in business regulation and thus should be in a position to contribute substantially to the attainment of the competitive goals, it has long been noted for its ineffectiveness. Although it handles a large volume of work, it continues to be bogged down in insignificant cases. During the fiscal year 1961, the Commission issued 410 complaints, but nearly three-quarters of these involved deceptive practices (primarily technical violations of the wool, fur, and textile labeling laws); only five new merger complaints were filed. Since July 1960 only six antimerger cases have been initiated, and only three between January 1961 and the middle of August of this year. This sorry performance has prompted one member of the Commission, Philip Elman, to say that there is in effect here "a kind of Gresham's Law (where the) trivial and inconsequential cases leave little room for, and tend to drive out, the substantial and significant." If the Commission is to perform a useful function in reducing existing concentration levels, it must allocate its enforcement resources more wisely. Like the Justice Department, the Commission's talents must be more productively employed.

### III. THE ROLE OF THE FEDERAL ADMINISTRATIVE AGENCIES

Over the years, a number of Federal administrative agencies have been created to regulate certain industries—most notably, transportation (including airlines, motortrucking, railroads, water carriers, pipelines), communications, and banking. The hope was that in this manner the behavior of these industries would be rendered compatible with the broader public interest in spite of their purportedly monopoly character. In actuality, however, the performance of the administrative agencies has been sorely disappointing. The agencies have not been able or willing to compensate for the lack of the inhibitions and rigors that competition imposes. Moreover, and of considerable importance, all too frequently the regulatory boards have begot monopoly, deliberately or through studied acquiescence, and curtailed what little competition typically reigns in these sectors.

Any effort to accommodate the antitrust policies of our country with the conduct of the various agencies is fraught with the utmost difficulty. Occasionally Congress will admonish these boards to consider the antitrust laws in reaching decisions, particularly those which involve mergers. More frequently, however, Congress has failed to indicate clearly whether, and if so and to what degree, the antitrust policies must be considered in resolving certain kinds of specific questions. In the approval of mergers involving motor carriers, for example, the pertinent statute declares that mergers may be approved if they are "consistent with the public interest." The Supreme Court has interpreted this phrase to mean that the Interstate Commerce Commission must weigh antitrust considerations in reaching its decisions, but that the antitrust features need not be given primary or exclusive weight; they are only factors to be considered along with all other relevant matters. The net result has been to leave antitrust policy in a very subordinate position, with the courts holding that the agencies' disposition of the antitrust issues is determinative. This places the administrative bodies on a pedestal and permits them, as they now so usually

do, to reduce their treatment of antitrust issues to little more than a ritual. This is true even where the law does not expressly vest the regulatory board with a final say in the matter. As an example, take the recent case involving the merger of the Philadelphia National Bank and the Girard Trust Corn Exchange Bank, the city's second and third largest banks which together have about 37 percent of commercial bank assets in the four-county metropolitan area. Under the Bank Merger Act, this consolidation required the approval of the Comptroller of the Currency. Pursuant to law he sought the opinions of the Attorney General and the Federal Reserve Board, both of whom advised that the merger would result in a substantial lessening of competition and a tendency toward monopoly. Nevertheless, the Comptroller approved the transaction. The Antitrust Division took the case to court and earlier this year District Judge Clary upheld the merger. While he did not feel bound by the Comptroller's finding, it is perfectly clear, from a close reading of his opinion, that he was strongly persuaded by the earlier determination. "The courts," he observed, "have uniformly held that once Congress has reposed its confidence in the expertise of a particular department, the courts (sic) should not substitute its judgment in the place and stead of the department involved."

More vivid illustrations will be provided if and when the ICC and CAB approve the various proposed airline and railroad mergers with which they are presently confronted. The consolidation of American Airlines and Eastern Airlines for instance, will bring together the second and fourth largest domestic trunk carriers and eliminate much competition, particularly in the northeastern part of the country. Nevertheless, and in spite of the Board's efforts in the years beginning in 1955 to open up new routes to competition from other, smaller lines, Chairman Alan Boyd has, during the past year, made several speeches encouraging mergers and suggesting strongly that the Board will be favorably disposed to consolidations that will substantially reduce competition in the industry. The point need not be developed at length in this context, but I offer the conclusion, based upon a rather close look at the evidence in the case, that if the American combination is approved, it will greatly inhibit airline competition and hamper the development of a more balanced airline industry.

It again deserves emphasis that if this merger is approved by the CAB (or if any of the pending railroad mergers are allowed by the ICC), the courts will not substitute their judgment, even though the CAB (and the ICC) is unlikely to give the antitrust factors very little more than a passing mention. I would be less disturbed if the evidence available indicated that the Board (and the other administrative agencies) could reasonably be expected to exercise its regulatory functions with dispatch and efficiency. But this cannot be anticipated. For another example, although the Federal Communications Commission has long had jurisdiction to regulate international carrier rates, it has never done so. This is why many people believe that the attempt to justify the Telstar proposal on the ground that the FCC will regulate its operation is humorous.

What emerges from this survey is that we have decided to the control of a number of administrative agencies the authority to regulate large and vital sectors of the economy (together accounting for something like 15 percent of our national income) without imposing adequate safeguards. In the process, the competitive ideal has been frustrated; the agencies have been permitted to encourage monopoly; and all of this without substituting effective economic regulation for the kind of demands imposed by the enterprise system.

#### IV. GOVERNMENT PROCUREMENT, PARTICULARLY RESEARCH AND DEVELOPMENT

Any effort to assess the relationships between Federal Government activities and industrial concentration must incorporate a consideration of procurement policies and practices. As we know, Federal purchases of goods and services as a share of the gross national product have increased steadily over the years, rising from 1.2 percent in 1929, for example, to 5.7 percent in 1930 and then in the post-war years after declining for a brief period to 6.7 percent in 1947, rising once more until today it makes up about 11 percent of GNP (\$57.0 billion in 1961).

As a consequence, the way in which these large flows of Federal funds are allocated can have a very serious impact in (a) accentuating, or reducing, or maintaining any given level of industrial concentration; (b) fulfilling or frustrating the congressional policy which declares, as expressed in the Small Business Act, that "the Government should aid, counsel, assist, and protect insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise. \* \* \*

Preserving fair access to Government research and development programs is just as important to fulfillment of national objectives as the procurement of goods themselves. Indeed it may be more important; speaking in 1956 former Attorney General Herbert Brownell pointed out that we must be deeply concerned "with the future of competitive enterprise, and it is important that its share of this (research) activity be administered to promote competition within the limits possible under the urgency and complexity of the defense program. However, although there is inadequate factual information upon which to judge the effect of Government subsidization of research, what indications that are available warn that the Government expenditures may not counter to the industry trend toward concentration, but in some degree may even reinforce it. \* \* \* The disproportionate share of total industrial research and development in the largest firms may foreshadow a greater concentration of economic power in the future. An adequate supply of technical manpower is the first prerequisite to any research and development program. Such programs themselves are basic factors in the development and expansion of our business economy. Therefore, a present concentration of such manpower and programs means that in the future an increasing share of anticipated improved technologies and new product lines will be introduced by the industrial giants."

Moreover, R. & D. leads to the creation of new products and technologies, and invariably when the Government elects to purchase these items in quantity it returns to the developer for their manufacture. Once an organization gets its nose under the R. & D. tent, it can readily enlarge its position through further developmental activity and ultimately hold a preferred position in manufacture. And this is not necessarily confined solely to purchases by the Government, for many products developed originally for special needs have clear civilian applications. These can range from such a simple item as the new type of sunglasses with straight sidepieces developed by the American Optical Co., for the Air Force under a \$367,000 contract to such large and important items as radar, jet airplane design (the Boeing 707, the first jet passenger in service, is a mere modification of the jet tanker used to fuel jet bombers in flight), penicillin and other antibiotics, blood plasma substitutes, silicon transistors, a variety of miniature electronic components, and so on through a very long list. If the smaller companies are effectively excluded from the Government R. & D. picture, the longrun implications for competition can be grave.

Over the years, valiant efforts have been made to gain a larger share of Government dollar outlays for smaller firms. Congress has created the Small Business Administration and the principal executive departments have pledged their diligence in insuring that smaller firms will be given a chance to obtain business from the Government. How successful this has been, though, remains an open question. In the fiscal year 1961, for example, the Department of Defense spent about \$23 billion with business firms for work in the United States. Of this amount, small business firms received approximately 16 percent (29.6 percent in the case of Army purchases, 15.5 percent for the Navy, and 9.3 percent for the Air Force). During the first three quarters of the fiscal year 1962, small business was awarded about 16 percent of total dollar outlays by the Department of Defense and its constituent services, with most of this, as usual, concentrated in transactions of less than \$10,000.

Whether this performance is good or bad is a matter which I do not wish to explore at this time. What I want to do, rather, is compare the situation in respect to military procurement generally with the specific case of research and development. Here the evidence strongly suggests that the smaller organizations have been seriously disadvantaged relative to their larger rivals and that the military services have made little serious effort to provide small companies with fair opportunities for doing the desired work.

#### *General information on research and development*

Outlays for research and development in the United States constitute one of the most dynamic forces in the economy. Between 1953 and 1961, for example, while the gross national product was rising only 43 percent, outlays for R. & D. from all sources rose by about 300 percent. Even more recently R. & D. has been accelerating at a faster rate than most other sectors of the economy; from 1957 to 1961 gross national product went up 18 percent, R. & D. outlays by about 50 percent. In 1961, the best available estimate indicates that \$15 billion was spent on R. & D. This compares with a little over \$14 billion in the prior year and with only \$10 billion as late as 1957. Reasonably detailed data show that while

the Federal Government provides about two-thirds of all funds for the performance of R. & D. the predominant share of the work itself is performed not by the Government but by private industry. Appendix table 1 indicates this more fully.

Digging beneath the surface, further analysis reveals that the performance of R. & D. is highly concentrated—almost regardless of the index of concentration employed. In 1959 (this is the latest year for which detailed information is now available) the 406 companies with 5,000 or more employees (3 percent of the total number of firms with R. & D. programs) accounted for 86 percent of aggregate R. & D. activity. At the other extreme, the 10,600 companies with less than 1,000 employees (90 percent of the total number of firms with such programs) performed only 6 percent of industrial R. & D.

Furthermore, most small companies have no R. & D. programs at all and of those that do, their outlays for this purpose are extremely small (nearly half of these companies spent less than \$10,000 on research in 1959). The big companies thus do most of the work, and indeed, the biggest of the big companies do almost all of the R. & D. And this concentration of activity is even more intense than is concentration generally. For instance, while the 100 corporations with the largest R. & D. programs accounted for 81 percent of aggregate R. & D. these same firms accounted for only about 41 percent of total sales within their respective industrial categories. Related data are contained in appendix table 2.

One finds as well that the bulk of R. & D. outlays are concentrated within a very few industrial categories and have rather specialized scientific objectives. In 1959, of \$9.6 billion spent on R. & D. in industry, over \$3 billion were in aircraft and parts, with another \$2.2 billion in electrical equipment and communication. The heaviest emphasis is on development and applied research as distinct from basic research. About 70 percent of total outlays in this sector are for development and another 20 percent for applied research. Basic research, by contrast, receives less than 10 percent of the total. Moreover, the physical and mathematical sciences dominate the scene, making up about 60 percent of total funds for basic research in 1959, and accounting, of course, for virtually all of the expenditures for development and applied research.

What emerges, therefore, in this kind of picture: amounts spent for R. & D. have been rising rapidly in recent years, with most of the funds flowing from the Federal Government; the bulk of the actual performance is done by private industry; within industry a small number of firms do most of the work and get most of the money appropriated by the Federal Government for this purpose; the principal portion of our attention is focused on a very few industrial sectors, principally those related to missiles, aircraft, and electronic and communication equipment; and little work is being done on basic research and very little on the life sciences.

Putting up two-thirds of the funds and engaging in considerable research on its own, the Federal Government rather obviously is principally responsible for the character of contemporary R. & D. In the present fiscal year it is estimated that the Federal Government will spend \$12.4 billion for this function, with \$7.2 billion, or 58 percent, of this originating with the Department of Defense; NASA will add another \$2.4 billion, or 19 percent; and the AEC an additional \$1.4 billion, or 11 percent. Together, then, these three agencies account for nearly 90 percent of all Federal outlays for R. & D. and it is their interests which naturally exert the largest influence on R. & D.

The way in which these agencies, particularly the Department of Defense, handle their contracting for R. & D. is thus of critical importance in evaluating the position of smaller firms in the overall picture. Here, for the sake of brevity, I will look primarily at the performance of the Military Establishment.

Just 6 years ago, in the fiscal year 1956, expenditures for EDTR (experimental, development, test, and research work—the military terminology for R. & D.) accounted for only 13.5 percent of all military procurement. Gradually this has increased, spurred on by missile and space-related projects, with the result that by fiscal 1959, EDTR accounted for 22.6 percent of total procurement. Since then it has risen less sharply to 25.7 percent in 1961. Among the individual services there are sharp differences in the relative importance of research activity. In fiscal 1961, although the Army spent merely 12 percent of its money on EDTR and the Navy 20 percent, the Air Force spent 36 percent and accounted for about two-thirds of all military funds allocated for this purpose.

In the distribution of funds for research work, small business concerns receive a disturbingly small amount of the total awards. Indeed, by comparison, military awards to small firms for procurement of hardware appear extremely generous. In fiscal 1961, small businesses received only 2.9 percent of total awards for EDTR—and this reflects a steady decline over the last 6 years, as appendix table 3 demonstrates.

Even among those corporations which are fortunate enough to share in the Department of Defense largess for research and development there is a similar degree of pronounced concentration. Of awards for EDTR in the fiscal year 1961, which in the aggregate totaled \$6.025 billion, eight corporations accounted for one-half of the total, with General Dynamics and Lockheed Aircraft Corp. together making up over 19 percent. More generally, one finds that the largest 20 recipients accounted for nearly three-fourths of all EDTR awards during the year. And this sort of pattern is true even if awards for all agencies of the Federal Government are included. The 300 manufacturing companies with the largest programs for R. & D. performance accounted for 99 percent of all Federal research and development activity in 1959. Looked at in a different way, judged by the size of the firm doing the work, one also finds that the largest firms did most of the Federal outside research. Concerns with 5,000 or more employees accounted for over 90 percent of all Federal financing in this area in 1959. (See appendix table 4.)

Not only is defense-related research activity concentrated in the hands of a very small number of firms, but a similar pattern is noticeable on a geographic basis. In fiscal 1961, California alone was the situs of over 41 percent of EDTR awards. New York accounted for another 12 percent and along with Massachusetts, Washington, and Colorado these five States recorded nearly 70 percent of all Defense Department activity. Quite properly the Department of Defense, in a rather surprising declaration, acknowledged this year that "a region that gains a long head start in a new and expanding field of procurement is bound to enjoy an enduring advantage, especially when R. & D. is a primary element." As this comment recognizes, the award of funds for R. & D. gives rise to a sort of snowballing process in which the award produces competence that becomes the basis later for still further awards, for ultimate production, and for civilian applications.

One contention frequently advanced by both industry spokesmen and officials of the Department of Defense, however, is that the kind of figures noted here fail to take account of subcontractors. Smaller firms may actually do substantial portions of the work involved, so the argument goes, although the money may flow through a large prime contractor. While perhaps a plausible argument on its face, a close look at the available evidence suggests strongly that very little subcontracting takes place in the R. & D. area. The National Science Foundation, in its comprehensive survey in this field, reports that in 1959 only 10 percent of all funds allocated by the Federal Government for research purposes was actually spent by firms with less than 5,000 employees, including less than 5 percent by firms with fewer than 1,000 employees. (It is important to emphasize that this evidence is based on questionnaires submitted to firms which ask them to report whatever research they actually do with Federal funds; i.e., the prime contractor would not report, therefore, on work which he did not in fact do, such as where part of the job was let to a subcontractor.) Certainly this indicates that whatever subcontracting does occur is insignificant and does not alter the intense concentration of Federal outlays that we have noted earlier.

There is still another question, however, which must be considered. The point is commonly made, particularly by those in the Defense Establishment, that only the largest firms possess the requisite technological skills and that the smaller firms are excluded, not because they are small, but because they lack the requisite know-how. One Defense Department official expressed this to me by saying, "The best evidence that the small firms do not have the proper skills is that they do not obtain a larger proportion of contracts for R. & D."

But this assumes that all firms, regardless of size or familiarity, are given an equal chance to secure R. & D. ends—and this is not presently the case. Naturally, the larger firms do have many outstanding people on their payrolls; but the smaller firms are not devoid of scientific skill. In fact, many of them are composed of individuals who formerly worked for the giant corporations. At the moment it is estimated that there are over 3,000 small research and development organizations in the United States, and the work that many of them have done is impressive. (Jewkes' study found that several major inventions, including continuous hot-strip rolling, DDT, and terylene polyester fibers, were developed

by relatively small organizations, not to mention the many inventions of independent inventors, like radio, cellophane, insulin, penicillin, streptomycin, and the jet engine.) To write off the smaller firms, as many of the Defense Department procurement people seem to have done, is thus of questionable wisdom.

This is not the place to attempt to assess the relative capacities of small and big organizations to do scientific work. But it is appropriate here to indicate that the processes employed by the Department of Defense in awarding contracts for R. & D. are such as seriously to discriminate against the smaller concerns. The existing contract procedures for R. & D., as employed by the Armed Forces, do not require any broad dissemination of information relating to anticipated contract awards. No formal advertising takes place for research and development. Only a limited amount of information seeps out through the synopsisizing requirement. As a consequence, the negotiation of R. & D. contracts is generally conducted with only a very few participants who have been invited by the contracting authorities.

The uninvited either are unaware negotiations are underway or are rebuffed if they even seek out information that would enable them to make a proposal relative to the job under consideration. Most contracts for R. & D. are thus awarded on either a sole-source basis or after discussions and negotiations with a very small number of contestants, competing with one another—not on the basis of price—but via comparison of their project proposals. The winner in this race is the firm that can produce the most glamorous and promising drawings. But at present this is largely a closed race, and only the largest companies are permitted to enter the starting gate.

In part, the secrecy of R. & D. contracting is evidenced by the fact that during the first 9 months of fiscal 1962 only 36 percent of the dollar amount of procurement awards was even publicized to small business—and this in spite of congressional policy which declares formal advertising, not just publicity, to be the usual means of Government procurement. Although Congress has made many exemptions to this general rule, in the Small Business Act of 1961 it required that all procurements which need not be formally advertised must be synopsisized in the Department of Commerce Business Daily. Yet in the first three quarters of fiscal 1962, only 22 percent of all contract awards were so announced. The problem is even more serious in the specific case of EDTR. While more detailed data would be helpful, it is known that in the first 9 months of fiscal 1962 only 16 percent of the dollar value of all research and development awards was made on a competitive basis. And actually only 3.2 percent of such awards was made on a competitive price basis. The absence of competition and the lack of effective publication go together.

As I have indicated above, the Small Business Act of 1961 makes it the duty of the Secretary of Commerce to publicize notices in the daily Department of Commerce synopsis for all proposed defense procurement actions of \$10,000 and above, with specified exceptions.

Implementing this requirement, the Department of Defense has adopted regulations which provide that "every specific procurement of research and development projects shall be publicized in the Commerce Business Daily \* \* \*". On the face of it, this seems to open up research and development contracting to public gaze, and to give firms, small or large, that might be interested in working on a project, a chance to participate in the early stages of selection. However, another provision in the Armed Services Procurement Regulation (ASPR) authorizes contracting officers to request proposals "only from sources which have been technically evaluated and found qualified to perform research and development in the specific field of science or technology involved." Indeed, ASPR 3-107.4 provides that solicitations to enter into negotiations may be limited to a single source where prior technical evaluation has been made. But technical evaluation, though it might imply a comprehensive screening of all interested parties, fairly informed, actually involves an extremely limited process; the appropriate survey is typically made by the contracting officer (complemented by engineering personnel) simply on the basis of what information he already has at his disposal. What this means is that a firm which has previously done work in the same general area has a clear inside track on the new contract for the simple reason that it is known to the contracting official. And under the existing regulations, no other firm need be given an opportunity to participate in the award. Moreover, even where procurement is not limited to a single source, usually only a very few firms are asked to submit proposals. In these instances of limited source procurement, the relevant synopsis, if and when it is published, only recites

that a contract is being awarded to a named firm or that "competition" is limited to named companies; all others are told bluntly to stay away.

Consequently, the Department of Defense and the contracting services are not now in a position to say that smaller firms are lacking in the kinds of scientific knowledge required to do work on EDTR projects. They simply do not know. They deal only with the established concerns and exclude from consideration anyone else. While everyone agrees that we want to use the best resources available in the performance of complex research, there is serious doubt as to whether we are actually doing so; the large firms, though generally capable and possessed of great talents, have no monopoly on technical expertise. Yet the Defense Department presently acts as if they did.

It is my considered judgment, on the basis of the inquiries I have made, that the Department of Defense could do a much better job in broadening the base of R. & D. awards if it revised its procedures to give all comers an opportunity to demonstrate their competence in respect to given research undertakings.

#### *The aftermath of R. & D. contract awards*

As was suggested earlier, a contract for the performance of research and development is only the beginning of the story. If the effort has its intended purpose and results in a usable item of hardware, production opportunities lie immediately ahead. And in most instances the large company anticipates that it will earn its largest returns at this stage of the process. When the contract for production is let, it is common for the organization that did the pertinent research to be awarded the new production contract. Defense Department officials admit frankly that the developer is in a preferred position, its familiarity with the product deemed to make it the most efficient manufacturer. And frequently this will be the case.

Yet once the product has been developed and detailed plans and specifications prepared and submitted (as the usual R. & D. contract requires) it is rare that other qualified firms cannot produce the item. But not infrequently they are simply denied the opportunity to bid. This kind of situation was reviewed recently by the Subcommittee for Special Investigations of the House Committee on Armed Services in respect to the Navy Department procurement of a radio known as the AN/PRC-41. There the Navy planned to grant a sole source, a \$4.4 million contract for production to the developer; another company sought to bid, but until a Member of Congress intervened strenuously in its behalf it was denied the opportunity; when it did attempt to bid it was handicapped because the developer had not submitted the detailed specifications and drawings required for manufacture; and ultimately the Navy did make the award to the company it had first favored. This is a typical example; thousands of others like it could be found. Once a company does the relevant R. & D. work, it will normally be awarded the production contract—a practice that thus tends to entrench further the initial pattern of concentration. (For the fiscal year 1961 the largest six recipients of EDTR awards from the Defense Department were also at the top of the ladder for non-EDTR procurement.)

When one considers also that many of the products developed under contract with the Government (e.g., chemicals, drugs, a variety of products and new processes) have immediate or long-term civilian applications, the significance of patent policy becomes readily apparent. This is a complex question and raises a host of other issues and I will not attempt to treat them more than superficially on this occasion. It is widely known that the Department of Defense does not generally seek a patent on products developed under its research contracts; it permits the developer to secure the patent even where Government funds may have represented all or nearly all of the costs incurred (and even where, as is usually the case, the project was financed on a cost-plus basis). The Defense Department simply takes back a nonexclusive, royalty-free license.

In following this course of action DOD not only departs from the policies of other Government agencies (like NASA and AEC), which take title to the patent, but also contradicts the procedure employed by private companies in dealing with their own employees and subcontractors. When they supply funds or facilities for research they require the subordinate to assign title to whatever patents that are acquired in the process. By following a different course the Defense Department (and NASA, if proposed legislation is adopted) seems likely to insulate still further the position of the big concerns with which it does most of its research contracting. And, as has been indicated, many defense-financed projects have civilian uses, so that the patents acquired may give the firm a dominant position in the civilian market as well as in military and Government sales.

One other facet of the Government-financed R. & D. sector deserves brief mention—namely, the fact that so little effort is made to exploit the vast quantities of information gained in the performance of research and development. Various Government agencies are presently provided small sums of money to publish abstracts of research reports. But the reporting standards are low: many reports are never submitted at all, in spite of contractual requirement; most are written in a fashion suggesting that the researcher wished to keep the information secret (which, no doubt, is a common objective); the technical abstracts are of little help, and of none to businessmen as distinct from scientists (and it is the businessman who must sense a possible use before the information can be placed at the disposal of the society).

In short, we are getting far less from our research expenditures than we could if the information so obtained were disseminated more widely, in more digestible form. This entire matter requires much fuller attention. But it may be at some time that Government will have to create a special agency charged with the task of collecting, analyzing, and exploiting the massive quantities of research findings we are now accumulating.

## CONCLUSION

If we sincerely want to reduce the prevailing levels of concentration in the American economy, as I believe we can and should in order to improve our chances of attaining our generally desired objectives (including those declared in the Employment Act), then the preceding survey should suggest many topics for further inquiry by this committee. The contradictory nature of our Federal policies in dealing with the whole matter of industrial organization warrants exposition and fuller analysis. What must be understood is that we cannot reduce monopoly and encourage competition by stirring together in one pot timid antitrust enforcement, monopoly incitement by the principal administrative agencies, and procurement practices that tend unduly and unfairly to favor the largest companies.

The way in which we handle our allocation of funds for research and development provides as good a test as any of our determination to enlarge the opportunities for smaller firms and in this way take a short step toward reducing concentration. Procedures can and should be developed that will give all businesses, new or long established, and regardless of size, a just chance to participate in the selection process and to perform R. & D. for the Federal Government. Such an opportunity does not now in fact exist, and most of the contracts are going to the biggest concerns, promising serious adverse consequences over the years to come. This situation can be corrected, freer competition can exist, increased concentration can be prevented—but not if we permit our present inconsistent and inadequate policies and practices to continue. Reforms are sorely needed and this committee is in an ideal position to stimulate their adoption.

APPENDIX TABLE 1.—*Intersectoral transfers of funds used for performance of research and development, by source and performer, 1960-61 (preliminary)*

[Millions of dollars]

Funds provided by—	Sectors—Funds for performance of R. & D.					
	Federal government	Industry	Colleges and universities	Other nonprofit institutions	Total	Percent distribution, R. & D. sources
Federal Government.....	\$2,000	\$6,130	<sup>1</sup> \$890	<sup>1</sup> \$140	\$9,220	65
Industry.....		4,370	50	70	4,490	32
Colleges and universities <sup>2</sup> .....			210		210	2
Other nonprofit institutions <sup>2</sup> .....			50	70	120	1
Total.....	2,000	10,500	1,200	280	14,040	100
Percent distribution R. & D. performance.....	15	75	8	2	100	

<sup>1</sup> This amount includes funds from the Federal Government for research centers administered by organizations under contract with Federal agencies.

<sup>2</sup> Data include State and local government funds. All data are based on reports by the performers.

Source: National Science Foundation, "Reviews of Data on Research and Development," No. 33, April 1962, table 3, p. 4.

APPENDIX TABLE 2.—Percentage of total R. & D. performance funds and total federally financed research and development accounted for by the 4 and 8 companies with the largest dollar volume of R. & D. performance, by industry, 1959

Industry	Percent of R. & D. performance		Percent of federally financed R. & D.	
	1st 4 companies	1st 8 companies	1st 4 companies	1st 8 companies
Food and kindred products.....	37	55	( <sup>1</sup> )	( <sup>1</sup> )
Textiles and apparel.....	58	70	( <sup>1</sup> )	100
Lumber, wood products, and furniture.....	42	55	( <sup>1</sup> )	( <sup>1</sup> )
Paper and allied products.....	44	58	( <sup>1</sup> )	( <sup>1</sup> )
Chemicals and allied products.....	45	56	86	91
Industrial chemicals.....	63	79	87	92
Drugs and medicines.....	45	67	79	94
Other chemicals.....	28	45	( <sup>1</sup> )	57
Petroleum refining and extraction.....	50	73	62	66
Rubber products.....	55	91	90	99
Stone, clay, and glass products.....	51	70	45	71
Primary metals.....	44	58	47	73
Primary ferrous products.....	59	75	( <sup>1</sup> )	( <sup>1</sup> )
Nonferrous and other metal products.....	56	72	( <sup>1</sup> )	88
Fabricated metal products.....	48	65	62	89
Machinery.....	48	58	64	79
Electrical equipment and communication.....	63	77	64	81
Communication equipment and electronic components.....	60	77	63	80
Other electrical equipment.....	89	91	97	98
Motor vehicles and other transportation equipment.....	90	94	93	98
Aircraft and parts.....	60	71	51	71
Professional and scientific instruments.....	62	70	71	81
Scientific and mechanical measuring instruments.....	75	83	92	95
Optical, surgical, photographic, and other instruments.....	64	79	63	81
Other manufacturing industries.....	60	66	57	66
Nonmanufacturing industries.....	33	40	69	73

<sup>1</sup> Not available.

Source: National Science Foundation (NSF 62-3), "Funds for Research and Development in Industry, 1959," app. A, table A-11, p. 62.

APPENDIX TABLE 3.—Awards for experimental, developmental, test, and research work, by type of contractor

[Amounts in thousands]

Type of contractor	Fiscal year 1956	Fiscal year 1957	Fiscal year 1958	Fiscal year 1959	Fiscal year 1960	Fiscal year 1961	July 1961-March 1962
Total experimental, developmental, test, and research <sup>1</sup> .....	\$2,404,440	\$3,256,371	\$4,031,076	\$5,239,087	\$5,551,964	\$6,023,402	\$4,299,677
	Percent						
Experimental, developmental, test, and research percent of all military procurement <sup>1</sup> .....	13.5	16.8	18.1	22.6	25.6	25.7	22.5
Army.....	10.1	9.5	12.4	16.2	15.0	12.3	12.9
Navy.....	9.1	12.0	15.5	17.5	23.0	20.0	10.1
Air Force.....	15.1	23.8	22.4	26.2	32.8	38.3	79.2
Experimental, developmental, test, and research percent of all procurement from business firms.....	13.5	15.9	17.1	21.5	24.6	24.6	21.4
Army.....	10.1	8.1	10.8	13.7	14.1	11.5	12.4
Navy.....	9.1	11.0	14.3	16.7	21.6	18.6	8.9
Air Force.....	15.1	23.0	21.7	28.2	32.0	35.2	38.2
Small business percent of experimental, developmental, test, and research.....	5.7	4.3	3.7	3.5	3.4	2.9	2.6
Army.....	9.4	9.7	7.1	7.6	6.2	4.7	3.3
Navy.....	8.9	8.4	8.9	5.8	5.5	6.4	8.6
Air Force.....	3.6	2.0	2.1	1.7	1.9	1.6	1.3

<sup>1</sup> Except intragovernmental and outside United States.

Source: Office of the Secretary of Defense "Military Prime Contract Awards and Subcontract Payments" (July 1961-March 1962), table 7, p. 24.

APPENDIX TABLE 4.—*Federally financed research and development performance, by industry and size of company, 1959*

	<i>Millions of dollars, 1959</i>
Total.....	\$5, 610
<i>Distribution by industry:</i>	
Food and kindred products.....	(1)
Textiles and apparel.....	7
Lumber, wood products, and furniture.....	(1)
Paper and allied products.....	(1)
Chemicals and allied products.....	284
Industrial chemicals.....	280
Drugs and medicines.....	3
Other chemicals.....	1
Petroleum refining and extraction.....	24
Rubber products.....	37
Stone, clay, and glass products.....	2
Primary metals.....	15
Primary ferrous products.....	2
Nonferrous and other metal products.....	13
Fabricated metal products.....	58
Machinery.....	404
Electrical equipment and communication.....	1, 575
Communication equipment and electronic components.....	842
Other electrical equipment.....	732
Motor vehicles and other transportation equipment.....	249
Aircraft and parts.....	2, 610
Professional and scientific instruments.....	175
Scientific and mechanical measuring instruments.....	123
Optical, surgical, photographic, and other instruments.....	52
Other manufacturing industries.....	101
Nonmanufacturing industries.....	(1)
<i>Distribution by size of company (based on number of employees):</i>	
Less than 1,000 (5 percent of total funds).....	276
1,000 to 4,999 (5 percent of total funds).....	276
5,000 or more (90 percent of total funds).....	5, 058

<sup>1</sup> Not separately available but included in total.

Source: National Science Foundation (NSF 62-3). "Funds for Research and Development in Industry, 1959," table III, p. 11.

Dr. BARBER. While I do not want to go over the ground that has been covered so splendidly by my fellow panelists, I think it worth emphasizing that the kinds of industries which they have been speaking of, automobiles, in the case of Professor Adams; steel, noted among other things by Dr. Kahn; chemicals, mentioned by Professor Lanzillotti, are excellent illustrations of the pattern of dominance that exists in our most basic industries.

I have outlined some of this data in a table at the top of page 3 of my prepared statement, merely to suggest the kind of situation that does prevail.

What we have in our industry is typically not a monopoly, but a situation in which a rather small number of firms dominate most of the output, make the critical decisions, and are able to enforce their policies throughout the market or markets in which they function.

As my colleagues have suggested, we have in these industries a kind of "spontaneous coordination" (the term is not mine), something which the lay observer regards as the equivalent of collusion. For example, in 1956—and this example, I might say, is also in Professor Adams' statement—the Ford Motor Co. initially announced an average cost increase on its models of 2.9 percent. Two weeks later,

General Motors increased its 1957 model prices by an average of 6.1 percent.

What happened? Did Ford hold on to its prices in order to increase its share of the market? It did not. A week later Ford revised its prices upward to match almost dollar for dollar the comparable General Motors prices. And Chrysler, I might say, later got in line.

To the outside observer this sort of conduct suggests it must be the product of actual collusion. It could be. I do not make any such allegation.

My own hunch, though, is that this typically stems from the structure of the market. When you have a rather small group of firms, each accounting for a significant share of sales, they tend, over a period of time, to get in step with one another.

I think you could draw analogies to international diplomacy. These firms do not want to, and they openly admit that they do not, consider price warfare a proper instrument of their diplomatic policy. They will compete in advertising, in corporate image, in product design, but not in price.

And this need not necessarily be the product of collusion. It is the product of the structure of the industry.

Senator BUSH. If they did compete in price, somebody is going to win, and you would have even a greater concentration, then, in the winner, than is disclosed in your table here; would you not?

Dr. BARBER. Well, there are, I think, two points to be made.

First of all, the kind of competition that I am looking for in price terms, Senator, would be the kind that would occur in an industry structurally competitive. In other words, I am not starting with the assumption that we would have two or three firms.

My second point is that I am not at all certain that we would have a winner. This seems to me to suggest that in some way we would have, say, an automobile company that could drive out all of its competitors. I do not think that is the case.

Senator BUSH. But the case has been made, here, that in the automobile industry they have driven an awful lot of them out. And they have it down, now, as you say, to where four companies control 99 percent of the business.

I remember 2 years ago there were an awful lot of automobiles.

Dr. BARBER. Yes; and a good bit of the disappearance of companies has come through processes of merger. Mr. Patman yesterday read into the record a statement of the number of mergers which General Motors had made over the years.

Senator BUSH. A lot of the mergers were a result of failures. They could not make a go of it, and so just sold out.

Dr. BARBER. In part. But some are important acquisitions, such as those of Fisher Body and Chevrolet. I think this point may come out as we proceed along, because I know we are short of time.

The situation that I am outlining here, in terms of the lack of price competition, the lack of aggressive pricing action, the refusal to consider this an appropriate instrument of policy, has, it seems to me, very serious implications insofar as broad economic movements are concerned, particularly on the downside. When a company adopts, as a formula, a target of 20-percent return after taxes

on invested capital over the long run, at 70 percent of capacity, what happens when you get a recession? What happens when demand slackens?

Well, sales begin to fall. Employment declines, as do profits.

Under these conditions, one might normally expect that a firm would make some downward adjustment in prices to offset these unfavorable short-run factors.

But if you have a target formula, your response is: "Well, we expect this. There will be good years, which will offset our bad years, and we are not interested in maximizing our return over a year period, or even a 2-year period. We are interested in gaining a certain return on our investment over a long period time."

Consequently there is a sort of a built-in stability factor, insofar as price is concerned.

And I think another important thing to recognize is that the ability of companies to stick with this policy, once they have defined it, stems from the concentrated character of the industry.

Well, against this background of the structure of these concentrated industries, how does our public policy shape up?

First of all, we have to turn to the antitrust laws and see how they are being enforced. Here, as I indicate on the first page, and also in more detail within my prepared statement, I find a highly unsatisfactory performance.

I think the laws are being enforced at the present time in an extremely conservative and cautious fashion. And what activity that does take place is unlikely to have any significant impact on existing concentration levels.

I direct attention to the fact that in the calendar year 1961, of 60 cases that were begun by the Department of Justice's Antitrust Division, 28 involved so-called per se violations, most notably price fixing, bid rigging, and such. Of course, these are clearly unlawful arrangements; they should be punished; they violate the law.

But the question I have is whether we should be putting as much emphasis upon this sector as we are, to the great lack of interest we are displaying in other kinds of problems.

Note also that 19 cases were directed against mergers, an important area of activity, but one which does not usually have the effect of achieving any lower level of concentration. Antimerger litigation is essentially preventive in nature.

The predominant enforcement attention, therefore, is being devoted to kinds of cases that deal with new developments, like proposed mergers, or with manifestly improper kinds of activity, like price fixing. Such kinds of cases should be undertaken. But I ask whether it would not be wiser to devote relatively greater attention to other kinds of issues, those presenting more fundamental economic issues.

And as I look at the current year, I find that the number of cases and the volume of work that the Antitrust Division is doing is declining. Last year, as I noted, the Department of Justice filed 19 anti-merger cases. So far, during this year—and this includes to date—the Antitrust Division has filed six cases.

Examining the list of industries involved in offenses in the per se area, which includes such "vital" product markets as venetian blinds,

the sale of kosher food products in New York City, ice show productions, and service station prices in Washington, I cannot help but think that we are allocating too high a proportion of our resources to triviality, and that we are not dealing with the more important sectors.

Indeed, Assistant Attorney General Loevinger, who testified here yesterday, admitted as much, in June, in an interview with Anthony Lewis, a reporter for the New York Times. In that article, an unidentified official of the Division was quoted as saying:

It is probably true that we are affected by business uncertainties to the point where we are holding up cases with a novel or uncertain legal approach. We are sticking pretty much to the predictable, to the established lines.

I think that well characterizes current activity of the Antitrust Division; it is not going to rock the boat. The Department of Justice seemingly is more interested in preserving business confidence than it is in carrying out the law and deconcentrating industries which, as we have noted, present some very real economic problems.

And if you look at the Federal Trade Commission, the other half of the antitrust enforcement team, you find the same kind of situation. In fact, I regret to note that the Commission appears to be doing less well than under the prior administration.

Indeed, so much of its work is concentrated on very minor offenses, technical violations of the textile-labeling law, for example, that it has prompted one member of the Commission, Philip Elman, to say that there is in effect here—

a kind of Gresham's law, where the trivial and inconsequential cases leave little room for and tend to drive out the substantial and significant.

What we must recognize is that neither of the two principal anti-trust agencies, the Federal Trade Commission and the Department of Justice, is doing a very aggressive job, a very imaginative job. Essentially, they are riding along, attacking the occasional overt and unquestionably evil cases, but not doing anything that will de-concentrate important industrial sectors.

Let me mention briefly the role of another group that is involved in this field, namely the Federal administrative agencies. I will make these remarks very short, but I do think it is important to recognize what has happened.

Congress has deeded to these agencies the authority to regulate a number of important industrial sectors which originate probably about 15 percent of our national income; and of course these are vital industries, mainly possessing the character of utilities, transportation, banking, and so forth.

The theory, of course, was that the agencies would substitute effective economic regulation for the absence of competition. Well, as it has turned out, the agencies, I think on the whole, have encouraged monopoly, on the one hand, and on the other hand have not accomplished effective regulation.

Typically, these agencies encourage merger, as is being done at the present time by the Chairman of the Civil Aeronautics Board, and do nothing effective in the way of regulating rates and other behavior.

This is why I think so many people believe that the attempt to justify the telstar proposal, on the ground that the FCC will regulate its economic implications, is little more than humorous.

Now let me turn to another area, that of Federal Government procurement. And I want to spend a bit more time on this, though the hand of the clock moves much too rapidly.

Here is an area, I suggest, where the Federal Government can have a strong impact, either on increasing concentration, preserving existing levels of concentration, or encouraging freer competition.

Well, what is it doing? We know that the Federal Government's position in terms of procurement of goods and services as a percentage of some figure, such as the gross national product, is rising. It now makes up about 11 percent of the GNP, for example. Within this category, we find that the share absorbed by the defense agencies is large, and has maintained this position for a long period of time. For example, in the fiscal year 1961, the Department of Defense alone purchased over \$25 billion worth of goods and services.

Senator BUSH. What percentage of that?

Dr. BARBER. The percentage of allocations for national defense. Let me give you a figure at an annual rate based on the second quarter of this year; that would be about 9.6 percent of the GNP.

Senator BUSH. No. I was speaking of the total Government. You said they did \$25 billion. What was the total Government procurement?

Dr. BARBER. In 1961, the Federal Government's purchases of goods and services were \$57 billion.

Senator BUSH. So it is a little less than half?

Dr. BARBER. That is right.

Now, within this defense sector, I want to look specifically at the procurement of research and development.

Research and development outlays in the economy as a whole constitute one of the most important and most dynamic items.

On page 17, I am reading, now:

Between 1953 and 1961, for example, while the GNP was rising only 43 percent, outlays for research and development from all sources rose by about 300 percent. Even more recently R. & D. has been accelerating at a faster rate than most other sectors of the economy; from 1957 to 1961, the gross national product went up about 18 percent; research and development outlays by about 50 percent.

Indeed, in the year 1961, the best available estimate indicates that \$15 billion was spent on R. & D., from all sources. But within this broad picture one must sense that the Federal Government plays the dominant role.

If you will look at table 1 of the appendix to my statement, at the end of the paper, you will see this. For the period 1960-61 that of a little over \$14 billion that was spent on performance of research and development, the Federal Government put up 65 percent of the money.

But if you will look down across the bottom, to the lower line, you will see that the Federal Government transfers the bulk of its research and development outlays to industry, to private performers, with the result that industry, though it provides only about 32 percent of all funds for R. & D., does 75 percent of the work. An image thus appears of the Federal Government playing a very large role in this picture, transferring most of its funds to the industrial sector.

Looking at the broad panorama of research and development in the economy, we see that the great preponderance of the work is done by a very small number of firms.

Looking at the bottom of page 17, I note that in 1959—and that is the last year for which really good detailed information is available—the 406 companies with 5,000 or more employees, 3 percent of the total number of firms with R. & D. programs, accounted for 86 percent of aggregate R. & D. activity.

Senator BUSH. That is 5,000 or more employees per company, is it not?

Dr. BARBER. That is correct, Senator.

You will find not only that the performance is rather highly concentrated, as that figure indicates, but if you will turn to page 18, while the 100 corporations with the largest R. & D. programs accounted for 81 percent of aggregate research and development, these same firms accounted for only about 41 percent of total sales within their respective industrial categories.

In other words, you have a situation in which there is a significant degree of concentration, anyway, but in which, in the performance of research and development, the concentration is far more accentuated than it is generally.

Now let me turn to the role that the Federal Government plays in this picture.

Senator BUSH. Is that bad, or good?

Dr. BARBER. I do not wish to draw a judgment on it. I am only reporting it and raising the point. But I do think it interesting when you find that a smaller number of companies do a larger percentage of the work in this area than they have of sales or production.

Let me go back here and point to this statement of the former Attorney General, Herbert Brownell, who, in reviewing this problem and commenting on it in 1956, said, and this is on page 15 of my statement:

The disproportionate share of total industrial research and development in the largest firms may foreshadow a greater concentration of economic power in the future. An adequate supply of technical manpower is the first prerequisite to any research and development program. Such programs themselves are basic factors in the development and expansion of our business economy. Therefore, a present concentration of such manpower and programs means that in the future an increasing share of anticipated improved technologies and new product lines will be introduced by the industrial giants.

In other words, I think we are looking at a situation whose long-run consequences, while now not clear, can be very serious.

To return to the role of the Federal Government, I have noted that in the period 1960–61, the Federal Government put up about two-thirds of all funds spent for research and development in the United States.

Of that amount, the preponderance came from the Department of Defense. If you will look at the budget for the fiscal year 1963, as submitted by the President, you find that anticipated expenditures of \$12.4 billion are reported, up from \$10.2 billion in the prior year.

Of this \$12.4 billion, about 58 percent stems from the Department of Defense, another 19 percent from NASA, and 11 percent from the AEC.

The Department of Defense is thus the most important source of funds. And what does it do with its money in terms of allocation among business units?

Well, you find that in the fiscal year 1961, looking at Department of Defense data, small businesses, defined in the usual technical way, received only 2.9 percent of total awards for EDTR, which is the military terminology for R. & D. And you can take a look at this in more detail, if you wish, in table 3.

I think it worth emphasizing that this is far beneath the share that small businesses get of so-called hardware purchases. In that sector, their relative position is much more significant than it is in R. & D.

This R. & D. performance, if you look at table 3, has been declining for the last several years. For example, small business received as its share of Department of Defense allocations for EDTR, 5.7 percent in 1956. And then there is a steady decline, so that in the 9-month period ending with March of this year it was only 2.6 percent.

Senator BUSH. How about the absolute figures, though—the dollar figures?

Dr. BARBER. I can give you the dollar figure, Senator.

Senator BUSH. Has that declined, or not?

Dr. BARBER. Well, I can get them for you, but we can make some estimate from the fact that we have \$6,023 million for a total in 1961; and we can also give you the detailed figures.

Senator BUSH. If I read it correctly, the total EDTR went up from \$2.4 billion to \$6 billion, and the small business percentage went from 5.7 down to 2.9. That would indicate that they went up in dollar volume, although the percentage declined.

Dr. BARBER. Yes. In dollar volume, in the fiscal year 1956, small business firms received \$137 million for this function. In fiscal year 1961, they received \$161 million. But note that total procurement during that period was rising, as you have pointed out, from \$2.4 to more than \$6 billion.

Senator BUSH. In other words, they did not go down absolutely, but they went down relatively.

Dr. BARBER. That is right. Let us say they are continuing to get a very small piece of this business, a smaller piece than they get generally of military procurement.

In terms of allocation among companies, we find a very highly pronounced concentration. Eight corporations, for example, in the fiscal year 1961 accounted for about one-half of all allocations for research and development; and, indeed, one of those companies accounted for just about 10 percent. Twenty companies took three-quarters of all allocations for this purpose, and if we look at Federal programs generally, you will find that 300 companies took 99 percent of total outlays.

I will not provide the additional detail in which I am certain some of you are interested. I do think, though, it is worth noting that you have here a situation in which a rather small number of companies are getting the great bulk of the funds, that the concentration is more accentuated than it is generally in the economy, and far more than in aggregate military procurement itself.

Now, why is this so? I do not wish to burden you and I discussed some of the reasons for this in my statement.

But let me say this: That the Department of Defense—and I have looked into the question to some extent—has so designed its procedures that small firms simply do not have a fair opportunity to compete for R. & D. work.

I do not wish to suggest what the proper allocation is between big and small. I only say that the procedures now are so devised that the small firms do not have an opportunity to even go in and present their case to do research and development, let alone to get it.

Indeed, you will find, for example, that—and these are general figures—of all work procurement awards made by the Department of Defense, only about 36 percent were even publicized in the fiscal year 1961 and that is in spite of congressional efforts to secure both advertising and, if not advertising, synopsisizing. The great preponderance are not even publicized to small business.

Is it little wonder, then, when you find that only 16 percent of all awards for research and development made by the Department of Defense are made on a competitive basis, that only 3.2 percent are made on a competitive price basis? I think not.

Senator PROXMIRE. Where did you get that last? 3.2 on a competitive price basis?

Dr. BARBER. 3.2 percent of all research and development awards made by the Department of Defense in the first 9 months of the fiscal year 1962 were on a competitive price basis.

Frankly, I think improvements can be made here. I think that the longrun consequences can be serious. And I think it worthwhile not only going back to the provocative words of Attorney General Brownell, but also keeping in mind that the patent policies in this area mean that the person who does the work for the Department of Defense secures a patent on the work that he has accomplished with Federal money.

Again, I am not judging. I am only suggesting strongly that the longrun implications for both military procurement and the civilian sector are and can be of major consequence.

When we talk about policies respecting industrial concentration, we have to look at our own house. And I think that while the antitrust enforcement officials have been doing a very timid job, and while the administrative agencies have been encouraging monopoly, the Department of Defense has been engaging in policies that have as their very clear impact increasing levels of concentration, denying opportunities to smaller firms, and in this way tightening up the economy, rather than loosening it, as the antitrust doctrine would seem to suggest.

Senator PROXMIRE. Thank you very much.

Now, I would like to commend you gentlemen on very provocative statements, and very helpful and useful statements.

I am somewhat concerned, though, as to what we can do about it. Mr. Kahn said he did not like to tilt with windmills, and frankly, I feel that to move ahead on this front at all, windmill tilting is one of the few things available, it seems.

For example, the last argument that you made so well, Mr. Barber, that here is an area that you think we can do something about, because this is within the control of Government. However, I am chairman of the Small Business Subcommittee of the Banking Committee,

and we have set-asides for small business, and the President of the United States, early in his administration, directed the Secretary of Defense to see that small business gets a better share of the procurement dollar.

We have done all we seem to be able to do to persuade the procurement officials to do this. We have had them up before this committee, before the Select Committee on Small Business, before the subcommittee of which I am chairman, and gone over and over again with them these procurement procedures they have, without very much success.

Now, when we get into the other area, that you other gentlemen are talking about, we are really up against it. And it seems to me, frankly, that we have to recognize that we are going to have a considerable concentration of economic power in American life, and I think it is going to increase. I think it is going to increase rather sharply. Maybe we can do something about holding down that increase.

One area, obviously, is space. Now, in space, we have the biggest increase in our budget this year, \$1.7 to \$3.7 billion. We had a speech yesterday, a very fine speech, by Senator Cannon, on the floor, in which he pointed out that the military possibilities of space have not been exploited by us.

And I think that this speech is going to catch fire to some extent, and we are going to increase our military expenditures in space.

Fortune magazine estimated space is going to have the impact on our economy within the next 4 or 5 years that the automobile industry has had—very severe and very substantial. But it also emphasized that this is going to be a concentrated impact, that a very small number of firms are going to do the overwhelming amount of work that is going to be done. I think they said something like seven firms are going to do virtually all of it.

R. & D. is the same kind of thing. The big firms have a tremendous advantage in handling research and development work.

The question I would like to ask you gentlemen is this: Recognizing that we have this concentration in industry, and we are probably not going to be able to break up United States Steel or General Motors, although Mr. Romney makes a pretty good case for breaking up General Motors, I am not sure we should follow the suggestions you gentlemen offer.

For example, Mr. Kahn hit hard at price supports for farmers, and at the possibilities of some kind of fair trade for small businessmen to permit them to have a fair margin.

I am inclined to think that this is one area where you will have success, because these people are politically very, very weak, in spite of popular opinion to the contrary. The farmers' political position has been deteriorating very rapidly as the farm population has dropped. I think there is every chance in the next few years that we will abandon the price support system, and then farmers will really be up against it.

Small business has been in serious trouble for the last decade. We had dramatic statistics yesterday that I put in the record from the *New York Times*, showing that in New York retail proprietors had dropped from 153,000 down to 66,000.

I think if we pursue this kind of theory that you gentlemen are offering us, we are going to end up with a greater concentration than we have now. You are going to get big farms, the loss of the family farm; the Mom and Pop store, which is in trouble, anyway, is going to be replaced by supermarkets; and I am just wondering if the very great thought and clear authority which you gentlemen have in this field is not misdirected, because you are not recognizing the grim political and social realities of life, and not tailoring your advice to us to see what we can do about bringing a greater measure of justice for all of our people in the kind of economic situation in which we are living.

Mr. Kahn, you talked about tilting with windmills. Did you want to go ahead?

Or Mr. Adams?

Senator BUSH. Mr. Chairman, may I first ask what the plan is for the rest of the day?

Senator PROXMIRE. If you would like the panel to come back, perhaps we can arrange that for this afternoon at 2 o'clock. If not, I thought we would go through and try to finish about 1 or so.

Senator BUSH. I cannot stay. It has been a very interesting morning, with very excellent statements. I am very much interested in hearing, now that all of these criticisms have been made very clearly, some of the answers, some of the cures for our problems, if we can, this afternoon. That is what I would like to do.

Senator PROXMIRE. All right. Fine.

Would you gentlemen be able to come back this afternoon?

Senator BUSH. Could we set it as late as a quarter past 2?

Senator PROXMIRE. How about 2:30? Is that all right?

Dr. ADAMS. Of course, Senator Proxmire, if you are correct in your diagnosis, then our qualifications are limited, because we have never met a payroll. We are impractical, abstract dreamers, as you have described us. I would like to dissent from that characterization.

Senator PROXMIRE. I have not characterized you as impractical dreamers by any means. I think the best qualification I have for the Senate is the fact that I taught briefly at Harvard; too briefly. I have the greatest admiration for your qualifications.

But I think I can ask you provocative questions without your feeling that I am trying to insult you at all.

Can you gentlemen come back at 2:30?

Dr. LANZILLOTTI. We would be delighted to.

Dr. BARBER. Yes.

Dr. KAHN. Of course.

Senator PROXMIRE. Since I have asked this question, why do you not go ahead?

Dr. KAHN. I would hate to leave it hanging, Senator Proxmire.

I think in some measure, you are summarizing what I had in mind when I said that I was not interested in tilting with windmills. I was talking at that point about the prospects of fundamentally altering antitrust policy as a means of breaking down major concentrations of economic power.

And while I agree with what you suggested, that I think the country probably would be better off if General Motors were broken up, and I think there is even less doubt that it would be better off if

United States Steel were broken up, I see no prospect of accomplishing it, either under the antitrust laws as they now are formulated, or as I see any prospect of them being reformulated. So to that extent I do agree.

It was for that reason that I made a number of other kinds of suggestions, which fall really into two parts.

One kind of suggestion, with which I think you do have some disagreement, and I know Professor Adams, too: that is, those suggestions among the many which would bear most heavily on small businesses and on agriculture.

And I want to say just one word about that, and then mention the second, that there are many of the other suggestions that I think are essentially neutral as between what they will do to small business on the one hand and big business on the other.

Taking the easier ones first, I do not see any excuse for a tariff on automobiles at all. Now, we do not have much of a tariff. It is pretty low. As I understand it, it is 7 or 8 percent.

Dr. ADAMS. 8½ percent.

Dr. KAHN. 8½ percent. Well, it ought to be zero.

The same thing is true of many chemical tariffs. In many cases you can get an argument, you see, on national defense grounds, and so on, but shifting to the case of quotas on oil, I see virtually no relationship at all between the explicit statements of the military about the extent to which we have to protect our domestic oil industry, and what, in fact, we have done.

The Defense Establishment used to say, "We need something like one million barrels a day of shut-in capacity in the oil industry, protected." We have over 3½ million barrels a day of shut-in capacity now.

We have massive overinvestment in the industry, as you are well aware, encouraged by our tax laws, as well as by these import quotas.

I think, therefore, that if you admit or realistically realize that you are not likely to break up these larger concentrations of power, then it makes it extremely important to pay attention to these other methods of holding the power in check.

And I would think the reciprocal trade agreements program, and especially what the President is asking for, becomes terribly important in dealing not only with our dispersed textile industries, but also with our highly concentrated industries, like steel, automobiles, chemicals, and oil.

Senator PROXMIER. In your judgment, would the President's trade bill help us in meeting the problem of concentration in the oil industry to any significant extent? Would it enable us to get more competition, so that oil companies would not pump 8 days a month and hold their prices up as they have, the most profitable industry in America?

Dr. KAHN. The President's program, I think, will have no effect whatever on the oil industry, because that seems to be handled under the ODM authority in the interest of national defense. And of course the trade agreement power that the President is asking for is power to negotiate with the Common Market countries, and our principal oil imports are from Venezuela and the Middle East and Canada. So I do not see much prospect that it will have any effect in that direction.

Now maybe there, as well, I am tilting with windmills, and I do not recognize the facts of American political life, that the oil industry is sacrosanct, that we will always have an oil cartel—I am talking about a governmentally enforced oil cartel—and there is nothing we can do about it.

I think if that is true, like Dr. Barber, I would say, "What are we shouting about?" Either we want price stability or we do not want price stability. If we want price stability, some prices are going to have to be permitted to fall.

Senator PROXMIRE. I do not mean to ask one question after another, but it seems to me we have a record.

The economic indicators here show that our wholesale prices have been stable for the last 3 or 4 years, and retail prices have not been increasing very much. They have not been increasing much in at least recent historical terms.

So in spite of this situation which you accurately describe, it seems to me that one way or another, somehow, we have achieved a fair degree of price stability, better than any other comparable country in the world.

Dr. KAHN. Exactly. But our unemployment has not dipped below 5 percent, except for 1 month, so far as I know, seasonally adjusted, in the last 3 or 4 years. And so I think it is fairly clear that we can achieve price stability if we want to keep the economy running on two cylinders.

Senator PROXMIRE. I see your point.

Dr. KAHN. The dilemma is: What happens if we really try to make a dent on this unemployment, which I think the committee itself has recognized is quite inadequately measured by the 5-percent figure?

There is all this part-time work, and there are a lot of people who just disappear from the labor force when jobs are not available. I think the committee itself estimated that probably we have something more like 8-percent unemployment than 5 percent.

Excuse me, Mr. Adams.

Dr. ADAMS. I just wanted to add a footnote.

We have maintained this price stability you talk about, Senator Proxmire, partly at the cost of significant unemployment, and partly at the cost of maintaining world markets. Now, if you examine the share—

Senator PROXMIRE. Cost of maintaining what?

Dr. ADAMS. World markets. We have priced ourselves and designed ourselves out of world markets.

If you look at the U.S. share in industry after industry in the markets of the world, you will find that the U.S. share is falling.

Senator PROXMIRE. Well. In spite of that, I just put in the Congressional Record an hour ago, when I went to the floor, the report in the Washington Post this morning that in the first half of this year our trade surplus, our favorable trade balance, went to \$5 billion on an annual basis which is phenomenal, it seems to me, and it showed, the analysis of statistics shows, that much less than half of that is accountable by foreign aid and that kind of thing.

And this, it seemed to me, is an indication that we are doing pretty well, really.

**Dr. ADAMS.** In absolute terms, yes; but we might and perhaps we should be doing much better than we are.

**Senator PROXMIRE.** If we do much better, what are the other countries going to do? To the extent our trade balance is favorable, trade must be unfavorable. They cannot continue forever with their unfavorable balances of trade this big, unless we are going to continue our foreign-aid program indefinitely.

**Dr. ADAMS.** I think the latter prospect is a good one, if we talk in terms of reality.

**Dr. KAHN.** Yes.

May I say a word about the balance of payments?

It is perfectly clear that it is an oversimplification to say that America has such a seriously deteriorated competitive position in world markets that it is unable to sell. The facts just do not bear that out. As you have pointed out, we have consistently run an active or favorable balance of trade. But we must remember that one major reason why we have done so is that we have poured out dollars to the rest of the world in various foreign aid, military expenditure programs, and the like. And I am sure that if we reduce those, our exports would decline correspondingly.

The critical question, as of course you are well aware, is: What is the relationship of our favorable balance of trade in goods and services with our unfavorable balance in these unilateral transfers? And there we have run a consistent deficit.

In other words, our balance of payments remains negative by a kind of basic core of about \$2 billion.

**Senator PROXMIRE.** Well, that is probably because of what you gentlemen pointed out—I am not sure Mr. Lanzillotti and Mr. Kahn did—in the enormous investments that our corporations are making abroad, taking advantage of the market, labor, skill, et cetera. And that kind of private investment abroad has been very substantial.

The fact is that our trade balance has been favorable in spite of all these factors which you gentlemen have been talking about.

**Mr. Lanzillotti,** did you want to comment on this general question?

**Dr. LANZILLOTTI.** Yes, Senator; either now or after lunch.

I would not like to leave the impression that it is the consensus of this panel that there is nothing we can do about this problem of concentration. I think there are many things that we might consider.

I do not accept the conclusion which apparently has emerged here, that the level of concentration is uncorrectable. But let us assume for the moment that I did. This does not mean that there are not measures we might adopt to make these highly concentrated industries behave more competitively.

I do not have to accept these competitive bids that are identical. Even if we accepted this concentrated industry, I would like to pursue this question—even within the framework of concentration, what specific things might be done—after lunch.

**Senator PROXMIRE.** I think that is an excellent point.

I think on these competitive bids there is a lot we can do and should do and must do. I think we can get public indignation on our side. And the documentaiton, I think, you have done here on the chemical industry is extremely persuasive.

**Mr. Barber?**

**Dr. BARBER.** I would like to dispel the notion that in some way the antitrust laws as currently drafted, and as interpreted, could not be used, by someone with imagination and with vigor, to reduce levels of concentration. I think the laws could be used in a far more meaningful fashion than they have been.

The fact is that they have not been used to reach out to the problems that are disturbing you and us when we speak of the concentrated industries.

And if we need any documentation of that, I suggest we simply go back over the last several years—and by that I do not mean one or two, but I mean roughly on the order of 20 years—to find any case begun that had as its purpose the reduction of concentration in a major industry; the major cases in this field, Alcoa, Tobacco, Paramount, for example, were all decided in the early postwar period, but were begun long before that.

The fact is that we have not been trying. We have not been using the law.

I do not think we are tilting at windmills. I think we can use the law usefully to deal with these questions.

I say we have not been doing it. And if we want to talk sensibly about this, and meaningfully, then the proper thing to do is to say: Let us use these laws, or get them off the books.

**Senator PROXMIRE.** When we return at 2:30, I would appreciate it, if you would care to, if you would give us some specific examples.

For example, break up General Motors, break up U.S. Steel, something in the chemical industry, and so forth.

And then there is this other thing you might be thinking about, too: The bugaboo is that this will destroy business confidence and somehow significantly damage the economy.

And while that may be dismissed out of hand, I think we ought to consider whether or not there is any realism behind it. We saw what happened when the President acted with, I thought, great and proper force in the steel situation, and there may have been some adverse consequences there.

Well, I want to thank you gentlemen very, very much.

As I say, I am tremendously pleased with the competence of this panel, and I certainly did not mean, Mr. Adams, to imply anything about not meeting a payroll.

**Dr. KAHN.** He is just a very difficult character.

**Senator PROXMIRE.** I am looking forward to seeing all of you gentlemen at 2:30.

(Whereupon, at 12:40 p.m., the committee was recessed, to reconvene at 2:30 p.m., the same day.)

#### AFTERNOON SESSION

**Senator PROXMIRE.** I want to thank you gentlemen for coming back and accommodating us this afternoon.

I yield to Senator Bush to kick off this afternoon's questioning.

**Senator BUSH.** Thank you, Mr. Chairman.

I am sorry I had to leave at 12:30. I hope I didn't miss too much.

Senator PROXMIER. They were very good, but we adjourned at 20 minutes to 1.

Senator BUSH. I hope my questions don't provoke any repetition.

But going back to Mr. Adams, the question that kept recurring to my mind during your presentation, and especially towards the end, is what do we do about these things?

What is the antidote, what is the cure for the problems that you discussed in here?

For instance, you speak of the decline in American automobile exports, and the increase in imports from abroad, and no wonder that the percentage share of American automobile exports declined radically not only in Europe and the world at large, but also in the Latin American market at our back door.

What is your observation about those facts, and why did this happen, and is there anything we should do about that?

That is rather a pinpoint question and I want to get into the broader question in a moment; but I would like to have your comment on that particular matter because we are faced with this trade bill very soon up here; and this sort of ties into that in a way.

Is it your thought, Mr. Adams, that we should limit the export of capital so as to prevent further development of American industries in Common Market countries, for instance?

It seemed to me from watching this development over the past, I would say, 6 years, or 7 years, I remember making two speeches on the Senate floor, one a year after the other, I think, going back to 1956, in which I pointed out that unless the American manufacturers got busy and produced a small automobile to meet the demand that really existed here, that we were going to have serious trouble in the automobile business.

They took the view at that time that they couldn't do it. They said, "We can't do it" and "We just can't make a car to compete with them."

But after the large influx of foreign cars was stepped up as high as 800,000, at its peak, I believe, they did do it, and they have produced a pretty satisfactory answer to that problem and got it priced down to around \$2,000, and produced a very satisfactory car, made cars available to a lot of people who couldn't afford them before.

Also smaller cars relieved congestion in garages and highways and everywhere else so it shows they can do it.

But what is your feeling about this tendency on the part of that industry and others to go to the Common Market countries, particularly those countries, and establish plants over there?

Have you any comment about that?

**STATEMENT OF ROBERT F. LANZILLOTTI, ALFRED E. KAHN,  
WALTER ADAMS, AND RICHARD J. BARBER—Resumed**

Mr. ADAMS. Well, Senator, I should preface my remarks, and I don't want to make a speech here, by saying that I may be tilting at windmills but I am sufficiently old-fashioned to believe in the feasibility and the practicality of competition in American industry.

I think again, if we stick to the automobile industry, in 1909, Henry Ford sold some 12,000 automobiles at \$950 apiece.

Senator BUSH. In 19 when?

Mr. ADAMS. 1909.

Senator BUSH. Yes.

Mr. ADAMS. This is Henry Ford the first. In those days the traditional wisdom regarded the automobile as a passing fancy, a craze. The traditional wisdom including the Wall Street brokers said, "You will never sell many more automobiles than 12,000 no matter what you do about price."

But Henry Ford was an industrial radical. He disagreed with the traditional wisdom, and as we all know he turned out to be right and the smart money boys turned out to be wrong.

What was the Henry Ford philosophy, and this ties into the question that you raised with Professor Lanzillotti? Ford's theory was very simple: to cut prices and take a lower unit profit on a larger volume. Each price cut would bring new groups of consumers into the market.

With increased volume would come substantial reductions in unit fixed costs, and the possibility of realizing the economies of mass production.

Each successive expansion of output would make possible new price reductions which, in turn, would attract new customers, and initiate a new phase of the expansion cycle.

As Ford put it himself "Every time I reduce the charge for our car by \$1 I get a thousand new buyers."

Senator BUSH. Isn't that something like what they did in 1957, 1958, 1959, and 1960 here?

Mr. ADAMS. What the automobile industry did?

Senator BUSH. Yes.

Mr. ADAMS. No. Quite to the contrary, Senator.

Senator BUSH. Will you point up the difference?

Mr. ADAMS. Well, the difference is simply this: By 1957 the American automobile industry had become an insensitive oligopoly.

The oligopolists thought they could continue playing this game of turning out larger and larger cars at higher and higher prices to a captive American market.

Now, of course, Senator Bush, your statement on the Senate floor was prophetic. You could see what was coming, but the great executives in charge of our automobile industry couldn't see the danger signs, and eventually they priced themselves out of the domestic market, and they priced themselves out of the international market.

Now, as far as the companies' self-interest was concerned, the pain was minimized, in part, by the fact that they could export production to their foreign plants. But as far as our economy was concerned, the American economy was concerned, this was a painful experience.

Now, you say, "Should the companies be discouraged from investing in the Common Market?"

What I submit to you very respectfully is the thought that we are making it profitable for them to export investment dollars and jobs incidentally—

Senator BUSH. Yes.

Mr. ADAMS (continuing). Rather than American-made goods by affording them a tax haven overseas.

You know that the profits that General Motors makes at its operational plants in Germany are not taxed until they are repatriated.

This is one of the great tax loopholes, and I think something should be done about that.

Senator BUSH. You don't think that is the sole reason that they are attracted to producing in Europe, do you?

Mr. ADAMS. I don't think that is the sole reason; no. But I think it is a very important reason, Senator.

Senator BUSH. We had testimony before this committee last December when the general policy of this new trade bill was being opened up before this committee for a couple of weeks, and the facts came out that wage differentials were a tremendous factor in the manufacture of goods in Europe vis-a-vis the United States and at that time the Department of Commerce showed that the average wage rate in this country for manufacturing was \$2.29 an hour, whereas in the Common Market countries it averaged around 55 cents or something like that, and in Japan 28 cents, I remember, including fringe benefits, and it seemed to me, rightly or wrongly, this was a tremendous inducement for these people, as long as there were no inhibitions about the export of capital, to manufacture over there, to meet the demands in that market.

What is your thought about that? We are talking now about a very important matter which is this question of capital export. What is your observation about that?

Mr. ADAMS. Well, Senator, that wage differential, of course, existed for a long time. It existed in 1948, in 1950, in 1952, and 1954.

Senator BUSH. Yes; but the competition didn't exist.

Mr. ADAMS. If we look at the wage differential we find that it has been narrowing rather than expanding over the years.

It has been narrowing, I can assure you of that.

Senator BUSH. It has been narrowing very slightly, though. I mean ours is still going up, and theirs is going up.

Mr. ADAMS. And Senator, if I may continue, I think this committee is too sophisticated to miss the distinction between high wage rates and high labor costs. There is a difference.

We have always been a high-wage-rate country. This does not mean that our labor costs per unit of output are high. I submit to you, very respectfully, that the highest cost burden borne by American industry today is not high wage rates but the deadly burden of unutilized capacity. It is the overhead cost that is imposed per unit of output by the fact that our steel companies are operating at some 70 percent of capacity. I don't know what the automobile utilization of capacity is, but it certainly isn't full utilization of capacity.

The greatest blow we can strike for cost reduction per unit of output is to increase output and utilize some of the unused capacity in existence today.

Senator BUSH. I agree with you that is highly desirable. But on your point about costs versus wage rates, I mean the National Industrial Conference Board last year made some studies on that and came up with pretty good—I thought convincing—evidence, that while there is a difference between high wage rates and labor costs, that their findings were that in items where you have a high labor content in the cost, that this was definitely a handicap in connection with our export business and with our competitive position vis-a-vis the oversea manufacturers.

Mr. ADAMS. Senator, that has always been true, of course, in those American industries which had a high labor component. But we have traditionally been strong in the export markets, precisely in the mass production industries where the labor factor, where the importance of the labor factor, was a minimum element in the cost structure.

What is the labor factor in chemicals or in petroleum, or even in automobiles or in steel?

I think this is a vastly exaggerated issue, and I am not making any brief here for wage increases beyond productivity increases or anything of that sort.

I am not trying to defend the wage-price spiral in any way. All I am saying is that as a matter of national policy our objective in the concentrated industries ought to be to get the kind of structural organization that will allow the Henry Ford philosophy, the Henry Ford I philosophy, to become operative.

This will be good not only for the country; it will be good for the corporations themselves.

Senator BUSH. What do we have to do to do that, Mr. Adams? I mean, how do we get that structural position that you think is so needed then?

Mr. ADAMS. All right.

Senator BUSH. I think you are right, too. I am not arguing this with you, but only to develop this point.

I think we are facing a very serious situation here, and I am not saying that you gentlemen—some of you have said you think General Motors is too big. I think that is a question we have got to look at very seriously. But where do we go now to implement your thought? How do we correct this structure?

You have made a case—some of you have made the same case, really, that because of the structure they are able to set what you call a profit target or something of that kind, and that everything revolves around that.

Mr. ADAMS. Precisely.

Senator BUSH. What do we do? Is there anything that Congress should do?

Is there anything that the executive branch should do to meet this situation?

What is it?

Do you recommend antitrust legislation in addition to what we have? Two of you, at least, mentioned—Mr. Kahn did, and I think yourself, also; it may have been our friend, Mr. Lanzillotti—mentioned the enormous economic and somewhat monopolistic power of the labor unions. This was touched on in two or three things.

The thing I would like to develop this afternoon, with the tolerance of my good friend over here, is what do we do, what is your recommendation?

You pointed out what you think are the flaws in our situation and made a very plausible case, if not entirely convincing, but still I am impressed with it.

What do we do? What kind of legislation or what kind of executive action do you think should be taken on behalf of our Government?

It is a big subject and I know it is pretty hard to condense.

(Discussion off the record.)

Senator PROXMIRE. We are back on the record, Mr. Adams; go ahead.

Senator BUSH. Let's approach it that way, and anybody who wants to chime in and ask to yield, why let's do it informally, but see if we can develop it.

Mr. ADAMS. Being a devout antimonopolist, I don't want to monopolize the discussion.

Mr. LANZILLOTTI. We will compete if it becomes necessary. [Laughter.]

Mr. ADAMS. I think it would be quixotic to assume that a mere enforcement of the antitrust laws would be enough to achieve the objectives of competition.

I think, as various members of this panel have pointed out, that the Government, by its administrative, executive, and regulatory decisions creates a great deal of the concentration and monopoly that the Anti-trust Division is supposed to combat.

The Defense Department in one day can probably do more damage in the procurement field than the Antitrust Division could correct in a year.

But in the antitrust field specifically, I think the only way to attack concentration is by the old-fashioned method of dissolution, divorce-ment, and divestiture.

The way to eliminate a trust is to bust it.

This is trustbusting in the literal sense.

Now, you may recoil at that idea, and say, "Wouldn't it be terrible; what about the efficiency of the American economy, of American corporate enterprise?"

I would argue very respectfully, Senator, that intelligent trustbusting would enhance efficiency in the American economy.

For example, if United States Steel were broken into three separate parts, this would be good, not only for the steel industry, it would not only promote greater competition, it would be good for United States Steel itself.

I think it is an open secret that United States Steel is not the most efficient corporation in the industry. A single plant like the Gary plant in Indiana is bigger than the entire operation of the National Steel Co. put together, and nobody has advanced the argument that National Steel is an inefficient outfit.

My proposition would be: if National Steel is big enough to be efficient, why can't the Gary plant, standing on its own feet and divorced from 71 Broadway, New York City, do an equally effective job?

I am in favor of technological bigness, to preserve the efficiencies of mass production. What I am opposed to is corporate bigness which exceeds the requirements of technical efficiency. I think the same argument could be made with respect to General Motors.

The Chevrolet Division alone produces 25 percent, I think, of the automobiles consumed in the United States.

Would anyone seriously argue that Chevrolet, if separated from the General Motors family, would not be big enough to perform in accordance with the requirements of technological efficiency?

~~I doubt it. I have faith in Chevrolet.~~

Senator PROXMIRE. I have a Chevy, too.

Senator BUSH. Would the research and development program of General Motors be affected adversely by the kind of action that you suggest.

Mr. KAHN. Since I had made a note earlier, I have General Motors "research" and I put research in quotes, I think that the automobile industry is one of the best examples of the lack of necessity for giant-sized business for effective research and innovation.

I should ask Mr. Lanzillotti to support me after I make the general statement because he is the one who has done some writing on automobiles; but I have consulted people who work in the automobile industry and are acquainted with it and they have great difficulty in showing anything of major significance that has come out of General Motors research laboratory.

The development of the gas turbine, one has heard talked about for 20 years, so far as I know, it still is very far from realization, and if it is going to come at all, apparently, it is going to come from Chrysler and not General Motors.

I gather that something like automatic transmission systems was developed by an independent company in the industry, one of the parts manufacturers.

The rear engine, Europe. Air-cooled engines, Europe.

So far as I can see, in automobiles, at least, we don't get any significant innovation from the major companies.

All they do is devote their attention to putting mustaches on the backs of cars or then taking them off.

Truly, they have fallen into this insane cost-increasing method of competition in a way that you couldn't say that was true in electronics where obviously research was important and we might want to raise your question about drugs or chemicals but automobiles, I think, is a poor example of the necessity for centralized companies of the size of General Motors.

Mr. ADAMS. And the same thing is true in steel. In terms of technological progress, certainly, United States Steel, the largest company in the industry, has lagged and not led.

It is not the paragon of virtue in the field of research or innovation.

Moreover, if we can accept the testimony of T. K. Quinn, who used to be a vice president of the General Electric Co., in charge of the appliance division, the same holds true in the electrical field. He, at one time, sat down and detailed each invention in his particular division and showed that these inventions did not come out of the GE laboratories, but came from independent sources, which later became captives of General Electric through corporate acquisition.

Mr. LANZILLOTTI. I must correct you on that, Professor Adams, Mr. Quinn did indicate that the garbage grinder was developed in the General Electric laboratories.

Senator BUSH. That is pretty good, I will say, for that.

Mr. ADAMS. I will accept that footnote, thank you.

Mr. LANZILLOTTI. But not refrigeration and all the important developments—

Senator PROXMIRE. Why don't you have them all finish this question!

Senator BUSH. I was hoping that these gentlemen would comment on the general question.

Mr. LANZILLOTTI. The general point which Professor Adams is making is one I would like to support: That he believes we do have within the framework of section 2 of the Sherman Act the tool to do the job. My friend and colleague, on my right here, Dr. Barber, has said we haven't brought the imaginative suits under section 2 that might be brought.

Part of the difficulty, I assume, on the part of the antitrust authorities who might proceed via section 2 of the Sherman Act, or section 7 of the Clayton Act, is that the courts are not prepared to deliver the kind of divestiture, dissolution, and divorcement of which Professor Adams speaks.

If this is true, and I am not sure that it is, I believe that the Alcoa decision indicates that it is possible, if you give a sufficiently broad interpretation to monopoly power, then it would be possible to bring General Motors under that interpretation.

They are very close to that particular situation, in my view.

If the language of the law is not sufficiently specific as to cover this particular kind of situation, the conglomerate bigness of which Dr. Adams speaks, then I think we should have an amendment to section 2 which would run along the lines that any corporation, or "person" which has dominant power of the type that is being described here this afternoon, that has anticompetitive effects shall also be in violation of the Sherman Act.

In other words, what we would be driving at here is dominant power with anticompetitive effect.

That language is not now embodied in the Sherman Act.

We might specifically amend the statute along these lines. That is the kind of specific thing that I think we could talk about. I am sure there are other things, but I don't wish to monopolize the time and I will pass for the moment, if I may.

Mr. ADAMS. You see in the conglomerate field—I am sorry.

Mr. BARBER. I am confident we could attain a great deal more competition within our basic industries if we simply defined, as our objective, the attainment of individual concerns of the minimum size necessary to attain full technological economies.

Some research has been done on this question, because, of course, it is a fundamental one. I think none of us, certainly not I, want to, in some way, harm efficiency. If we need big companies or a company of a certain size to be optimally efficient, then I don't wish to go below that. But even accepting this as our standard, we could do a great deal more than we are without giving up efficiency.

Professor Joe S. Bain has studied a number of industries and he has reached conclusions consistent with this hypothesis.

A good argument, for example, can be made that in the automobile industry you could have 10 firms of about equal size producing automobiles under fully efficient conditions.

Now, I think that if we were to attain that sort of a situation in the automobile industry we would have a great deal more competition, more opportunity for innovation and I think we would find, based upon observations of similarly less concentrated industries in other parts of the economy, a good bit more price competition—not the sort

of thing that we would read about in classical economics, but certainly a great deal more than we have now.

Let me then for a moment turn to this question of whether we can attain this standard by utilizing the legal tools that we have available.

Well, first of all, it is important to say that the law here is not as clear, not as certain as anyone would like.

There are questions. But, having gone through this material on a number of occasions, I feel that the possibilities of using the law as it stands are much greater than they are typically portrayed by those who, when asked why they did not push harder, in defense say the law is inadequate.

For example, I found that Mr. Loevinger's statement yesterday exhibited a kind of cautious interpretation of the precedents that I believe he knows to be excessively conservative.

I feel that the law, including section 2 of the Sherman Act, section 1 of the Sherman Act, and there are some possibilities there, as well as section 7 of the Clayton Act, could be used to reach the oligopoly situation.

In addition, I think it well to keep in mind that the Federal Trade Commission has authority to enter this field.

It has not done so. It too has been unduly cautious.

I don't want to imply that there is clear sailing, that if we wished to start a suit tomorrow against a major company, such as General Motors, that the road markers would be clearly identified. They would not.

But I do think that the law is sufficiently clear, the outcomes are sufficiently optimistic from the Government's standpoint, so that a suit such as this should be and could be intelligently and reasonably initiated.

Indeed—

Senator PROXMIRE. Could I interrupt to ask—

Mr. BARBER. Yes, sir.

Senator PROXMIRE. Are you suggesting, Mr. Barber, that we might pass a law or we might try to adopt antitrust policy around the thesis that we should break up any firm or prevent any firm from growing to a size that would exceed the optimum minimum?

Mr. BARBER. I am suggesting this as a rough standard.

We need some sort of objective, it seems to me.

Senator PROXMIRE. If you had a situation in which you should decide that an automobile corporation which had half a billion dollars worth of sales, or maybe let's make it smaller than that—

Mr. BARBER. Let's put it in terms of the percentage of the market. I think this would be a more useful criterion.

Senator PROXMIRE. Well, except that varies a lot, it goes way up and way down.

Mr. BARBER. Productive capacity.

Senator PROXMIRE. I think that might be better because you are talking in technological terms and not in terms of market.

Mr. BARBER. Yes.

Senator PROXMIRE. You see that would be an entirely new approach, a refreshing idea.

Frankly, it is new to me. It might be very intriguing if we could adopt it but it seems to me we have a long, long way to go to get en-

forcement of what we have got, let alone get into a concept where we wouldn't let a firm grow beyond what you would call an optimum minimum of production facilities.

How do you prevent it?

What do you do if it is an efficient firm and—

Mr. BARBER. As a practical matter, I suppose, if we were to start on any such program today, that, first of all, we would want to prevent increases in concentration that would exceed estimates of this efficiency point, and secondly, begin to roll back to this efficiency point in those industries that are, (a) the most important, and (b), the most highly concentrated.

Well, as an example, I would think that if we were to adopt some such standard perhaps simply as a statement of policy, that a move in the automobile industry to break General Motors into four or five pieces would be entirely consistent with that standard, and would be entirely feasible and leave us entirely efficient operative units.

Senator PROXMIRE. May I just move ahead?

Senator BUSH. Yes.

Senator PROXMIRE. Did you want to comment?

Mr. LANZILLOTTI. I wonder if I could generalize this particular suggestion that Mr. Barber is making in the form of a question to the committee.

Would it be very rash or radical, do you believe, for us to have a working policy or amendment or philosophy, if you wish, that there would be a presumption of illegality, a violation of section 2 of the Sherman Act, if you will, if for a period of 5 years or longer, a single company persistently supplied more than 50 percent of a market or where, let us say, four firms supplied as much as 80 percent.

Now, that is a specific kind of question.

Do you gentlemen believe that any company should persistently supply more than 50 percent of a market?

This would take care of your cyclical factor, Senator.

Senator PROXMIRE. I would say a couple of things on that.

In the first place, I would say this is fine. It is good to get a specific suggestion because then we can really begin to discuss what we can practically do about it.

But you are getting away from the technological concept, which I think is a very sound one, into something else. I can envision a situation in which the market for some limited kind of commodity might be such that the technologically optimum production might be more than 50 percent.

Furthermore, it would seem to me that if you have this presumption, all GM does is they come to 50 or 49 percent, and they just tell their dealers, "You are out of luck, you won't get another shipment until January 1st." and this isn't very efficient, it is not very satisfying to anybody, especially those of us who like Chevrolets.

Mr. LANZILLOTTI. Senator, I am sorry that we are discussing this completely in the framework of General Motors.

I don't believe there is any desire to discuss the problem only in terms of this particular company.

But even General Motors, as much as it tries, its influence is so persuasive that it pushes over the 50-percent mark.

Indeed it is embarrassed by it. The story in the Wall Street Journal of several months ago (April) indicated, that pushing up to 58 percent this year was giving the corporation great concern.

Well, they themselves are conscious of their enormous power and their influence in this industry. I purposely raise it as a general question, leaving the presumption of illegality of this type to be rebuttable with appropriate kinds of evidence; namely, if there were impelling technological and technical reasons why a given company had to have that particular percentage share of the market, then I think we face another question.

If the technology of an industry is such that only one firm or two firms can most efficiently supply the market then we have another policy, and another philosophy which governs that situation; namely, public utility status.

That is the public utility philosophy. If there is a natural monopoly, technologically speaking, then this kind of an industry is a public utility.

It is affected with the public interest. That is why we have the regulated industries in our midst today. It is a very unsatisfactory solution, I might add, and I am very happy that the technological considerations are such in the industries of which we are speaking here this afternoon that it is not necessary, technically speaking, to have firms of such size that they supply persistently over half of the market.

Senator BUSH. I would just like to comment on this.

You have emphasized the importance of competition.

Mr. LANZILLOTTI. Yes, sir.

Senator BUSH. I can recall as long ago as in the twenties, that the question of mergers, mergers were inhibited at that time by the Department of Justice on the basis that they wouldn't approve a merger if it resulted in giving the larger company or the merged company more than 50 percent of the market.

That was a rule of thumb that was good at that time, I believe, and it stopped many mergers from taking place.

In other words, if Procter & Gamble wanted to buy a smaller soap company, but it had enough business to put it up over the estimated 50 percent of the market the Department simply wouldn't approve of it.

Now, I think that is all right and as far as I know that is still their policy.

Do you gentlemen know that?

Mr. LANZILLOTTI. Well, I am very glad, Senator Bush, that you brought this up. I know some of the other members of the panel—

Senator BUSH. Let me finish my point.

Let's assume it is still their policy and I think it is a sound policy, generally speaking, but once you have got a merger, and let's say you come up to 47 percent through a merger which may be a desirable merger because of any reason, let's say, let's say it is a good reason, I don't think you ought to set up any limit that would inhibit the growth of that merged company to where it might go on to get 54 percent or even 56 or 57 percent.

One of the things we want to stimulate is growth in this country, in industry.

Mr. LANZILLOTTI. Within a competitive framework.

Senator BUSH. Yes. That is right. But it seems to me that if a company is going to increase its position, let's say, from 47 to 55 percent, it is doing it competitively and somebody else is losing the business while they are getting it in a competitive market.

Senator PROXMIRE. I see Mr. Kahn and Mr. Adams are very anxious to get into this on growth.

Mr. Kahn, do you want to go ahead?

Senator BUSH. Everybody wants to get into it.

Mr. KAHN. Yes.

I, probably of the four people around this table, have been more concerned about the danger that you have raised about having the antitrust laws so set up that they will condemn a firm merely because of its share of the market, and it has seemed to me that this might inhibit competitive effort, in just the way that you are mentioning.

Senator BUSH. And growth?

Mr. KAHN. Yes, sir; precisely.

Not wanting to overstep the 50-percent boundary, I say that as a preface to establish the cleanness of my credentials.

Senator BUSH. Yes.

Mr. KAHN. Because it seems to me there is really an important off-setting consideration.

The people at General Motors themselves claim that they are constantly inhibited today in competing strenuously by their fear that they will get and maintain more than 50 percent of the market, and that, therefore, they will become targets of an antitrust attack.

Now, it seems to me that the answer to that contention is that General Motors really would be better off and the cause of really intensive competition would be served if the constituent companies of General Motors would be broken up.

There would be no hesitation in saying to Chevrolet, the Chevrolet Division of the company, "go out and compete as strenuously as you can; you only have 25 percent of the market; don't turn around and say to me, 'I am terribly embarrassed by my high-profit margins'."

This is just what the General Motors people say, "It really pains me terribly to charge so high a price, I could charge a lower price but the nasty old Department of Justice will get on my tail if I cut prices."

It seems to me the only way to free these companies to compete effectively is to cut them down so they don't fall afoul of this prohibition.

Now, the case of United States Steel is a perfect one.

Senator BUSH. So they can't cut prices?

Mr. KAHN. It is exactly what I want General Motors to do and they are not doing it. The tendency is when you have a very small number of firms dominating an industry and particularly if you have one firm with 50 percent, as you well know, to hold an umbrella over the industry, to hold an umbrella over prices. This was, of course, the historic policy of Judge Gary in the steel industry and from his point of view it was a great success because it is what saved United States Steel in the 1920 decision.

When the U.S. Government brought a monopoly suit against United States Steel, all United States Steel's competitors came in and said, "They are not hurting us, we love United States Steel."

Why did they love them? Because United States Steel held a high price umbrella under which the more efficient firms could enjoy fat profit margins and could grow more rapidly. It was the consumer who suffered.

That is why I think that the primary emphasis must be on market power.

Do we have the conditions for effective competition?

The technological consideration should be a way of rebutting, this is precisely what Mr. Lanzillotti has said, a way of rebutting the presumption.

The same thing about a merger. I would certainly say I can't think of a case by which a company could, by a merger, rise from 40 to 50 percent of the market and give me a convincing explanation that would be justified.

If it is so efficient let it grow and build plants but let it not grow the easy way by exchanging its stock with another company.

Mr. LANZILLOTTI. Please note in the other case you have new investments rather than mere transfer of ownership.

Senator PROXMIRE. I would like to ask you gentlemen, the myth and the reality here in this country is we believe in competition.

In Europe they follow a cartelized monopolistic approach. We have at least one distinguished U.S. Senator, a very, very able man, who has argued we have been too vigorous in the enforcement of our antitrust laws, and far more vigorous than Europe has been and this is one of the reasons why Europe is moving ahead, expanding, growing more rapidly, the standard of living growing, increasing more rapidly than ours.

I don't happen to agree with that, but I think that this does seem to be the case that they have not had a Sherman Act or a Clayton Act or antitrust policy generally as we have had it, and yet they have had a very remarkable growth, particularly in the last 10 years.

What is the answer?

Mr. Adams, I think you were talking about our position vis-a-vis Europe.

How about that?

Mr. ADAMS. I am always the leadoff man, and these gentlemen have more time to think.

Mr. LANZILLOTTI. We are just good counterpunchers. [Laughter.]

Mr. ADAMS. Well, I would point out that until about 10 years ago, the United States was unique as a country in basing its national policy on the antitrust philosophy.

We were the only country in the world that consciously tried to promote competition. It was 10 years ago that the Europeans decided that the cartel philosophy was the thing that held them back, and I think many souls over there have been saved by the productivity teams that came to the United States under the auspices of the Marshall plan and saw precisely the growth element implied in competition.

Senator PROXMIRE. Do you have any studies that indicate the degree of concentration in European countries as compared with this country in industry?

Mr. ADAMS. No. But you see, Senator, the mere creation of the Common Market has broadened the area within which competition

takes place, and this has automatically weakened the power of cartels and monopolies which were dominant in individual nations but which could not dominate the broader Common Market. If I may tie this to something that Professor Kahn said just a moment ago, the danger of concentration is that you get industrial statesmanship.

Corporate managers look over their shoulder. They try to act responsibly in the interest of their stockholders, their laborers, and the consumers.

I don't want them to do that. I want them to go out in search of profit. I want them to compete.

If we think back, I think it is fair to say that Adam Smith looked upon competition not so much as a technique for allocating resources, but rather as a technique for stimulating economic growth.

He felt that the concentrated mercantilist system stifled growth in Europe. By introducing a competitive regime, by dispersing and decentralizing the centers of initiative, Smith hoped to liberate the creativeness and the growth energies that reside in the entrepreneur, and thereby achieve national economic growth.

Of course, the experienced Europe in the early 19th century proved the wisdom of that policy orientation.

In the latter 19th century, Europe suffered a relapse and returned to the cartel system that stifled growth. Today I think the Europeans have again recognized the benefits of competition. They have taken a leaf out of our book and, I might say, they have done us one better. They are more competitive than we are today, to their advantage and our disadvantage.

Senator PROXMIER. I think that has to be documented, too. There is still a heavy concentration at least in some industries in Europe, is there not?

Mr. KAHN. There is.

Senator PROXMIER. Some industries are far heavier than it is here.

Mr. KAHN. And particularly if you take it by countries. But I do think this is terribly important, that the liberalization of trade in Europe in the last 10 years even before the Common Market agreement—you had national quotas imposed on importation of foreign goods, and under the OEEC program in 1948 you got the progressive liberalization of intra-European trade—the consequence was in real economic terms that you got a sudden massive deconcentration; in effect, a massive deconcentration of European industry.

Fiat had 95 percent of the Italian automobile market. Now Fiat has to compete like mad with Renault and Volkswagen, and it is this opening opportunity and mutual market interpenetration that has, I think, played a major role in the expansion of European industry.

May I make one other historical analogy that I think might be illuminating?

The first book I wrote was on the position of Great Britain in the period between World War I and World War II.

And I think it has particular pertinence today when Great Britain is trying to get into the Common Market countries. One major problem of Great Britain, which had been, as we have been, the leading industrial country of the world, with higher wages, higher living standards than were enjoyed by any of their major competitors, was that British businessmen had become sluggish. They had a higher

level of concentration than we have in the United States. They were conservative, they pursued policies for the most part of cost plus pricing which, of course, will sound familiar to you.

This is not a question of the fault of individuals, but a matter of historical evolution.

The U.S. manufacturers have in the same way enjoyed until fairly recently a wonderful position. They led the world in some of the most important growing industries, whether it was television or movies or automobiles, and on the basis of this headstart they fell into sluggish ways. I genuinely believe that is true. It is too sweeping a generalization but in too many industries it is true.

That is why I place so much emphasis on the President's proposal with respect to trade. Just as the salvation for England has to be found in exposing themselves to the competition and to the opportunities of the Common Market, so I think this is true of the United States in the 1960's. In many ways, there is such a parallel between our position and theirs: Our balance-of-payments problem, for example, is just like England's in the 1920's.

Senator PROXMIER. So we open a free world trade area just like the Common Market and including the Common Market and in doing that we tend to a sort of relative deconcentration to a very considerable extent.

This is another of your proposals and, incidentally, I think it is a practical one because I think we are going to pass this bill with some changes but pass it, and this may give us an automatic antimonopoly effect, at least an automatic increase in competition.

I would like to ask you about one other aspect of this that frankly troubles me a lot because I agree very strongly with you gentlemen, except I am concerned about what actually happened to this country in the depression of the thirties when we did turn not toward greater competition but as you said, we turned toward the NRA, and toward price fixing, and I can see why we did it.

It seems to me if you get too much of this competition, I can't say too much, if you get competition of this kind, under some circumstances it can be extraordinarily deflationary, particularly if you develop a situation in which labor unions become quite weak, it can result in wage cutting and as I think Mr. Kahn, you implied in your paper, we are not so sure it could not be worse than it is now.

Mr. KAHN. Yes. I think that is quite true.

If one is talking about a general economywide deflation and decline, I don't think most economists believe that the way to get out of a recession is to let prices and wages fall.

I agree with you completely. But I think we are at a juncture now where we are not talking about a general major depression or recession in which generalized price cutting leading to wage cutting leading to price cutting will just take you down, there is no bottom so far as I know to that kind of spiral.

We are rather at a kind of a critical point where we are growing but not enough.

Senator PROXMIER. This is a matter of balance really, isn't it?

We can't go all the way either, all the way. If we do go all the way with competition we are likely to get into a situation you can't exactly

call chaos, but very sharp cyclical movements that can be enormously destructive of human values.

Mr. ADAMS. Senator, I must dissent from this proposition.

I don't think that the NRA type of price fixing got us out of the depression of the 1930's.

The problem of depression in the 1930's was an inadequacy of purchasing power, and the way to get out of that depression was to get more purchasing power into the hands of people who would use it.

It is not by Government fiat artificially to raise prices that a country can solve the problems of depression.

The NRA was a hopeless fiasco. It was certainly not an effective antidepressive device and the more of that type of rigidity that we build into our economy, the more deleterious, I think, the effect would be.

I shudder at the thought that we would promote NRA types of cartels in any of our industries at any time.

Senator PROXMIRE. I am not saying we should do that. I am saying we have to recognize that if we should have this kind of vigorous, unqualified competition, which I think is most unlikely, but if we should have this kind of thing, that we might also have this kind of serious problem.

I wonder, you gentlemen are all familiar with Edward Chamberlain's book on the theory of monopolistic competition.

As I understand this book when I studied it it suggested that we have very imperfect price competition anyway, very imperfect price competition, because you don't have commodities that are precisely homogeneous with thousands of sellers selling precisely the same thing.

Under these circumstances that since almost everybody in the economy can limit their supply, whether he is the member of a labor union, a lawyer, a doctor, a big manufacturer, or a small manufacturer who moves under the umbrella of the big one you have to recognize we have this kind of an economy. Now, others in the society, to wit, farmers, if Government should step out, find themselves in a position of perfect and pure competition because what they produce is homogeneous and because there are thousands of sellers. Under these circumstances don't you have to have some protection for these people?

Without that don't you have a situation in which they are bound to be exploited, as farmers have been?

Let me just finish my statement by saying this and I would love to document if I had time how farmers have been exploited.

They work 12 hours a day in my State, they invest 40 to 50 thousand dollars per farm, they have enormously increased their efficiency three times as much as people off the farm have, they take a big risk and what do they get? Sixty cents an hour on the average, this is the average farm.

Mr. LANZILLOTTI. Senator Proxmire, I would like to comment on this statement you have made.

You touch on one thing. I would like to say I don't believe the small farmer is advantaged by the kind of farm program that is based upon high rigid price supports, as we have had in this country for quite some years.

The small farmer, I think as you well know, simply doesn't have enough production to benefit from that kind of a program. The farms that are advantaged by it are the large corporate-sized farms.

I happen to have lived in the State of Washington for 12 years where the effects of high price supports can be seen most vividly.

Senator PROXMIRE. Let me interrupt to say at this point we produce more milk than any other State in the Union. We export more than the next five States combined. I don't know a single corporate farm that produces milk in the State of Wisconsin, they are all family farms.

There are some large family farms that take four or five sons to operate them but not corporate.

Mr. LANZILLOTTI. I am speaking about the "basics." You don't have price supports in dairying that come under the basic price-support program.

Mr. ADAMS. Let's talk about the farm problem outside the dairy industry.

Mr. LANZILLOTTI. Very well. Outside of dairying. The point is this. It is not the small, family-size farms that benefit from the price-support program. The large corporate wheat farmer in the Polouse country of Washington, the Big Bend country, the Wheat Belt, for example, these are the ones who are benefiting because they have the acreage. The small farmer doesn't have either the funds or the land available to be purchased if he did have the funds. The large corporate-sized farms are the ones.

You mentioned the way in which the farmer was disadvantaged. One of the reasons why the small farmer is disadvantaged is through the impact of the concentration in the food and food-processing industries.

I made an analysis of these industries a few years ago, and you find all of the kinds of situations that we are talking about here in the food-processing industries. You have collusive pricing, you have mergers in food that are increasing more rapidly than any other industry in the United States.

You find joint ventures, and you have various types of collusive practices resulting from high concentration in these industries.

Conglomerate operations of which Professor Adams spoke, discretionary power of which Professor Kahn spoke, these are the things that are helping to put the squeeze on the small farmer.

Senator PROXMIRE. I couldn't agree with you more on food processors. There is no question they have all of the attributes of industrial operators. But I still maintain whether you are producing dairy products or hogs or beef or producing wheat, that most of our farms in this country are still family farms. There are some exceptions, and most of the production of our country is overwhelmingly in the family farming area and I have statistics up to here to establish that.

I have poured it into the Congressional Record now for 5 years. There is just no question about it. There has been a transition. There are a few areas where some of the corporations are operating in a big way, or big co-ops are. But by and large, our production is still on a family farm basis and I just want to say one more thing because I want to apologize to Senator Bush because I am off the point.

Senator BUSH. That is all right.

Senator PROXMIRE. I do want to emphasize here is one area where we have really shown the rest of the world the way and especially the Communist world.

We have family farming in this country and our productive efficiency is greater than in any other area of our production as compared with the Communist bloc. They are starving in China, they are starving in Cuba, they are tremendously disadvantaged in Russia because they have to take 50 percent of their people to produce their food.

In this country we are doing brilliantly with our farming. It is in the free, competitive, individual, independent area. This makes a strong argument for what you gentlemen are saying.

Mr. ADAMS. Precisely.

Senator PROXMIRE. But at the same time, I say pure and simple justice requires us to have some kind of a farm program which will give these people something.

If you do what the CED tells us to do and just take out the farm program entirely, as the Iowa State University, as the Department of Agriculture, as virtually everybody who has studied this has said, farm income will drop 25 percent.

Mr. ADAMS. Senator, all the panelists are suggesting, and I hope I am not being presumptuous in speaking for my colleagues, is that you save American industry from this kind of centralized, sovietized, authoritarian control which has failed in the Soviet Union in the field of agriculture.

Now, with all the strength at our command, we ought to avoid that kind of system in American industry. Certainly in agriculture we have tried to avoid that by maintaining a large number of competitors.

Let us do the same thing in industry. That is all we are saying, and I think this can be done feasibly, it can be done in accordance with the imperatives of modern technology.

Senator BUSH. Mr. Chairman, I am sorry but I have got to go at 3:30.

I just want to express my appreciation to the members of the panel for a very interesting day, indeed. I am sorry I will have to cut it off. It is very helpful and very interesting.

Senator PROXMIRE. Thank you so much, Senator Bush. I just want to ask a couple more questions. I want to thank you gentlemen, too, for being extremely responsive.

What alternative do our firms have—they are losing their export market—except to buy and build a plant abroad? I am thinking of a very fine firm in Wisconsin, Kearney Treaker, it exported in effect about 1,300 to 1,500 Milwaukee jobs over to England, built a big plant in England, took advantage of the fact their market was in Europe and wages are lower and so forth. No. 1, I am not sure necessarily this is a bad thing because this is still the free world being built up and we are building up their strength by commercial private investment instead of by impositions on the taxpayer, and No. 2, I just wondered what I would do or you would do, Mr. Adams, if you found yourself in the position of losing your export market and finding this marvelous market in Europe, with these great opportunities there, why shouldn't you invest in it?

Mr. KAHN. Since Mr. Adams raised this problem, I might say that perhaps there is a difference of opinion between us.

I certainly agree with him to the extent that this flow of capital abroad is encouraged by tax preferences, tax havens.

Mr. ADAMS. Which it is.

Senator PROXMIRE. I think that is right.

We have a proposition we are probably going to lose in the Senate a week or so when it comes up but I think that is true.

Mr. KAHN. Apart from that I don't think there is anything wrong with it.

Mr. LANZILLOTTI. I would like to inquire about that statement, Professor Kahn, whether you don't mean to recognize that these companies, by going abroad, still have a protected or captive concentrated market at home.

Now, if our own home market were free to have the encroachment from abroad in different forms, then I would have no objections to it.

But here is where they can have their cake and eat it, too. These companies need not fear the encroachment, the competition from foreign markets under protective tariffs or quotas or what have you in chemicals.

Senator PROXMIRE. We are inviting other countries to come in and develop their own industries in this country, and Japan said they would take us up on it but of course they don't have the capital.

Mr. LANZILLOTTI. I would suggest lowering our tariffs, and other trade barriers that Professor Kahn has alluded to earlier. You ask if there is anything wrong with our companies investing in plants abroad. No, I would support the notion and I would tend to support Professor Kahn provided we open our markets more to foreign competition.

Senator PROXMIRE. I would like to ask you gentlemen if any of you could tell me, if there is any substance, in your judgment, in the claim that business confidence would be badly damaged if we followed a policy of vigorous antitrust.

President Kennedy, whenever he runs across what to him is a puzzling and I must say is quite puzzling to me, criticism that he is antibusiness, says, "What do you mean, because we are enforcing the antitrust laws?"

He said that a couple of times, and I think that there may be a general feeling in the business community that if any administration enforces the antitrust laws vigorously they don't like business. Because of antitrust big firms have to be careful about growth and expansion and about building more plants and about hiring more people, and this may have an adverse effect on the economy.

How about that?

Mr. Barber?

Mr. BARBER. I think there is no question but that this is a serious problem. To my way of thinking though, it is a problem that is not limited only to this kind of question.

It seems to me there are many things which a Chief Executive or a political figure must take which are unpopular.

Senator PROXMIRE. I am not talking about the unpopularity but talking about what effect it is going to have on the economy, on employment, purchasing power and so on.

Mr. BARBER. I am getting to that.

Senator PROXMIRE. I think it would be very popular, incidentally.

Mr. BARBER. Well, here, I similarly have a question.

Senator PROXMIRE. Maybe we ought to divide it this way: If you are not a stockholder in a firm that is the target of antitrust prosecution, it probably is popular.

Mr. BARBER. That calls to mind the report that appeared in the Wall Street Journal the earlier part of this month which reported on a survey made by the Opinion Research Corp. of Princeton for 70 big—this is the Wall Street Journal saying—big corporate clients.

It was a cross-section survey of the population as a whole, and the persons interviewed were asked whether they thought one or two companies have “too much control” in the Nation’s largest industries.

It seems to me the results were rather surprising: 61 percent of the people answered “Yes,” and indeed 68 percent of the businessmen who were polled answered in the affirmative, a larger percentage than of the public generally.

But when you get down to more specific questions as to what you want to do, the initiation of specific cases, then the percentage of popularity of this may tend to decline.

When we consider the effect on the economic situation, first of all it strikes me that there probably would be some impact in the stock market but if we are going to ask the kind of longer run question what would be the impact ultimately upon employment, upon growth, upon income, the distribution of those incomes and such, then it seems to me there is a very strong case that greater competition would be achieved through a vigorous program and, as a consequence, you would attain a climate that would be more favorable to business.

So I think that the longrun implications of any such program would be distinctly favorable to the businessmen, to business opportunities.

From this point of view, therefore, it seems to me that the program is the kind that we should go forward with even though at the outset you would be bound to get a degree of hostility on the part of certain interest groups.

Mr. ADAMS. Senator, I don’t think, with all due respect, that the issue is necessarily a genuine one. In fact, it may be an altogether phony issue.

I think we ought to be aware of the fact that there was more vigorous antitrust enforcement under the Eisenhower administration than there has been under the Kennedy administration so far, and no one, to my knowledge, has considered the Eisenhower administration anti-business for that reason.

Senator PROXMIRE. I suppose that is right; and historically isn’t it true there was less vigorous enforcement under the Taft than under the Roosevelt administration?

Mr. ADAMS. Yes, sir.

Senator PROXMIRE. Because of Teddy’s fierceness, and so forth, he was labeled by many, at least, as a trustbuster, and Taft quite to the contrary.

Mr. ADAMS. Of course, again, if we refer to history, I think it is safe to say that Teddy instead of speaking softly and carrying a big stick, spoke loudly and carried a twig [laughter]; besides, I don’t think we should accept this argument that vigorous law enforcement

will undermine business confidence. If there is something wrong with the antitrust law, by all means take it off the statute books.

If the law is right, there is only one alternative you have, and that is to enforce it.

Mr. KAHN. I think additionally it is hard to imagine the institution within a very short period of time of a major effort. It takes a long time to prepare suits; it is hard to imagine the administration suddenly breaking out in the next 2 weeks with such a rash of major suits against all the leading companies in American industry as to have any such significant effect realistically.

Senator PROXMIRE. I understand that Judge Loevinger will be here tomorrow morning. He was here yesterday, and I wish you had been here before he had been, but we will get another crack at him tomorrow on the basis of information that identical bids are being released this morning at the Department of Justice building. I do want to ask, have the CAB, FCC, and ICC been contributing to economic concentration?

By and large they regulate industries which tend to lend themselves to a degree of great size and and to some extent real monopoly.

Also particularly ICC and CAB are regulating railroads, airlines which have had an awful lot of economic difficulty and trouble, and some of which have actually failed, and they have had the alternative and it is a very tough alternative of either permitting a merger or just accepting the failure with a terrific loss of investment, loss of jobs, loss of service for the public. Would you acknowledge that under these circumstances transportation being such a very difficult trial for both the railroads and airlines, that when they have permitted mergers, they have done so more on the basis of apparent economic necessity than any philosophy that we should follow a greater monopolistic concentration?

Mr. KAHN. Since I have to catch a train, may I say a sentence and leave?

Do you mind if I have the last word?

Senator PROXMIRE. You may.

Mr. KAHN. May I put in a plug for Professor Adams' book, "Monopoly in America, the Government as Promoter."

That is the first thing.

Secondly—

Senator PROXMIRE. Yes; I have heard very good things about that book, and I am anxious to read it.

Mr. KAHN. It is an awfully popular book, but still [laughter] the second thing is I am not so sure that the mergers are the major problem in transportation, as I argue in my statement.

The critical question is are we going to let the railroads compete or aren't we going to let them compete. To a large extent the efforts of the administrative commissions are to protect one kind of transportation as against another.

I am concerned, for example, about the effort of the coal industry to get pipelines built. I think this would be magnificent, this is a great technological advance, it is a way of cutting costs and we are running into opposition on the part of competing industries, so it seems to me in the interest of companies themselves, I think greater competition might be to their advantage.

The merger question I can see is a much more difficult one.

Senator PROXMIRE. Thank you very, very much, Mr. Kahn.

Why don't you go right ahead and we will just permit the others to answer and then we will wind up.

Mr. LANZILLOTTI. I think Professor Adams is best qualified to talk of this. Afterwards if you don't mind, I think we might come back to this question of acquisition and mergers and possible legislation.

Senator PROXMIRE. Professor Adams?

Mr. ADAMS. Well, I think that the prevailing concentration of power that you find in the American economy and certainly that you find in the regulated industries, is not something that is a God-given fact. It is not a law of nature. It isn't inevitable.

Senator PROXMIRE. To some extent it is. One of the panelists said a while ago that if an industry is going to have such a large proportion of monopoly we ought to regulate it. You ought to give them a public utility status, these have something of a public utility status, they are regulated.

Mr. ADAMS. That is fine; but most of the concentration you find, I think, is manmade, it comes of man and not of heaven.

Now, in the transportation field, I think there was some logic to regulating the railroads in the 19th century when the railroads had a monopoly. They fitted the category of natural monopoly, and regulation was set up to protect the consumer against this exploitative monopoly. Today, this situation has changed so completely, both in the passenger field and in the freight field, that the greatest single thing we could do in my opinion, as far as surface transportation is concerned, is to deregulate the whole industry. Have the ICC close shop and let the railroads and the trucks and the barges and so on fight it out within the limits of the rules set up by the antitrust laws.

Competition in this industry is perfectly feasible. It is perfectly feasible, both technologically and economically. Unfortunately, it is being artificially restrained by the Government.

As Fortune magazine put it some years ago, the Government has created a huge freight cartel, and that is precisely the situation we are in today.

Senator PROXMIRE. That is a very, very interesting suggestion. You are suggesting we just abolish the ICC and the CAB?

Mr. ADAMS. Well, no, in the case of the CAB, I think you have a few more problems.

But even on that score (laughter) if I may invite your attention to a historical fact, the progress that was made in air transportation came about largely as the result of the marginal competition that was offered by the nonscheduled airlines.

This was the stimulus for growth in that industry.

Senator PROXMIRE. Let me ask you, Is there support for your view to your knowledge in the industry?

For instance, Mr. Robert Young some time ago was an advocate of greater competition of various kinds between the railroads. Is there any figure in the railroad industry who advocates competition?

Mr. ADAMS. Senator, I think generally speaking, the people who hold a certificate—

Senator PROXMIRE. I don't mean this at all critically, but I am just wondering.

Mr. ADAMS. Those who hold any Government grant of privilege are obviously protecting a vested interest position.

Senator PROXMIRE. So many of these railroads are doing so badly, many of them are losing lots of money. We have one up in my State that claims to be losing \$1,500 a day and they are pleading with the ICC to have a chance to abandon their operation entirely.

Mr. ADAMS. I think they should be allowed to. Where a railroad operates and how it operates ought to be left to its own managerial discretion.

Senator PROXMIRE. Here is where you run into a really tough political problem because the people who use that service don't want to see it abandoned. They depend on it, they need it. They say it is the only way they can commute, many of them can't afford automobile transportation, or it is very inconvenient, and also, of course, you have literally thousands and thousands of jobs.

Now, in spite of the ICC we have lost all kinds of railroad service and railroad operation, and we are going to continue to. That makes it difficult.

Mr. ADAMS. If it is—well, if it is the judgment, the legislative judgment of the State legislature or of the Congress, that a particular type of service ought to be maintained even though it is unprofitable, then the only thing to do is to grant that kind of service an outright subsidy.

In that case you would know precisely what you are buying and how much it is costing you.

But to prevent competition in order to achieve this kind of protection, this is the most inefficient way of subsidizing an industry.

It would be analogous to saying to the carriagemakers in the 19th century, "We are not going to permit the competition of automobiles in order to protect the jobs and the investment you have made in your industry."

Senator PROXMIRE. Mr. Lanzillotti, do you want to finish off the ICC? [Laughter.]

Mr. LANZILLOTTI. I think Adams has taken care of that problem.

Senator PROXMIRE. Do you support it?

Mr. LANZILLOTTI. I support him on this; yes, sir.

Senator PROXMIRE. Well, we will have the ICC before us on Thursday at this rate. [Laughter.]

Mr. LANZILLOTTI. We face these risks rather repeatedly. You mentioned a point earlier about antitrust laws and business uncertainty. There was a very small point I wished to make on that particular problem, or dilemma.

We could reduce the uncertainty which faces the business community today in that area, and I think we should. I think it is unfortunate that we have so much delay in the decisions in this particular area of merger cases. I don't think it is good for the antitrust agencies program nor do I think it is good for the business community.

In other words, what I am saying is we need to cover more ground and cover it more rapidly in the area of mergers. The law has been on the books here now for over 10 years and while I am gratified with recent decisions, we have covered hardly no ground at all.

Business firms that wish to acquire or merge with firms find that the final decisions are not yet rendered, and I think we could adopt some amending legislation to expedite matters. For example, I would endorse the O'Mahoney bill, the one on prior notification, particularly the injunctive provision for the FTC.

I think this would be a very positive measure and it may be that we also could develop rules of thumb regarding the percentages that would be presumptively illegal if firms of, say, 20 percent or more tried to merge with some other firm, having say 10 percent, horizontally or vertically, that they would be illegal on their face, and the presumption could be rebutted with appropriate evidence.

These very suggestions would carry us into a new area—but I do think we could reduce business uncertainty about how the merger law is going to affect them if we did amend it along the lines that I have just indicated.

Senator PROXMIRE. Mr. Barber, do you want to comment?

Mr. BARBER. There is a great deal of merit to the kind of suggestions that Professor Lanzillotti has made, and which, among others, Professors Kaysen and Turner have developed in their books, "Antitrust Policy," which would set out guidelines and indicate in a given situation that firms proposing to merge or firms in a certain position shall be treated in a specified manner. I feel this would simplify the administration of the law and would go a considerable distance to help in achieving lower levels of concentration.

I recognize we can prolong this for a great period. But let me only suggest again that what strikes me is that while we have talked today about a great many aspects of this problem and about antitrust laws and possible changes in them, I fear that we may leave with nothing more than a long discussion.

I think what we do need are some specific considerations, proposals, and I can't help but think that if we are sincerely interested in this problem, that if we really think it is significant enough to devote even a day's hearings to, we should look at it a lot more closely and reach some determinations. Otherwise we have wasted a lot of time.

I think we have got to make up our mind at some point whether we mean it when we say we want to help small business, when we want to enforce antitrust policies, when we want to have free competitive markets and so forth, and that if we don't mean it then I think it would be well to use the resources we spend in this way on something more constructive, like the construction of fallout shelters or something. [Laughter.]

This brings me back to one point that you raised, Senator. I know you have done a great deal in the procurement area and have worked very aggressively and sincerely and have tried to improve the situation. But I do not share the conclusion that you came to earlier that it seems virtually impossible to do anything about it. I think things can be done about this. I think they should be done. But I agree it is going to take some very close hard prodding at middle-rung military officials, not the top rung.

Senator PROXMIRE. Thank you very much.

As a middle-rung Senator we are going to have Judge Loevinger tomorrow who is below the President.

At least, in that sense he is kind of a middle-rung operator. But seriously, we are going to press him hard on these things. I think the suggestions you gentlemen have made have been extremely useful, many of them very provocative, and I think I would like to add to what Senator Bush said this has been a very instructive, enlightening, entertaining, and useful day, thanks to you.

Thanks a lot, and we will adjourn until tomorrow morning at 10 o'clock when Judge Loevinger will appear.

(By order of the chairman, the following statement is included in the record of the hearings, inasmuch as Professor Clark was not able to testify in person :)

STATEMENT OF JOHN M. CLARK ON THE RELATION OF INDUSTRIAL CONCENTRATION  
TO THE PURPOSES OF THE EMPLOYMENT ACT

Concentration may be defined as a condition in which a large fraction of the capacity and output of an industry in any given market area—possibly a majority, but not necessarily so—is produced by a small number of large firms. There may or may not be also numerous small firms, which may or may not be important factors, in the aggregate, in the behavior of the market. For a careful analysis, most of these terms would need further defining. It may be assumed at the start that concentration is not carried to the lengths of monopoly, this being a distinct problem and one for the antitrust laws. As to the effects of concentration on high and stable employment, it seems clearly impossible to make overall general statements that would be either accurate or useful. Some aspects of its effects are favorable, some unfavorable, all subject to modification by the setting of public controls and private policies, including responsibilities voluntarily accepted, in which industry operates. Thus the only useful diagnosis must take the shape of a discriminating analysis. This may begin with the conditions necessary or favorable to high and stable employment.

First and most basically important is a total volume of effective demand for goods and services, big enough to absorb our total productive power, with unemployment of labor limited to voluntary nonemployment plus a small percentage incidental to normal job shifting. Since productive power is continually growing, this means that effective demand must grow with it; and since such growth involves irregularities and uncertainties, and inequalities as between different branches of production, the minimum necessary allowance for job-shifting unemployment runs into the millions, even though a small percentage of the total labor force. Such unemployment should be temporary and transitional for particular workers, though persistent in the aggregate as a feature of a growing and mobile economy.

A second major requirement is that fluctuations in the economywide rate of economic activity—production, income, investment, and consumption—should be moderate, so that cyclical maximums of unemployment do not become unmanageably great. Whatever effect industrial concentration may have on this requirement will be in connection with any public policies bearing on cyclical stabilization of industry.

Thirdly, the same requirement holds for fluctuations in particular industries or products and the personal incomes of those deriving income from them, to the extent that these fluctuations affect the total incomes of these persons, especially workers employed in these industries, and are not entirely offset by job shifting, including supplementary employment, or in other ways.

Fourthly, as already indicated, there is need for adequate and enlightened policies minimizing the amount of necessary shifting to unfamiliar jobs, employers, or family residential locations, and aiding the shifts that remain necessary. The impact of technical progress means a reduction in the proportion of purely manual labor and a corresponding increase in the proportion of more highly skilled employments involving the superintending of more elaborate and effective technical, chemical, or similar applications of applied science, together with the planning, devising, and developing of these applications of applied science, and of the science itself. This includes the devising and developing of new or modified products, and of demand for them. This means a major movement "upward" in the proportion of occupations, toward those

with less exacting physical requirements and more exacting mental and technical requirements. And workers need facilities and assistance toward finding their places in this changing assortment of occupational opportunities.

Reverting to the first and most basic requirement, as I have said elsewhere ("Competition as a Dynamic Process," Brookings Institution, 1961, pp. 83-85): " \* \* \* the main requirement is that consumers shall spend a large enough fraction of their income so that \* \* \* voluntary savings will not be more than business will want to spend for investment to carry out the accompanying total volume of production. As an approximate rule of thumb, one might assume that this requirement will be met if we continue to spend for consumption the same fraction of our growing income that has marked the trend of our growth in the recent past. But if real income per capita increases by more than 20 percent in a decade, it is obvious that consumers will not simply buy 20 percent more of everything, or 10 percent more of some familiar things and 30 percent more of others. If production were planned on such a basis, much of the output would fail to find buyers and industrial contraction would result. To avoid this kind of failure \* \* \* calls for a combination of new products and improvements or elaborations of existing ones, the test being always whether the consumer can be persuaded to pay for the new products or the elaborations. This gives the advertising industry much work to do \* \* \*. And this raises the question whether advertising might perform the function that is here in question by merely misleading the consumers into buying what industry offers, regardless of whether it gives them any net increase in service values. To this the ultimate limit comes when consumers become too disillusioned to respond, but one must regretfully admit that consumers appear capable of absorbing large amounts of misleading salesmanship before reaching the ultimate limit of no response.

"What we want, of course, is an assortment of offerings that would embody our whole increase in productive power in products and values which, in the light of informed hindsight, we would judge to be worth their cost. This cost includes the cost of research and market exploration and of the selling effort necessary \* \* \* also the inevitable false starts and failures. \* \* \* Another side of the same coin consists of the losses suffered by producers whose products are superseded. Such costs of obsolescence are inevitable features of growth; whether we should judge them wasteful depends mainly on whether the superiority of the successful products represents enduring serviceability or the vagaries of taste or mere novelty. In the latter case, successive displacements might leave no residue of enduring consumer gain.

" \* \* \* there may be a limit to the rate at which our machinery for exploring and developing such things can find them and make them marketable. If there is such a limit, and if we reach it before we reach the limit of our productive power, we face an interesting question: Is it better for us to be stimulated into spending the excess of our potential income on wasteful, futile, and frivolous consumption, or not to spend it at all?" From the single standpoint of high and stable employment, the argument is loaded in favor of the conclusion that misdirected production is better than involuntary idleness, as Keynes suggested by his illustration of the building of pyramids. But any such course would be a confession of failure in the real task of generating demand sufficient to absorb rapidly increasing power of production and well directed to serviceable ends.

An equivalent for pyramid building, coming nearer home, might be what the present writer has called product inflation as a tendency likely to occur when giant firms in an industry are too few and smaller competitors are too few and too weak. A prime example would be the elaboration of passenger car models and the coolness of the Big Three to economy models, until a smaller competitor forced the pace. This tendency to product inflation is definitely connected with an unduly small number of giant firms, each of which lacks room enough to increase its physical volume of sales by a large enough proportion to increase its total net earnings by offering the buyers, competitively, a free selection of economy models at a corresponding saving (op. cit., pp. 252-257). Other examples of a slightly different sort might include the growth of extravagant packaging, and the exorbitant prices exacted for brand-name drugs, together with the extravagant methods of promoting their sales.

Reverting to page 85 of the work already quoted: "Suffice it \* \* \* that if any considerable fraction of the effort so spent yields cumulative improvements in our level of living, this cumulative improvement outweighs whatever fraction of our resources we devote each year to bringing it about. We should like to

reduce the wastes and increase the serviceability. But most economic students would prefer an economy actively energizing its productive resources and progressing annually, with an amount of waste motion, to one with less waste motion and less employment of resources or slower economic progress. The former represents the direction in which the institutions of market research and sales promotion are energetically steering the American economy."

The question assigned to this paper is the relation of industrial concentration to this whole process of absorption of productive resources. Since, let us say, the end of the Civil War, realized productive power has increased with remarkable steadiness, while concentration has been increasing. Even if figures for recent years should show some slowing down of the rate of increase, this could not clearly be traced to concentration itself as its responsible cause. The causes are more complex, and include protective responses of organized labor to the fear that the process known as automation is bringing an unduly sudden and rapid spurt in man-hour productiveness, of a labor-displacing kind and extent. Meanwhile the expansion of demand for products has not visibly slackened, but may be moving into areas of products requiring more creative imagination, both in services themselves and in methods of financing them. This includes health services and recreation activities and the uses of that leisure for the masses which is such a recent and such a transforming feature of our present economy. These areas of product innovation may be less obvious than those of the late 19th century, and the research and exploration called for are often in the fields of public or noncommercial action. In industry's particular field of marketable products, the advantages of the giant firm count heavily in some kinds of innovation; and emphasis seems to be shifting in this direction, as against the "multitude of small undertakers" to which Alfred Marshall, in 1890, attached decisive importance ("Some Aspects of Competition, 1890," in *Memorials of Alfred Marshall*, A. C. Pigon, editor, 1925, pp. 279-281).

Firms of any size can succeed in product innovation; but the most characteristic modern kinds stand a better chance if the innovating firm has size enough to combine the advantages of numbers and independence with size enough to be able to afford a department of research, engineering, and design, or at least to secure these services from a specialized agency. The more extensive operations of the big firms have wider coverage, especially where the big firm deals in diversified products, and this affords more chance for cross-fertilization of different innovating activities; also for the dovetailing of fluctuations of different products.

As to regularization of investment outlays, which are crucial for cyclical stabilization, the big concentrated firms have developed a tendency to program such outlays on an annual schedule, thus mitigating the irregularities which can result from the fact that single enlargements of productive capacity, by a giant firm, involve very large acts of investment outlay. Of course, such advance programing is modifiable, if requirements do not come up to the expectations on the basis of which the program was laid out; but in spite of this it appears to have considerable regularizing effect.

While we are not identifying concentration with monopoly, its effects on the character of competition call for attention. Competition is, in general, held to be favorable to high and stable employment, though not sufficient by itself to bring this result about. It may be, as some hold, that if the economy were more unmitigatedly competitive than it is, business recessions would be more likely to cause business firms to slash prices in the attempt to maintain physical output in the face of weakened demand, rather than cutting output and resisting declines in prices. Unfortunately, experts disagree as to which kind of price behavior is a better way of sustaining employment. "For maintaining overall demand, economists prevailingly hold that ruthless competitive slashing of prices is less effective, as well as more disturbing, than well-judged monetary and fiscal policies" (op. cit., p. 82. What follows is based on this passage, though not quoted verbatim).

Given the latter, and more moderate sensitiveness of prices, what competition can do is to help the economy to be flexibly responsive to adequate total demand, carrying out the mobilizations that will always be needed to place resources where they are called for by expanding productive power, and minimizing the pools of unemployment that may persist in an economy where there is not enough of this adaptable mobility. Social security and other security policies need to be so handled as to avoid creating obstacles to proper mobility; such as are created when retirement rights are of a sort which a worker sacri-

nces if he changes jobs. As I have said elsewhere, the economy would respond better if freed from undue rigidities of particular prices and wages. If price policies under industrial concentration are of this unduly rigid sort, they are unfavorable to the objectives of the Employment Act; but if they remain flexible and merely avoid unmitigated competitive price-slashing, they can involve helpful cooperation with other more positive policies looking to the stabilization of employment.

To sum up certain high-spot conclusions to which this brief and inadequate analysis points, there are some features of industrial concentration that can be unfavorable to the objectives of the Employment Act, especially if the surrounding smaller firms are too negligibly weak to introduce reasonable competitive flexibility and prevent undue price rigidity. On the other hand, there are policies facilitating the really very exacting shifting of occupations that is called for, which very large firms, leaders in an industry, are in a position to promote more effectively than the members of an atomistic industry.

(Whereupon, at 3:55 p.m., the committee adjourned to reconvene at 10 a.m., Wednesday, August 22, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

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WEDNESDAY, AUGUST 22, 1962

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representative Patman; Senators Sparkman, Proxmire, Pell, and Javits.

Also present: William Summers Johnson, executive director, John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will please come to order.

This is the concluding session of the committee's hearings on the state of the economy and on policies for achieving maximum employment production and purchasing power.

We have considered monetary policies, fiscal policies and policies for maintaining competition. Each of these policies is in some degree a substitute for the others. It would not be practical, it seems to me, to hope that we can solve all of our problems through improvements in any one of these policies, so the task ahead, it seems to me, is to try to achieve improvements in all three as well as in other policies and procedures of the Federal Government.

This morning we have a return visit from Mr. Loevinger, Assistant Attorney General in Charge of Antitrust.

Judge Loevinger, we had an opportunity to peruse your identical bid report yesterday afternoon and I think you are to be warmly congratulated, sir.

Previous Assistant Attorneys General in Charge of Antitrust have tried over many years to get systematic reporting of identical bids and failed.

I believe you have accomplished a very difficult task. I have been around Washington long enough to know that it takes time and experience to install a new reporting system where so many different agencies are involved and I would not expect that your first report would be perfect.

The important point is that you have made a good start and I have no doubt you will make improvements in future reports on this subject.

Judge Loevinger, you may proceed in your own way and after we have heard your comments members of the committee may wish to put questions to you. I assume you would like to discuss the identical bid report.

**STATEMENT OF HON. LEE LOEVINGER, ASSISTANT ATTORNEY GENERAL IN CHARGE OF ANTITRUST DIVISION, DEPARTMENT OF JUSTICE; ACCOMPANIED BY LEWIS MARKUS, CHIEF, ECONOMIC SECTION, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE**

Mr. LOEVINGER. Yes, sir.

Thank you very much, Mr. Chairman, for your kind comments.

You are quite correct in saying since this was a new venture, involving the handling of a mass of new data and its arrangement in a new way that we were, perhaps, a little slower than we might otherwise have been. That accounts for the delays in the issuance of the report which we had thought might have been available earlier, but for the difficulty in handling the data and insuring accuracy in the report.

It would not be fair to present this report to the committee or to the public without giving full credit to this committee and to its distinguished chairman, Congressman Patman, for the report itself.

The initial idea for the kind of reporting system upon which this identical bid report is based came from the Joint Economic Committee, which on March 14, 1961, adopted a resolution recommending that the President issue an Executive order relating to this subject matter.

Following a White House conference 2 days later the President authorized the chairman, Congressman Patman, and Senator Douglas to announce the President's intention to issue such an Executive order.

The Executive order, in fact, was issued on April 24, 1961, and the reporting system thereafter was instituted pursuant to the Executive order by the Department of Justice in cooperation with the Defense Department and the General Services Administration.

This report is the first report of its kind under this Executive order, and as I say is due, in large extent, to the interest and the stimulation of this committee and its chairman.

In presenting the report it probably should be noted also that it is not meant to say that identical bids are always necessarily illegal.

However, it is suggested that identical bids can serve as warning signs of collusion that may be violative of the antitrust laws.

We feel that the submission of identical bid reports gives the Department of Justice broader sources of information on which to base investigations of possible collusive bidding as well as indicating other areas in which there may be a lack of competition even though there is no actual collusion.

The program of reporting identical bids pursuant to the Executive order was actually initiated by the Federal agencies on July 15, 1961.

The actual reports, as is indicated in the text accompanying this report, were, of course, received later than that.

The Department has also invited purchasing officials from more than 2,000 State and local government units ranging from States to school districts to participate in this program beginning November 1, 1961.

The Executive order requires the Attorney General to consolidate the information furnished under the order in a report to the President and the Congress.

The first report is being released this morning at this time. Copies of the report have been made available to the committee, and I might mention a few of the highlights.

First, this is a preliminary look at the first 6 months of reporting by Federal agencies, and something less than 3 months of reporting by State and local governments.

Although the order has been in effect for longer than this period, the difficulties that I have mentioned have prevented the report from being issued more nearly currently with the cutoff date.

In the future we should be able to minimize this lag period.

Second, while a projection of the report's experience indicates that identical bidding affects only a relatively small percentage of total public procurement, the sample on which the projection is based is not reliable enough to establish this conclusion firmly.

Third, the report points up a number of sectors in the economy in which public procurement encounters price rigidities and these sectors are of sufficient national importance to warrant further scrutiny.

Finally, the report reveals that while identical bidding may be suspect of collusive agreement it may also be the consequence of factors unrelated to illegal activity which can be corrected by means other than antitrust enforcement.

The report suggests that identical bidding appears to be a significant public procurement problem in several broad product categories including asphalt road materials, chemicals, lumber, textiles, and compressed and liquefied gases.

In a large number of cases all bids were precisely identical as to price. In other cases identical bids were interspersed among disparity bids.

Sometimes the identical bids were the low bids creating problems of tie bid resolution for the procurement officer while in other cases the identical bids were below the low bids and were thus not in the area of competition.

The diverse factors which may be responsible for identical bidding suggest that a case approach is essential to determine the underlying causes responsible.

At one extreme identical bidding may be the result merely of unsophisticated procurement policies and procedures which tend to induce and perpetuate it.

At the other extreme identical bidding may be the result of conspiratorial agreement. Where the cause of identical bidding lies in procurement policies and procedures, remedial steps may be taken by new procedures designed to discourage the practice.

Where Federal or State laws are responsible for identical bidding action may be taken to recommend or legislate their modification.

Where collusive agreements among bidders are suspected the facts giving rise to such suspicions should be reported to Federal, State, or local law enforcement agencies which can then investigate and take appropriate action.

In markets where price competition appears to have been subordinated to other forms of competition, it is obvious that public procurement by competitive bidding tends to be frustrated and it may be necessary to introduce methods of procurement which will induce competition for public business.

The two principal objectives of the Executive order are first to publicize information with regard to identical bidding and advertised

procurement of Federal, State, and local governments in order to discourage future submission of such bids.

And second, to make more effective the enforcement of the anti-trust laws by insuring that the Department of Justice shall have information which may indicate any conspiracy in restraint of trade.

Assessment of the effectiveness of the publication of identical bids in discouraging identical bidding of future procurement must of course, await the reaction of identical bidders and procurement officials to this report.

The effect of such exposure will, of course, be measured by the reduction of the volume and the frequency of identical bidding in public procurement subsequent to the issuance of this report.

Such evaluation will, of course, be present in future reports to be issued under the Executive order. Although I do not have any sound grounds for saying that this must be so, I have a personal intuitive feeling that the relatively small percentage of identical bids reported herein is at least in part the results of the activities of this committee and of the Executive order and of the reporting system.

These activities and the issuance of the Executive order were well publicized substantially in advance of when the reports were to be gathered, therefore, there was time for a deterrent effect to be felt and this may be in part the reason for the relatively low incidence of identical bids.

It is premature to evaluate the results of the program in achieving the second objective of the Executive order. The relatively short period of time that the program has been in operation makes truly objective evaluation difficult.

However, it is well established that identical bid reports provide a stream of current market intelligence which is a valuable aid to anti-trust enforcement.

In the recent past a number of significant investigations in antitrust cases have had their genesis in identical bid reports.

Just since July 1961, identical bid reports affecting 15 product categories have shown sufficient indica of collusion after analysis to warrant further investigation.

In addition to forming the basis for leads to investigations, identical bids are used extensively as aids to investigations already underway. They are used to provide information in the preparation of cases for trial or settlement, and they are used to observe the effects of and compliance with decree provisions in litigated and negotiated judgments.

In time, it is contemplated that the vast record of price information accumulated and organized as a consequence of the operation of the Executive order, will provide an historical background against which to compare shifts in price behavior in a large number of markets ranging across the entire spectrum of the national economy.

Such information is extremely valuable for antitrust enforcement purposes at the Federal and State levels. It is further contemplated that these records will be made available to State and local governments to aid them in the prosecution of cases which may indicate violations of State laws and in correcting abuses at the local government procurement level which may restrain competition and increase the cost of government.

This is essentially all I have to say in presenting this report, Mr. Chairman.

Again I should like to emphasize the contributions that I think that this committee and its chairman have made in getting this program instituted. We recognize that this is our first attempt in the field, that it is probably incomplete, and imperfect.

However, the Department of Justice will certainly carry out its duties under the Executive order to the best of its ability, and we believe that our ability to handle this data will improve as time goes on and we will be able more efficiently to make reports in the future.

Chairman PATMAN. Senator Javits is being compelled to go to the Appropriations Committee soon and he would like to ask questions.

Senator JAVITS. Just one question.

Judge Loevinger, I am very glad to see you and I am very anxious to get from you either now or when it is convenient to you, in the form of a communication to the committee, the answer to the following question.

Is the antitrust policy of the United States, which is now being pursued in respect to American business the same as, different from, and if so, to what substantive extent, than that pursued under the previous administration.

Mr. LOEVINGER. Basically, Senator Javits, I think that the antitrust policy is the same substantively.

The enforcement of the antitrust laws is a matter of law enforcement. This is a fact that I think academic economists sometimes overlook. We are not legislating, we are not making law. We are enforcing laws that have been passed by Congress and that have been interpreted by the courts. It is our duty as lawyers to enforce those laws according to the policies established by Congress and the interpretations given by the courts and we do this. We do it more or less well, and opinions may differ as to that.

I think that in some respects we have been more efficient and more vigorous than some of our predecessors. We have reorganized the Antitrust Division simply in order to handle some of the matters more efficiently.

We are engaged in more activities than previously the Division was engaged in.

The report that is being presented this morning is an example of this. This has required the institution of whole new procedures of handling data. Basically, however, in substantive terms, we are a law enforcement agency and I do not believe that there can be great differences among honest and vigorous law enforcement officials in the substantive enforcement of the law, because we are necessarily governed by congressional policy and judicial interpretation.

Senator JAVITS. If the Chair will allow me just one other followup question, I shall then be through. I am very grateful to my chairman and my colleague, Senator Proxmire, for their graciousness.

We are hearing here and you are part of the hearings, the question of the state of the economy.

Now, would you—or perhaps you would have to go back and consult the Attorney General—have any recommendations for us as to the way in which we could constructively, helpfully, affect the economy by anything that we could do about the antitrust laws.

As you say you are a lawyer, you are bound by the law and you are bound by the cases as they have implemented the law.

As we considered various suggestions, people came here and talked about tax cuts, and various other things. What about antitrust law revision?

Do you think your Department is prepared to make any recommendation to us as we deal with the question of improving our economy, with relation to the antitrust laws?

Mr. LOEVINGER. Well, I think I can give you at least a general answer to that, Senator Javits.

We have commented during the course of the last year and a half on between 300 and 400 legislative proposals from the viewpoint of antitrust.

Those range across the entire spectrum of the antitrust law enforcement or of antitrust law policy.

Basically, I believe that we feel that the antitrust laws are sound and substantively are well adapted to secure their basic objectives.

We have made some recommendations for legislation. The one I would urge upon this committee is probably not very controversial even, the provision for a civil investigative demand which has been passed by both Houses of Congress, either has been or I believe is about to be reported out by a conference committee as to certain minor differences between the Houses, and we would very much appreciate having that expeditiously enacted.

Senator JAVITS. Civil investigative demand, meaning the right to get data—

Mr. LOEVINGER. The right to get documents from corporations in civil investigations.

Senator JAVITS. Without subpoena before a grand jury?

Mr. LOEVINGER. Yes. I believe that substantially the entire conference committee is in accord on the resolution of the minor differences between the versions of the bills before the House and the Senate, and I believe that this will be presented to the Congress very shortly.

This is one of the major enforcement tools that we believe will be useful.

Now, notice, this has no substantive effect on the law at all. It simply is a matter of enforcement.

Senator JAVITS. So you do not recommend a substantive change in the law?

Mr. LOEVINGER. We are not recommending any substantive changes at this time, with the reservation that we have commented favorably on certain proposals that are not, I believe, fundamental to the antitrust laws. They tend to be relatively peripheral.

Senator JAVITS. Thank you so much, Mr. Chairman, and thank you, Senator Proxmire.

Chairman PATMAN. Thank you, Senator Javits.

Judge Loevinger, several of the panelists we had yesterday met with the staff and they commented on your report. These were Professors Adams, Lanzillotti, and Barber. They were all highly pleased with the report and the fact you have instituted this reporting procedure. They all did express disappointment, however, in one aspect of your

report which is this: You report in table 2, where you show the details of the bids, only those bidders who submitted identical bids and you omit the names of the other bidders. They felt that the first report you prepared for us on the sample of the 193 bids, for years prior to the President's Executive order, was a great deal more informative and useful in this respect whereas your new report may conceal more than it reveals and could be misleading in some respects.

For example, at page 177 you report bids for truck and bus tires. The report indicates that there were 14 bids and 4 of them were identical. Then you list the four companies who submitted identical bids and these are the Big Four in the rubber industry.

But the fact that you show there were 14 bids and only four identical would suggest to State and local purchasing agents that perhaps they could expect a lot of bids at a variety of low prices for such truck and bus tires.

Yet I wonder how many of those 14 bidders were only local dealers for the big four rubber companies and I would assume that the local dealers would likely submit higher bids than the manufacturers.

How many rubber companies, Judge, are there who are making first line truck and bus tires, do you know?

Mr. LOEVINGER. I don't know, Congressman, I am sorry.

Chairman PATMAN. You don't know.

Do you know any reason why the name of the low bidder shouldn't be published?

Mr. LOEVINGER. No.

As a matter of fact, I think the low bid is indicated here. I should give credit to Mr. Lewis Markus, the head of the economic section—

Chairman PATMAN. Suppose you identify him for the record.

Mr. LOEVINGER (continuing). Who is here with me, Mr. Chairman. Mr. Markus has been largely responsible for actually assembling this report and doing the economic work, and supervising the detailed manipulation of data involved here.

Chairman PATMAN. It is page 117 that I am referring to.

Mr. MARKUS. Congressman Patman, if I may go back to your first question?

Chairman PATMAN. Yes, sir.

Mr. MARKUS. On the omission of the nonidentical bidders.

Chairman PATMAN. Yes, sir.

Mr. MARKUS. The impression that we had at the time we undertook this program, was that we would want to lay heavy emphasis on the identical bidders throughout the report. The feeling we had was if we identified within the framework of the report the nonidentical bidders the inference may be drawn that they were in the same category as the identical bidders and for that reason, at least, we did not include all of the details as to every bid that was submitted in response to an invitation.

Chairman PATMAN. It is being brought to your attention so that you can consider it in the future reports. We realize this is a pioneering venture and we can't expect to have everything just exactly right at the beginning.

Mr. MARKUS. Certainly.

Chairman PATMAN. This never has been done before, we realize that.

Your reports exclude all procurements of a value of \$10,000 or less, and in view of the fact that in fiscal 1961 the Defense Department alone bought over \$1 billion under contracts of less than \$10,000, wouldn't it be a good idea to at least sample a significant portion of contracts in this smaller size range?

Mr. LOEVINGER. I suppose this is a matter of judgment, sir.

The \$10,000 limit is established in the Executive order. My recollection is that the Attorney General has the authority to vary this limit as may appear necessary, and indicated by experience.

It might be advisable to sample some of the other bids. I think that it is a question of the degree of burden that the procuring agencies are willing to bear, of getting used to the procedures, of getting our own techniques for handling the data sufficiently well established so that we can give any assurance that if we get any additional data it can be usefully handled.

Chairman PATMAN. Judge Loevinger, I am very much interested in some of the statements you make on pages 7 and 8 of the report. You point to the fact that there are so many variables involved in determining the price at which to submit a bid that—

It is difficult to justify identical transaction prices and particularly those filed in response to invitations for sealed bids.

In view of that statement and giving attention to the highly concentrated character of many of these industries, wouldn't it be a good idea if we had legislation making identical bids *prima facie* evidence of antitrust violations?

Mr. LOEVINGER. I don't think that I can really comment on such a proposal, Congressman Patman, without giving a little more careful consideration to it and seeing the proposal.

Conceivably there might be constitutional problems depending upon how this were done.

If, for example, the filing of identical bids were made *prima facie* evidence of violation of the Sherman Act, this might involve establishing a presumption in a criminal case that could not withstand constitutional attack.

I am not saying that it would, and I am speaking off the cuff, so that I am rather unsure of myself. I think that such legislation would have to be very carefully drafted, although I think that there may well be an area in here in which some legislation might be appropriate.

Chairman PATMAN. Thank you, sir.

As I read over your report and think about some of your comments, it seems clear to me as I think it does to you, that where there has been a high incidence of identical bids a collusive situation is frequently found.

Wouldn't this suggest very strongly the wisdom of the kind of legislation I mentioned to you just a moment ago; namely, a law making the submission of identical bids, perhaps over a period of time or on a number of different occasions, *prima facie* evidence of antitrust violations?

In other words, go beyond what we were discussing a while ago, and where it is a kind of chronic or continuing situation, consider it *prima facie* evidence?

Mr. LOEVINGER. Yes.

Well, I believe that this carries out the suggestion in my prior answer, sir, that you cannot give a dogmatic response to this. It depends upon the drafting of the legislation.

There are situations in which identical bids are obviously not necessarily the result of collusion. Thus resale price maintenance laws may well account for identical bidding in certain situations; certain programs of the Agriculture Department account for identical bidding quite legitimately.

Account must be taken of these situations, and therefore any attempt to create presumptions must be rather carefully drafted.

Chairman PATMAN. Senator Proxmire, would you like to ask some questions?

Senator PROXMIRE. Yes.

Judge Loevinger, how extensive is identical bidding? On the basis of your examination so far, can you give us a notion whether this constitutes 5 percent, 10 percent, 2 percent of procurement?

Mr. LOEVINGER. Yes, sir.

Our answer necessarily depends on extrapolation from data which, we hasten to assure you, are incomplete and therefore not wholly reliable, and you must realize that we are extrapolating from what we really admit are not wholly adequate data.

However, the figures roughly are these: that the total amount of procurement by State and local governments in the course of a year is a little bit in excess of \$10 billion. So far as we can ascertain virtually all of this is advertised or competitive.

The total procurement by the Federal Government in the course of a year is on the order of \$31 to \$32 billion. However, because a very large part of this is by military agencies, and agencies such as the AEC, which predominantly negotiate—

Senator PROXMIRE. And that is—

Mr. LOEVINGER (continuing). Their procurement, there is only about \$4.8 or \$5 billion that is advertised.

On the other hand, our reports do not cover all State and local procurement; therefore, we have something on the order of \$10 to \$15 billion, \$15 billion being the maximum and \$10 billion being about the minimum, of procurement that is competitive or advertised that is covered by these reports.

The extrapolation indicates identical bidding affects about \$100 million worth of this, or about 1 percent in terms of total value. As we have indicated this is rather less than we expected to encounter, and may indicate that the activities, and the inquiries and the reporting system, have already had some effect.

Senator PROXMIRE. I take it from what you have said before that this is simply one method of collusion.

You talk about indicia of collusion that identical bidding may be one aspect of it.

Another aspect of it may be simply rotating a low bidder and dividing up the market that way.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. I am wondering if you have any kind—of course, you wouldn't have the kind of specific mathematical estimate with regard to these other kinds of collusion that you would have with regard to competitive bidding.

I would presume, however, that identical bidding is more common when dealing with less experienced and smaller procurement officials where the large firms involved feel they can perhaps get away with it.

I notice the example which you give out in Oregon was a case of buying county asphalt, and they came in and the procurement official had just thrown up his hands and said, "This is the same thing, boys; year after year you come in with the identical bid and year after year there is nothing we can do about it, we just accept it, and we will give firm A the business this year, D had it last year, and B the next, and so on."

Is it the conclusion—your conclusion on the basis of your observation—this identical bidding will be engaged in where the sellers feel they can get away with it because of less sophistication or knowledge on the part of procurement officials?

Before you answer I would like to say this: You give some excellent advice in your report to procurement officials who want to stop identical bidding.

You point out what they can do is give it to the firm for whom the bid is the most expensive; that is, whose mill is farthest away from the delivery point, or give it to the same firm year after year and don't let them share the market this way.

So I would think a really determined procurement official who really wants to stop identical bidding, which is repetitive, can do so.

Mr. LOEVINGER. I think a great deal can be done by procurement officials. I am not sure that we are prepared to pass judgment to the extent of saying it is most common where the procurement officials are unsophisticated or inexperienced. This gets into a kind of subjective judgment that is hard to make.

I think I can say this, however, because we have had considerable discussion with State law-enforcement officials and with State procurement officials, I believe that the State officials feel that it is very difficult for them to deal with these problems.

There is, of course, as you know, concurrent jurisdiction between Federal and State Governments, in the antitrust field. Nevertheless, State law-enforcement officials feel that the Federal Government is the only law-enforcement agency that can effectively deal with restraint of trade and particularly with large companies and particularly where it extends over large areas.

Senator PROXMIRE. So a big contribution here could be, No. 1, to inform local procurement officials of what they can do to stop identical bidding, or at least, discourage it.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. And, No. 2, that the Federal Government stands ready to act in the event that this is reported and can be one evidence, at least, of collusion, and one evidence of breaking the antitrust laws?

Mr. LOEVINGER. Yes, sir.

I believe this is true. I believe that the report itself, and the reporting system, have had a very widespread educational effect and we have received a good deal of correspondence from State procurement and law-enforcement officials saying that they felt this program was a helpful and useful one.

Senator PROXMIRE. Judge, I am going to be a little tough, and I hope you will understand I have the greatest admiration and sympathy for you.

But yesterday we had a series of papers from outstanding professors who were very critical of our antitrust policy, very critical indeed, and they documented it and I thought it was most impressive.

One of the well-documented papers was by Professor Barber of Southern Methodist University.

I want to read part of the excerpts because I think it is a mighty serious indictment.

He said:

The Antitrust Division of the Department of Justice is the principal enforcement agency in the field of antitrust, charged with the responsibility of enforcing the Sherman Act. Looking back over the last year and a half, one finds an extremely unsatisfactory performance.

The cases initiated in number are many (60 cases were commenced in the calendar year 1961; in 1960, the comparable number was 90; but of these, 39 involved the heavy electrical conspiracy).

But, in character, they reflect little enforcement imagination and seem, by and large, unlikely to have any significant impact on reducing the level of prevailing concentration.

I do not wish to imply that the work of the Division has been unimportant; certainly not. What I do suggest, however, is that the resources of this agency are not being employed to their fullest potential.

Of the 60 cases begun in 1961, 28 involved so-called per se violations (most notably price fixing, but also including allocations of territories, and bid rigging—the latter a variant of price fixing).

Most of these were hard-core, overt conspiracies in which the Government usually possessed uncontradictable evidence of law violation. In many of these cases, the defendants did not dispute the charge, pleaded guilty or nolo contendere, and were fined.

All too frequently the fines constituted little more than a slap on the wrist. The firms were chastized, held up to modest public ridicule, and told to sin no more.

The work of the Antitrust Division in suppressing corporate mergers is of much greater importance, although I think it deserves emphasis that this is essentially only preventive in nature; it does not usually reduce existing levels of concentration.

In calendar year 1961, the Department of Justice filed 19 cases, seeking to block or set aside corporation consolidations. Most of these were of importance and involved firms of substantial size, whose affiliations promised reduced competition.

Interestingly, however, two of the more important of these cases (one involving American Smelting & Refinery Co. and the other the Penn-Olin joint venture) were brought during the final days of the preceding administration.

And, actually, as the year progressed, one finds that the antimergers work of the Antitrust Division gradually slackened. This trend, of considerable importance, persists to the present time. So far during the year 1962, only a few cases involving mergers have been filed. What explains this curtailment in activity is not clear. And it is associated with, what seems to me, a growing number of trivial cases.

The list of industries involved in cases brought this year includes, for example, a variety of conspiratorial behavior in such vital product markets as venetian blinds, kosher food products in New York City, service station prices in Washington, and ice show productions.

And then there is a quotation here from Assistant Attorney General Loevinger, yourself, to Anthony Lewis. In Mr. Lewis' article you are quoted as saying:

It is probably true we are affected by business uncertainties to the point where we are holding up cases with a novel or uncertain character approach. We are sticking pretty much to the predictable, to the established lines.

Just one more observation. Mr. Barber says:

The gasoline station operators who agree upon prices at which they will sell their products are speedily brought within the criminal reach of the law. But the major oil companies who are able to achieve coordination in price, because of the concentrated character of the industry, go free. Both should be brought within the law.

I would be very interested in your comments on this very serious indictment by a responsible and able scholar.

Mr. LOEVINGER. I agree that the witness is an able scholar, and I have no doubt that he is responsible but I don't believe that the indictment is responsible, Senator.

It is very easy to say that you should reduce the concentration in the oil industry.

However, I should like to know precisely what this means. I have heard these criticisms before. I have seen these articles and I know that there are academic economists who have made suggestions of this sort.

As a matter of fact, I have sat down with a number of them, and have talked not for hours but for days. At one time my first assistant and I spent 3 days talking to a group of economists who included at least one of the witnesses who has appeared before this committee seeking specific ideas of the character of those that they are discussing before this committee.

If they mean that we haven't taken a list of the 50 or the 100 largest corporations in the United States and gone out and started to break each of these up into smaller pieces, of course, they are quite correct; we haven't.

I don't believe we are authorized to do this under the present law.

No prior administration has undertaken to do this, either.

Senator PROXMIRE. Well, in the criticisms that I read, I didn't talk about—they didn't talk about dissolution at this point in his paper. He was talking, as I understand it, primarily about mergers and preventing mergers, and also, of course—

Mr. LOEVINGER. We have been active in this field. We have maintained as high a level of vigor and enforcement activity as any prior administration.

As a matter of fact, the calendar year 1961 showed that we have brought very nearly twice as many cases under the Celler-Kefauver Act as any prior administration.

Senator PROXMIRE. Yes, but what is the significance of the cases you bring? In the particular fields in which he mentions here, venetian blinds, kosher food products in New York City, service station prices in Washington, and ice show productions, these are trivia. These are not the fundamental moving groups in our society, these are not the big steel, automobile, oil companies where concentration is clear, and where there seems to be a real power to maintain prices, and to hold up prices, and in the judgment of some, to retard growth and economic expansion.

Mr. LOEVINGER. Senator Javits might not agree that kosher food products in New York City is not a fundamental industry.

Senator PROXMIRE. I am sure he would not agree with some of the rest of this.

Senator Javits is very able. We disagree on antitrust policy.

Mr. LOEVINGER. However, I think that there is an interesting point here. At the time the antitrust laws were passed in the latter part of the 19th century and the earlier part of the 20th century, there were great movements toward the establishment of national monopolies—the formation of the United States Steel Corp., the formation of the Standard Oil Co., the formation of the original American Tobacco Co. Under the antitrust laws proceedings were brought to prevent or break these companies up. The suits against Standard Oil and American Tobacco were successful; the suit against United States Steel was unsuccessful.

However, there have been no comparable movements in recent years. There is no comparable movement going on today. The mergers that are being talked about today are mergers of big companies with a few little ones but there are no mergers of giant companies getting together to form national monopolies.

It is interesting to note, for example, that at the time the U.S. Supreme Court held—I think somewhat dubiously but nevertheless held—in 1920 that the United States Steel Corp. had not violated the law in forming this giant corporation, it had about 40 percent of the steel business in the United States, and today its share is down to slightly over 30 percent.

So that concentration, by that measure at least, has not increased. Now, this business of measuring concentration is a very tricky business. We are at work on this. We have gathered all the data available to us. We are watching the very able work being done by the Kefauver subcommittee on this. We are attempting to analyze their data but you can't simply say concentration has or has not increased across the board.

You have got to look at specific markets and specific situations.

Senator PROXMIER. In many specific ways it certainly has. There is no question in the retail trade industry it has increased in the sense that the small proprietor is disappearing and in some areas he has all but disappeared. You have the statistics that were given yesterday by Dr. Barber on page 3 of his testimony where he pointed out the percent of value of shipments accounted for by four largest companies, passenger car, 99 percent; sheet glass, 95 percent; locomotive parts, 92 percent; electric light bulbs, 90; primary aluminum, 82; cigarettes, 80; metal cans, 80; power and distributing transformers, 80; computing machines, 77; wheel tractor parts, 72; tires and tubes, 71; sheet ingots and semifinished shapes, 71.

In other words, you have some very, very important industries where only four companies clearly dominate, and where it is evident, I think, to all of us that these four companies can affect, come close to fixing prices and in some cases in some of these industries do, in fact, fix prices, establish prices.

Mr. LOEVINGER. Where we find them fixing prices we bring cases. We have brought cases on price fixing against United States Steel, Bethlehem, and certain smaller companies involved in a price-fixing arrangement.

It is perfectly true that Dr. Barber can pick out some cases involving small companies that sound as though antitrust is, in the words of Senator Monroney, watching mouse holes.

It is not true that all cases against small companies are necessarily insignificant.

For example, one case that we brought against three small banks in New Jersey, the *Hunterdon County Bank* case, involved the fixing of uniform service charges by these banks.

A consent decree was entered into in this case; there is no question about the facts in the case. They did it openly. They didn't attempt to conceal what had been done. The bringing of this case and the bringing of this consent decree were very widely publicized in banking circles and they resulted in the issuance of an order by the Comptroller of the Currency to all national banks.

That resulted in the institution of an enforcement program by the Comptroller of the Currency and I am certain if you talk to bankers that this case has had a profound effect throughout the banking world even though it was itself a small case.

On the other hand, it is not true that the predominance of our cases have been small or trivial in any sense.

In the automobile field, we have brought cases against General Motors, Ford, and Chrysler. The last administration in the automobile field, I think may have had a case against General Motors, although not involving automobiles, which our cases have; involving automobiles they brought cases against Renault, Hambro, and Volkswagen.

In the communications field we have brought a case against Columbia Broadcasting Co. and against MCA, which was accused of being—and we believe was—essentially a monopoly in the entire talent field.

As I say, in steel we have brought cases against United States Steel and against Bethlehem. You can go down the categories, and we have not neglected the big companies. We have no warrant, we have no authority, simply to go into a field and say there are three or four or five big companies, and, therefore, they must be broken up.

However, we have not avoided bringing cases against big companies, either.

Where we have found big companies engaged in activities that were anticompetitive, antitrust suits have been instituted, and certainly the big companies are watched more carefully with respect to merger activities.

We have a case against the Ford Motor Co., because of its acquisition of Autolite assets, which involves spark plugs and certain other automobile parts.

Senator PROXMIRE. I will have some more questions; my time is up.

Chairman PATMAN. Federal agencies, Judge, are required to report only in the case of procurements made at \$10,000 or more, where identical bids are found in line items valued at \$2,500 or more. How significant is this latter exclusion? It seems to me it invites splitting of a bid of, say, \$10,000 in five pieces where you expect identical bids so as to avoid reporting.

Mr. LOEVINGER. I am not able to answer altogether on this, Congressman Patman.

Chairman PATMAN. Suppose you answer, then, for the record when you look at your transcript.

Mr. LOEVINGER. I am not sure I can give a much better answer later. These things were worked out in cooperation and consultation with the procurement agencies.

We have no reason to believe that the procurement officer of Defense and GSA were anything other than highly cooperative and doing their very best to help us work out practical limits and practical criteria for securing the best possible reporting.

If experience indicates that these limits are too high, I don't think that there will be any difficulty in lowering them.

I don't believe there has been sufficient experience to indicate this now.

Chairman PATMAN. That is right.

Mr. LOEVINGER. I just don't have enough information to give you a good judgment on it.

Chairman PATMAN. As we said in the beginning, this is a pioneering venture and we will probably profit by the experience we have in the future.

If four companies selling the same products were to rotate their bids, company A making the low bid once, then the next time company B, and so forth, with no identical bid submitted on any given bid, then that wouldn't be covered in your report, would it?

Mr. LOEVINGER. No, sir.

Chairman PATMAN. It wouldn't be possible.

The Executive order does not relieve the head of Federal departments from reporting under the Armed Services Procurement Act, and the Federal Property and Administrative Services Act.

How many reports under these two laws did you receive during the reporting period?

Mr. LOEVINGER. I don't know, Congressman.

I suppose that it is obvious that the armed services and the General Services Administration will not make duplicate reports, and to the extent that the data they might otherwise report are covered in the identical bidding report, they won't make additional reports.

These statutes would impose on them the duty only to report some particular situation where there were nonidentical but apparently collusive bids so that these would quite obviously be relatively limited in number.

Chairman PATMAN. Have you had much resistance in the Federal agencies about making the kind of report you feel is necessary?

Mr. LOEVINGER. No, sir, they have been very cooperative.

Chairman PATMAN. Fine.

In the previous report you made for us, some industries appear to be habitually making identical bids. Have you compared the new report with the previous report to see whether some of the industries have changed their bidding practices since the President's Executive order was announced?

Mr. LOEVINGER. Not yet, no, sir.

Chairman PATMAN. I call your attention to page 226 of your report and several subsequent pages, about the electric companies.

It seems they are still making identical bids. You indicate, on page 226 that in the case of one item amounting to \$925, the same bid was presented by Graybar Electric of Newark, N.J.; Westinghouse Electric Supply Co. of Newark, N.J.; Wagner Electric Corp., St. Louis, Mo.; Jersey State Electric, Jersey City.

Right below it is another item of \$1,458 where General Electric, Westinghouse, and General Engineering all submitted identical bids. Then there is one on page 227 where Westinghouse, General Electric, and General Engineering, all made the same bids of \$972.

Then on page 279, there are three examples, and without objection I will just put these in the record without enumerating them.

(The information referred to follows:)

## POLICIES FOR FULL EMPLOYMENT

FPC COM- MODITY CLASS	FPC CLASS TITLE AND AGENCY, RESTRICTION, PRODUCT DESCRIPTION, UNITIZATION NUMBER, BIDDING INFORMATION	AMOUNTS AWARDED		BASIS OF AWARD	NAME OF IDENTICAL BIDDER AND AWARD INDICATION	EVALUATED BIDDING PRICE (dollars)	F.O.B. PRICE BASIS	CASE NUMBER	LINE ITEM NO.	BID OPEN- ING DATE
		UNIT OF MEASURE AND QUANTITY	TOTAL VALUE (dollars)							
6110	ELECTRICAL CONTROL EQUIPMENT DEPT. INTERIOR, BUR. OF CLAM. DENVER COLO. DIST. REDDING CALIF. DISTRIBUTION BOARDS DS-944 07 BIDS 02 IDEN BIDS	UNITS 18	8,310	LOW	GENERAL ELECTRIC CO. DENVER COLO. GENERAL ELECTRIC CO. DENVER COLO. GEN. ELECTRIC SUPPLY CO. DENVER COLO.	461.69 691.67 691.67	DEST DEST DEST	519	1	9/61
6120	TRANSFORMERS DISTRIBUTION AND POWER STATION ESSEX CO. HALL OF RECORDS NEWARK N.J. DEPT. W. CALDWELL N.J. JERSEY OIL IMMERSED & SELF- PROTECTED DISTRIBUTION TRANSFORMERS 2818 07 BIDS 04 IDEN BIDS	UNITS 3	2,775	LOW	GRAYBAR ELECTRIC CO. NEWARK N.J. WESTINGHOUSE ELEC. SUP. CO. NEWARK N.J. WAGNER ELECTRIC CORP. ST. LOUIS MO. JERSEY STATE ELECTRIC CO. ELIZABETH N.J.	925.00 959.00 959.00 959.00 959.00	DEST DEST DEST DEST DEST	50013	1	11/61
	CITY COMMISSION JACKSONVILLE FLA. DEPT. NEPTUNE BCH. FLORIDA OIL FILLED- OUTDOOR TYPE POTENTIAL TRANSFORMERS 59111-10 03 BIDS 03 IDEN BIDS	UNITS 6	8,748	OTHER	GENERAL ELECTRIC CO. NEW YORK N.Y. WESTINGHOUSE ELEC. CORP. PITTSBURGH, PA. GENERAL ENGINEERING CO. JACKSONVILLE FLA. AWARD	1458.00 1458.00 1458.00 1458.00	DEST DEST DEST DEST	50056	5	11/61
					CONTINUED					

FPC COM- MODITY CLASS	FPC CLASS TITLE AND AGENCY, DESTINATION, PRODUCT DESCRIPTION, UNIT/TON NUMBER, BIDDER INFORMATION	AMOUNTS AWARDED		BASIS OF AWARD	NAME OF IDENTICAL BIDDER AND AWARD INDICATION	EVALUATED UNIT PRICE (\$/unit)	F.O.B. PRICE BASIS	CASE NUMBER	LINE ITEM NO.	BID OPEN- ING DATE
		UNIT OF MEASURE AND QUANTITY	TOTAL VALUE (\$/item)							
6120	TRANSFORMERS, DISTRIBUTION AND POWER STATION CITY COMMISSION JACKSONVILLE FLA. DEST. WFTUNE BCH, FLORIDA OIL FILLED OUTDOOR TYPE CURRENT TRANSFORMERS 59111-10 03 BIDS 03 IDEN BIDS	UMITS 3	2,916	OTHER	WESTINGHOUSE ELEC. CORP. PITTSBURGH PA. AWARD GENERAL ELECTRIC CORP. NEW YORK N.Y. GENERAL ENGINEERING CO. JACKSONVILLE FLA.	972.00 972.00 972.00 972.00	DEST DEST DEST DEST	90057	8	11/61
6145	WIRE AND CABLE, ELECTRICAL  NAVAL SUPPLY CENTER OAKLAND CALIF. DEST. FOREIGN SHIELDED, SINGLE-CONDUCTOR DIRECT BURIAL, POWER CABLE IFB-228-17609-62 17 BIDS 02 IDEN BIDS	FT. 140000	27,981	LOW	WESTINGHOUSE ELECTRIC WESTINGHOUSE ELEC. SUPP. OAKLAND CALIF. GRAYBAR ELECTRIC CO., INC. SAN FRANCISCO CALIF.	.1999 .2343 .2143	DEST DEST DEST	637	1	11/61
	U.S. ARMY ENGINEER DIST. NEW ORLEANS LA. DEST. MULTIPLE  ELECTRICAL POWER CABLE ENG-18-047-62-9 12 BIDS 02 IDEN BIDS	FT. 1000	2,826	LOW	ANACONDA WIRE & CABLE CO. NEW YORK N.Y. NU-LITE ELEC. WHOLESALERS NEW ORLEANS LA.	2,826 2,903 2,903	DEST DEST DEST	776	1A	11/61
	CITY COMMISSION JACKSONVILLE FLA. DEST. JACKSONVILLE FLA. UNGROUNDING NEUTRAL NEOPRENE JACKET CABLE 1316 06 BIDS 06 IDEN BIDS	FT.		NO AWD	CONTINUED			90054	3	11/61

POLICIES FOR FULL EMPLOYMENT

FIC COM. BIDDING CLASS	FIC CLASS TITLE AND AGENCY, DESTINATION, PRODUCT DESCRIPTION, UNIT/ITEM NUMBER, BUDGET INFORMATION	AGENCIES APPROVED		DAYS OF AWARD	NAME OF IDENTICAL BIDDER AND CITY OF RESIDENCE	EVALUATED BID PRICE (dollars)	F.O.B. PRICE INDEX	CASE NUMBER	LINE ITEM NO.	BID OPEN- ING DATE
		UNIT OF MEASURE AND QUANTITY	TOTAL PRICE (dollars)							
61A5	WIRE AND CABLE, ELECTRICAL				ANACONDA WIRE & CABLE CO. NEW YORK N.Y.	5.072				
					OKORITE CO PASSAIC N.J.	5.072				
					PHHELPS-DODGE COPPER PROD. NEW YORK N.Y.	5.072				
					SIMPLEX WIRE & CABLE CO. CAMBRIDGE MASS.	5.072				
					U.S. STEEL CORP. JACKSONVILLE FLA. TENN. COAL & IRON DIV. JACKSONVILLE FLA.	5.072				
					GENERAL CABLE CORP. JACKSONVILLE FLA.	5.072				
	CITY COMMISSION JACKSONVILLE FLA. DEST. JACKSONVILLE FLA. UNGROUND NEUTRAL NFOBPBNE JACKET CABLE 1318 06 BIDS 06 IDEN BIDS	M.F.T.		NO AND	ANACONDA WIRE & CABLE CO. NEW YORK N.Y.	7991.00			50055	4 11/61
					OKORITE CO. PASSAIC N.J.	7991.00				
					PHHELPS-DODGE COPPER PROD. NEW YORK N.Y.	7991.00				
					SIMPLEX WIRE & CABLE CO. CAMBRIDGE MASS.	7991.00				
					U. S. STEEL CORP. TENN. COAL IRON DIV. JACKSONVILLE FLA.	7991.00				
					GENERAL CABLE CORP. JACKSONVILLE FLA.	7991.00				
	CITY OF LURBROCK LURBROCK TEXAS DEPT. LURBROCK TEXAS BARE WIRE OF STRENGTH OF 4200 LBS. 6379 06 BIDS 05 IDEN BIDS	CWTS. 200		LOTTERY					50151	1 12/61
					GRAYBAR ELECTRIC CO. AMARILLO TEXAS	33.51				
					CONTINUED	33.51				

POLICIES FOR FULL EMPLOYMENT

FSC COM-MODITY CLASS	FSC CLASS TITLE AND AGENCY, DESTINATION, PRODUCT DESCRIPTION, UNITIZATION, MAKE, OTHER INFORMATION	AMOUNTS AWARDED		BASIS OF AWARD	NAME OF IDENTICAL BIDDER AND AWARD INDICATION	EVALUATED UNIT PRICE (dollars)	F.B.S. PRICE BASIS	CASE NUMBER	LINE ITEM NO.	BID OPENING DATE
		UNIT OF MEASURE AND QUANTITY	TOTAL VALUE (dollars)							
6145	WIRE AND CABLE, ELECTRICAL				GENERAL ELECTRIC SUPPLY LUBBOCK TEXAS AWARD	33.51	DEST			
					WESTINGHOUSE ELECT. SUPP. LUBBOCK TEXAS	33.51	DEST			
					SOUTHWESTERN ELEC.SUPPLY LUBBOCK TEXAS	33.51	DEST			
					C.B.ANDERSON CO. AMARILLA TEXAS	33.51	DEST			
	ELECT.& WATER UTILITIES JACKSONVILLE FLA. DEST.JACKSONVILLE FLA. NEOPRENE JACKET CABLE 1316 06 BIDS 06 IDEN BIDS	FEET 7171	OTHER 36,471		ANACONDA WIRE & CABLE CO. NEW YORK N.Y. AWARD	5.086	DEST	50240	3	12/61
					THE OKONITE CO. PASSAIC N.J. AWARD	5.086	DEST			
					PHELPS DODGE COPPER PRODS NEW YORK N.Y. AWARD	5.086	DEST			
					SIMPLEX WIRE & CABLE CO. CAMBRIDGE MASS. AWARD	5.086	DEST			
					U.S.STEEL CORP. JACKSONVILLE FLA. TENN.COAL & IRON DIV. JACKSONVILLE FLA. AWARD	5.086	DEST			
					GENERAL CABLE CORP. JACKSONVILLE FLA. AWARD	5.086	DEST			
	ELECT.& WATER UTILITIES JACKSONVILLE FLA. DEST.JACKSONVILLE FLA. NEOPRENE JACKET CABLE 1316 06 BIDS 06 IDEN BIDS	FEET 2928	OTHER 23,453		ANACONDA WIRE & CABLE CO. NEW YORK N.Y. AWARD	8.01	DEST	50241	4	12/61
					THE OKONITE CO. PASSAIC N.J. AWARD	8.01	DEST			
					PHELPS DODGE COPPER PRODS NEW YORK N.Y. AWARD	8.01	DEST			
					CONTINUED					

POLICIES FOR FULL EMPLOYMENT

FIC CON- ADDITION CLASS	FIC CLASS TITLE AND AGENCY, DESTINATION, PRODUCT DESCRIPTION, INVITATION NUMBER, BIDDER INFORMATION	AMOUNTS AWARDED		BASIS OF AWARD	NAME OF IDENTICAL BIDDER AND AWARD INDICATION	EVALUATED UNIT PRICE (dollars)	F.O.B. PRICE BASIS	CASE NUMBER	LINE ITEM NO.	BID OPEN- ING DATE	
		UNIT OF MEASURE AND QUANTITY	TOTAL VALUE (dollars)								
6145	WIRE AND CABLE, ELECTRICAL				SIMPLEX WIRE & CABLE CO. CAMBRIDGE MASS. AWARD	8.01	DEST				
					U.S. STEEL CORP. JACKSONVILLE FLA. TENN. COAL & IRON DIV. JACKSONVILLE FLA. AWARD	8.01	DEST				
					GENERAL CABLE CORP. JACKSONVILLE FLA. AWARD	8.01	DEST				
	LIGHT, GAS & WATER DIV. MEMPHIS TENN. DEST. MEMPHIS TENN. ELECTRICAL POWER CABLE NONE 06 BIDS 04 IDEN BIDS	FT. 3000	OTHER 2+722					50250	1	12/61	
					PHELPS DODGE COPPER PROD. NEW YORK N.Y.		+9074	DEST			
					ANACONDA WIRE & CABLE CO. TULSA OKLA.		+9074	DEST			
					SIMPLEX WIRE & CABLE CO. CAMBRIDGE MASS.		+9074	DEST			
					GENERAL CABLE CORP. MEMPHIS TENN. AWARD		+9074	DEST			
6210	INDOOR AND OUTDOOR ELECTRIC LIGHTING FIXTURES										
	CHICAGO TRANSIT AUTHORITY CHICAGO ILL. DEST. CHICAGO ILL. INDOIS NARROW BEAM MERCURY FLOOD LIGHT P-3857 04 BIDS 04 IDEN BIDS	UNITS 9	OTHER 1,597						50018	1	11/61
					ELECTRIC SUPPLY CORP. CHICAGO ILL.		177.48	DEST			
					HYLAND ELECTRICAL SUPPLY CHICAGO ILL.		177.48	DEST			
					GRAYBAR ELECTRIC CO. CHICAGO ILL.		177.48	DEST			
					EFENGEE ELECTRIC SUPPLY CHICAGO ILL. AWARD		177.48	DEST			

Chairman PATMAN. On page 230 there are two examples and on page 231 there is one example.

Is there anything you can do about cases like General Electric, which has been convicted, and is paying terrific damages for admitted collusion, and yet, they still go ahead and submit these identical bids?

Is there anything being done about that, Judge Loevinger?

Mr. LOEVINGER. Well, I am sure that the electrical companies would say that these were largely shelf items which were bid out of catalogs on standard prices, and that this accounts for the identity rather than any collusion.

So far as what we can do is concerned, the situation is this: the defendants in the *Philadelphia Electrical* case indictments are also defendants in civil cases in which we are seeking injunctive orders against continuation of the practices and having certain specific provisions designed to discourage these practices.

A large number of these civil cases have either resulted in or are very close to resulting in agreements on judgments to be entered.

Some of the more important ones are still under negotiation.

One of the reasons that they are under negotiation, incidentally, is that I am seeking somewhat broader and more effective provisions in the decrease than were originally demanded at the time the suits were instituted and the time negotiations were started in December of 1960.

But until these civil cases have been disposed of, and the decrees entered, we are not in a position, of course, to effect enforcement.

Once the decrees have been entered then we will observe what effect they have and we will examine future instances of this to see whether or not they are in compliance with the decrees.

Chairman PATMAN. There are quite a few identical bids by the big steel companies on a delivered price basis shown in this new report of yours.

Have you had an opportunity to look at the Federal Trade Commission's order to the steel companies concerning the use of the basing point system, Judge?

Mr. LOEVINGER. I am familiar with it generally. I have not examined it specifically with relationship to this report, no, sir.

Chairman PATMAN. Is there any doubt in your mind that the steel companies are still quoting prices on the basing point system?

Mr. LOEVINGER. Well, I don't think that the question of my subjective feelings with the steel companies is particularly important. I have considerable doubt that there is any evidence that the order is being violated.

At least I assume that the Federal Trade Commission is examining this matter and following up on compliance with its own order.

Chairman PATMAN. Is there much evidence that it is being observed?

Mr. LOEVINGER. I don't really know, Congressman.

Chairman PATMAN. Throughout your report there are instances where four or five companies bid identically on a particular item, but the low bidder's name is not shown, then on the next bid for the same item, there will be four or five identical bidders with the name of one of the previous bidders missing.

It seems to me also that if you published all of the bids where two or more of the bids are identical, State and local purchasing agents

could draw some conclusions about those companies that are rotating the low bid, and perhaps avoid stepping into a trap.

Incidentally, the bill I introduced and which the House has passed, and which is still pending before the Senate Committee on Government Operations, would require you to report all of the bids wherever two or more of the bids are identical.

This bill incidentally was not drafted just off the cuff, but it was drafted after careful consultation with a large number of experts who spent many years on identical bid rigging matters, both the economics and the law on the subject.

So, I hope that in your future reports you will report all of the bidders. It seems to me you could do that in table 2.

Another thing, Judge Loevinger: Of the 737 Federal cases of identical bidding reports that you reviewed, 118 were excluded on the ground they required "special treatment."

That is a pretty high percentage. Most of these, I gather, came from the Agriculture Department.

Would you comment on this, and are you and the Justice Department convinced that these identical bids submitted to Agriculture for purchases for the school lunch program are not the result of collusion? Have you investigated this situation thoroughly, Judge?

Mr. LOEVINGER. I suppose a candid answer is "No," we have not investigated the situation thoroughly, and we do not mean to suggest, either, that the cases excluded are not the result of collusion or that the cases included are the result of collusion.

We have had to adopt certain fairly arbitrary criteria for getting the report up, and the criteria do not involve completeness of each case, of the kind that we give an antitrust case, nor a judgment as to whether or not there has been a law violation.

I think it must be clearly understood that these are cases reported on the basis of fairly arbitrary criteria and that additional analysis and investigation must be made in order to reach a judgment as to the significance of the cases.

Chairman PATMAN. Judge, your summary table on page 16 shows that you received 1,259 reports of identical bids and that your report covers less than half of these. You included in the report 599 and threw out 660.

One of the reasons you threw some out of that 123, according to the table, was that they "required separate treatment." Could you give us some information about the nature of the problem in the case of these 123?

Then you threw out 186 because you say the data are incomplete. Are you doing anything about checking missing data, particularly from the Federal agencies?

Mr. LOEVINGER. Perhaps Mr. Markus can answer that.

Chairman PATMAN. All right, Mr. Markus.

Mr. MARKUS. As to the incomplete reports, we have underway a canvass and a recanvass of the agencies that did not complete the reports in accordance with the instructions.

Chairman PATMAN. I see.

Mr. MARKUS. Eventually, these reports will be included in subsequent analyses that will be made in future reports.

Chairman PATMAN. Fine; that is all right.

Thank you.

Mr. MARKUS. As to the reports that required separate treatment some of those are included in the chapter in which we discuss Agriculture Department procurement, and others will probably be treated in supplemental reports that we will issue from time to time. But they were problem types of reports. They were either very large in the number of items involved and the number of bidders and required very special treatment.

Chairman PATMAN. Yes, sir.

Then you threw out the 129 which you say you found to be not identical after evaluation. And 115 of these came from Federal agencies. It seems to me a little puzzling that you would have so many which the procurement agency thought were identical but after review, your staff found not to be identical.

I wonder if you could give us a memorandum for our records showing a breakdown of these as to the reason why they appeared to be identical but were not judged identical.

Could you prepare that for the record when you submit your transcript back?

Mr. LOEVINGER. Yes, sir.

(The material referred to appears in the appendix at p. 952.)

Chairman PATMAN. Thank you.

Judge, in table 2 where you show the basis of the award indicating that it is sometimes made on the basis of low bid, sometimes by lottery, and sometimes you show that no award was made. But a very large percentage of the awards are shown to have been made on other bases. I wonder if in future reports we couldn't have a better specification as to how the awards were made rather than having so many shown to have been made on an unspecified basis.

Mr. LOEVINGER. Yes, I think that could be done.

Chairman PATMAN. Fine; thank you, sir.

Senator PELL?

Senator PELL. I have no questions.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Yes, I would like to go back to what I was asking about.

Professor Barber says that so far during the year 1962 only a few cases involving mergers have been filed in spite of the fact that some trivial, as he describes it—and I think they are relatively trivial—cases have been brought with regard to relatively small industries.

What explains this curtailment in activity?

Mr. LOEVINGER. There has been no curtailment in activity, Senator Proxmire. We bring cases as the facts come to our attention and as they arise.

My prediction is that with the Supreme Court decision in the *Brown Shoe* case which in a speech to the American Bar Association I have described as judicial ratification of the Celler-Kefauver Act, there may very well be fewer merger cases.

The explanation, I think, is quite simple. The explanation is that as the legal standards become known, and become clearer, there is greater voluntary compliance. Lawyers advise clients not to undertake mergers. Mergers are submitted to the Antitrust Division for clearance

in advance, and we advise companies that they should not merge, the situation simply does not arise.

Senator PROXMIRE. See if I understand then what you are saying is there has been no curtailment, but there have not been as many cases involving mergers brought simply because there are fewer mergers that would be in violation of the law.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. Well, yet there is an increasing concentration in American industry, it seems to me. The statistics that I gave the other day in the retail area which alarm me and concern me very deeply, the fact that in New York City with a growing population, tremendous increase in sales, the number of individual proprietors is less than one-half what it was 10 years ago.

Now, the number of retail firms which sell more than \$100 million has tremendously increased. It is awfully hard for me to believe that there isn't under these circumstances some concentrations in some areas that involve a degree of monopoly of one kind or another.

Mr. LOEVINGER. I am sure that there are concentrations that require further antitrust analysis. The difficulty with this approach is that it involves jumping from one base and one time to another and comparing disparate things.

For example, the figures on concentration are meaningless unless they are relatively long range.

The most recent figures that are available, as far as I know, are those recently issued by the Kefauver subcommittee that are based, I believe, on the 1958 data.

Now, to talk about concentration in terms of a 1948-58 trend, and then say since January of 1962 up to the end of July 1962 you haven't brought as many merger cases simply doesn't mesh at all. You may have wholly different trends in 1962 than you did in 1957. I don't know whether you do or not. But the figures——

Senator PROXMIRE. You think there is some evidence that maybe the concentration trend has been arrested and reversed and there is less concentration now and they are moving in the other direction?

Mr. LOEVINGER. Our analysis of the concentration ratio figure, Senator, says that these are very difficult things to work with in overall terms.

I think that there are periods when mergers apparently tend to take place, and in other periods when they tend not to take place and these things have more to do with the expansion or contraction of the market and tax considerations than they do with tendencies toward concentration as such in most cases.

I think, for example, that the figures with respect to the retail stores in New York probably have very little to do with mergers. I would suspect that most of the small proprietors who went out of business did not engage in mergers of a character that would ever come to the attention of any of the law enforcement agencies or be reflected in any statistics if indeed there was anything that could be called a merger.

Mostly, they probably involved small proprietors going out of business and going out and getting jobs as employees.

Senator PROXMIRE. Could you identify the steel items for which you have brought price-fixing charges against United States Steel and Bethlehem?

Mr. LOEVINGER. Steel forgings.

Senator PROXMIRE. Only steel forgings?

Mr. LOEVINGER. Steel forges.

Senator PROXMIRE. These are not the volume items such as sheets, bars, and so forth, where the power of the big steel companies over price really counts; are they?

Mr. LOEVINGER. I think the power of big steel companies over price really counts in these. These go into very important commodities including battleships.

They count more in other areas because the other areas involve greater volume; yes, sir. We have investigations going on in the other areas and what may develop I am not in position to say.

Senator PROXMIRE. There is no question but that the pattern has been, when one steel company, often United States Steel, sometimes another, raises prices, the others usually do precisely the same to the penny within 24 or 48 hours; isn't that correct?

Mr. LOEVINGER. There certainly has been price leadership; yes, sir.

Senator PROXMIRE. Is there nothing the Antitrust Division can do under the law?

Mr. LOEVINGER. We don't know. We are looking at it.

Senator PROXMIRE. Well, how did—I hope you look awfully hard.

How about the situation with regard to oil? Here is the most profitable industry in America, and certainly the most tax privileged industry in America.

Here is an industry which restricts production, operates 8 days a month, 7 days a month, almost always less than 10 days a month down in Texas, gets high profitable prices, is able to persuade the Congress to restrain imports.

Now, I am just wondering whether or not there is some kind of action that can be brought with regard to the concentration in the oil industry that would prevent them from restricting production or is this something that the State, particularly the State of Texas preempted and there is nothing that can be done about it.

Mr. LOEVINGER. The restriction of production is pursuant to State action and as you have noted, the restriction of imports is due to congressional action.

I don't believe it is within our jurisdiction to sue either the States or Congress. I am being facetious, of course.

The action taken by legislative bodies, whether State or Federal, is not within the scope of the antitrust laws, Senator Proxmire, and there are influences of this sort that are basically anticompetitive, I am sure, that are taken by legislative action on the basis of legislative judgment presumably that this is appropriate.

Despite its anticompetitive implications when such action is taken by either State or Federal legislative action, the antitrust laws simply don't apply. There is no question about it.

On the other hand, in the oil industry we are constantly watching the large companies, and we do, in fact, bring suits when it appears that there is any tendency toward lessening competition substantially or toward monopoly.

We have, for example, a case pending against Standard Oil of Indiana and certain other oil companies, another oil company or com-

panies, I have forgotten the number of defendants, involving the acquisition of the assets of the Honolulu Oil Co.

There are a great many people who criticized us for bringing this case, saying that this is an attempt to extend the Celler-Kefauver Act too far.

I think the case is justified, and we intend to pursue it. But actually in the kind of statistical analysis that you have mentioned previously, the oil industry is, of course, not a highly concentrated industry.

There are a great many companies in the oil industry, a great many competitors.

Senator PROXMIRE. Looking at it from a national basis, I suppose you could say that. But there are certain phases and aspects of the oil industry in which there is a degree of economic power and certainly the power to get together and limit production as a result establish a profit margin and a price, and so forth.

You say the academicians, I understood you to say, have not come up with the kind of constructive ideas which their criticism would suggest they might on how to reorganize the highly concentrated industries.

Have not people like Professor Bain, discussed antitrust policy with the Division economists and worked up reports on steel and other industries, hasn't there been some of this going on?

Haven't they made constructive suggestions?

Mr. LOEVINGER. I don't know of a report by Professor Bain on steel, Senator Proxmire.

Senator PROXMIRE. I don't mean necessarily on steel, but on the concentrated industries, other concentrated industries, perhaps?

Mr. LOEVINGER. We have a great many economic analyses of concentration, both generally and in specific industries.

Senator PROXMIRE. You wouldn't say that academicians have not made a constructive contribution to alternative ways of organizing these concentrated industries?

Mr. LOEVINGER. Yes, sir; I would.

Senator PROXMIRE. You would?

Mr. LOEVINGER. In this sense that the academicians have given us a lot of analyses, a lot of statistics as to what they claim concentration to be, but I have had no practical suggestions as to what, under the antitrust laws should be done about situations, nor, indeed, have any of them, so far as I know, suggested any objective criteria by which we can determine when concentration has reached an impermissible level either from the legal or the economic viewpoint.

Senator PROXMIRE. Well now, I understood you to say along that same line you have no warrant, no authority to deal with concentrations as such, and by dissolution and divestiture, and yet the Sherman Act, I understand has been interpreted to reach oligopoly situations where there has been price identity.

Is this a lack of warrant because the matter isn't important in your view to achieve competition; that is, the concentration is not sufficiently great in steel and in automobiles and other industries so that this does interfere with competition or is it your feeling that the interpretation of the law is not as clear as I stated?

Mr. LOEVINGER. No. I say this, Senator. That merely because four companies may have, say, 60 or 80 percent or whatever percent-

age it is, of the production in an industry, this in and of itself does not warrant antitrust action.

Now, if these four companies in fact, act in combination or concert in setting prices, then this certainly does warrant antitrust action.

If any one company or any group of companies act to monopolize, to exclude competitors, to engross the entire area of a field, then this warrants antitrust action.

But the raw concentration figures do not in and of themselves provide a basis for antitrust action.

I think the problem arises because there are some who feel that antitrust being essentially a principle for the defense of liberalism in a classical sense, for the organization of power on a pluralistic basis in the economic realm, for the establishment of a foundation, as the Supreme Court has said, of social conditions that permit democracy to flourish, they feel that because it is of this character that it can be used to remake the economic structure of society into an image closer to some Utopian goal.

Senator PROXMIRE. No. Let me say I feel very strongly the men who appeared before us yesterday were not thinking in Utopian terms.

They were appearing before this Joint Economic Committee and they were not appearing before us for the purpose of suggesting a political Utopia. They argued that because we have this degree of concentration, because we have administered pricing, because we have this friction in competition, we are unable to get the kind of growth that we ought to have, we are unable to get the kind of expansion of markets that we ought to have, unable to get the price flexibility we ought to have that would open up markets and they say this is one of the reasons why we have to follow a fiscal policy of increasing our budget deficits even though the economy is expanding in order to do something about a serious unemployment problem and lack of full utilization of our industrial capacity.

This was a real economic analysis. The only gentleman who appeared yesterday who wasn't an economist was Professor Barber, but I do think that his testimony is primarily economic testimony related, as I understood him at least, to the economic situation and not to the notion that somehow we want to be more pluralistic and somehow we want to avoid the evils of political and economic power combined.

In other words, it was a very real and genuine effort to try to do something about the economy which is the responsibility of this committee.

Mr. LOEVINGER. I agree with much of what has been said, Senator.

I think as I indicated in my testimony on Monday, that a flexible economy, a competitive economy, an economy in which there is a pluralistic organization of power, if you like, is indispensable to the achievement of efficiency, full productivity, and prosperity.

I think it is indispensable to the effectuation of monetary and fiscal and other policies.

Senator PROXMIRE. Let me just interrupt to say, wouldn't you agree also at the present time the reason why we have this continuous nagging high level of unemployment and underutilization of our facilities in spite of the fact we have been in a period of economic expansion for a year and a half is because of monopolistic concentration, because of administered prices?

Mr. LOEVINGER. No, I wouldn't say that is true.

Senator PROXMIRE. I just want to interrupt also—I hesitate to interrupt twice in a row—but I want to say I was wrong about Professor Barber. He has two degrees in economics and two degrees in law so I think he qualifies as both an economist and a lawyer. [Laughter.]

Mr. LOEVINGER. I think that the economists fall into the fallacy of oversimplification when they suggest that merely having greater competition is going to solve all of the problems of cyclical economics.

I think that—

Senator PROXMIRE. I would agree with that.

Mr. LOEVINGER. I think that antitrust, as I said before, is a necessary but not a sufficient condition for full productivity and prosperity.

I believe that antitrust establishes conditions that permit the effectuation of monetary, fiscal, tax, trade, and many other policies.

Senator PROXMIRE. We all agree with that. You see—

Mr. LOEVINGER. But it doesn't replace them.

Senator PROXMIRE. Certainly.

And we have had hearings on fiscal policy, monetary policy, experts in those fields.

Now, we are hearing the expert in the field of competition and monopoly. We recognize this is only one part of our economic policy, but an important part, and here they feel we failed as we failed perhaps in the other areas, too.

Part of the reason why we haven't been able to expand and grow and move is because we have not had the kind of vigorous competition that we should have and because we have had an increasingly concentrated economic situation in this country, in which prices have been very sticky, in which, in spite of the fact as was brought out by Professors Lanzillotti, Kahn, and Adams yesterday, even though we have a decline in demand and move into a recession, steel prices continue either steady or move up, and this isn't only true of steel, it tends to be true of automobiles, it tends to be true of these other industries.

We want to do something about this, and you said to Senator Javits earlier, that by and large you agree with the antitrust philosophy that has guided this country over the past several years, and that you aren't recommending any substantial legislation, at least at the present time.

It looks as if we are just going to accept greater and greater concentration and these frictions in our economy that are going to give us great economic difficulties.

Mr. LOEVINGER. Concentration has not, I think, been increasing in the steel industry.

It has been increasing somewhat in the automobile industry. I think that there is some difficulty in simply lumping these things all together.

I suppose the point at which I disagree with the economists is this, in thinking that the antitrust laws have not, on the whole, been pretty effective. I think that the antitrust laws have not been a failure. I think the antitrust policy has been fairly effective.

If you say it should be carried out more efficiently and better I won't quarrel with you for a minute. I am sure there is much room

for improvement. When we get to the point where we don't think we can improve, then somebody really ought to do something about us, but I don't think we have failed. I think we have been doing an efficient and an effective job, and to the degree that the economy needs further stimulation, I believe that it will come from other policies than simply going out and swinging an antitrust club.

I think the continued efficient, effective, vigorous enforcement of antitrust is necessary to permit these other policies to be effective, and we are moving—we are moving in some new fields.

We are moving in the field of banking which I think is an important field, where similar suits had not previously been brought, for example.

Senator PROXMIRE. I just have a couple of more questions.

Let me say that in the area of banking we certainly have had a tremendous increase in mergers, in concentration, in enormous expansion of the assets by a few huge banks and so forth.

But I would like to ask you if you don't feel that since administered pricing has this very great economic significance, and you would agree, I think, that it does have economic significance.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. Why can't we begin suits against major industries which do engage in administered pricing?

If it would take new legislation, I think many of us would sympathetically consider, in fact, enthusiastically support, that kind of legislation.

Mr. LOEVINGER. Administered pricing is an economic concept. I don't believe it has yet been reduced to sufficient precision to be used as the foundation for legal action.

If it has been, and if there is a definition that can effectively be used for legal action, we certainly would be glad to consider it.

I believe it has been referred to in our report, which I suppose you are looking at, as indicating essentially inflexible pricing which presumably results from relatively oligopolistic market structure.

But this is not the kind of concept that in any way that I am able to project, can be used for legal standards by itself.

It seems to me it requires some refinement.

Senator PROXMIRE. Well, my final question is a technical question that reverts back to your estimate that about 1 percent of the bidding was identical, and on that particular point, I understand that you have thrown out more than half of the 1,200 cases here, and it is my understanding that in doing that you have changed the numerator, denominator is still 10 billion, and since you have thrown out about half that you ought to at least modify your denominator accordingly and you come up not with 1 percent, but 2 percent, or more than 2 percent.

Mr. LOEVINGER. I prefaced my statement by saying our data are not complete and sufficiently extensive to justify any accurate extrapolation.

This is a very rough estimate. It may be one-half of 1 percent, it may be 2 percent. I am sure that there is this degree of what the statisticians call probable error.

Senator PROXMIRE. Let me just make these other further qualifications and see if you can agree: (1) Only selective cities were invited

to report; (2) the cities and States reported on a voluntary basis, there is no assurance of complete reporting; (3) the Federal procurement of less than \$10,000 and State procurements of less than \$1,000 are excluded; and (4) more than one-half of the reports received were excluded from your tabulations for various reasons.

Is that correct?

Mr. LOEVINGER. Yes, sir; those are all correct. I think it should be said that the cities and States that were included were those that encompassed the overwhelming preponderance of State and local procurement, however. That the units that were included were selected in such fashion that the exclusions were relatively small in both number and volume.

Senator PROXMIRE. Thank you, Mr. Chairman. Thank you so much, and I apologize for taking so long, but this has been extremely helpful.

Chairman PATMAN. Interesting and helpful, Senator Proxmire, we appreciate your doing so.

Senator Sparkman?

Senator SPARKMAN. Thank you, Mr. Chairman.

Judge, it is good to see you here again and hear you.

This is a very interesting report that is on our desk. I have been looking over the news release that goes with it, and I don't intend to be critical, but I was somewhat surprised by the note of optimism throughout the news release.

As a matter of fact, I had been led to believe, purely from newspaper reports back over the last year or two, that this identical bidding for Government contracts had developed into quite a serious matter and was rather extensive. In fact, our committee, the Joint Economic Committee, just about a year ago, August 1961, put out our own publication, I am sure you have seen it.

Mr. LOEVINGER. Yes, sir.

Senator SPARKMAN. It reported 93 cases involving identical bids. The material was obtained, I recall when we instructed the staff to get in touch with the Antitrust Division and to get the information, and to make it available.

Now, are we to understand that after exploring the matter quite fully you have come up with the conclusion that perhaps it is not as extensive as you thought it was?

Mr. LOEVINGER. This is our conclusion, Senator; yes.

Now, why it is not as extensive we aren't prepared to say yet. Some of the reasons suggested by Senator Proxmire may affect the statistics.

I suggested earlier that it is conceivable, and I have an intuitive feeling that there is some influence exercised merely by the interest of this committee, the Executive order, the program of reporting, and the publicity given to all of these things.

This report encompasses reports, the first of which was not filed until about August of last year.

This was some 5 months after this committee had indicated an interest in it, and at least 4 months after the Executive order.

Furthermore, the reports, the mass of reports are sometime after that so that there was plenty of time for the publicity to have had some effect.

Senator SPARKMAN. Well, I may say that my thought regarding this, perhaps, was stimulated by the recent acceptance by the General Electric Co. of an agreement that had been worked out.

Mr. LOEVINGER. Yes, sir.

In the civil damage cases?

Senator SPARKMAN. Yes; in the civil damage cases.

Mr. LOEVINGER. That was not—

Senator SPARKMAN. That was not handled by your division, was it?

Mr. LOEVINGER. Yes, sir; it was.

Senator SPARKMAN. Was it handled by your division?

Mr. LOEVINGER. Yes, sir; I personally handled the negotiation of the final agreement.

Senator SPARKMAN. Oh, yes, the first settlements were with the Federal Government.

Mr. LOEVINGER. Yes, sir.

Senator SPARKMAN. And then I believe they turned to certain cities to whom they had sold equipment and either settled with them, or are in the process of settling with them.

Mr. LOEVINGER. The second announced agreement was with the New York State Power Authority.

Senator SPARKMAN. Oh, yes. I think I have seen in the press they were extending that out generally to all of the agencies and individuals, I suppose, with whom they had done business.

It seems to me that the bigness of that coverage was such as to emphasize to the ordinary person that it was quite widespread.

I hope that your work on this has had some good effect. Certainly it should have.

I notice in the news release that some successful methods to discourage identical bids are suggested by the report.

I am wondering if most of those bids were not negotiated bids in the beginning or invited in such a way that there was not the feeling that there was really the competition that ordinarily comes with bidding.

And I wonder if some invitations to bid go to only a selected group or if they were thrown open so that everybody including small business was invited to come in to bid.

The Senate Small Business Committee, which was set up in 1950, has filed a report every year since then, starting in 1951, and I believe in every single report we have come out with the suggestion that if all of the Government bidding was on a competitive basis small business would have no complaint, because it knew it could come out all right in the field of free, open, competitive bidding.

And I wonder if, after all, that is not the best method of discouraging identical bids: open, competitive bidding where small business and big business can all bid alike, but with the understanding that the contract will go to the successful low bidder.

Mr. LOEVINGER. I think there is no question that this is a desirable, and in most cases the most desirable, method of procurement, Senator.

I am sure that we favor this, that we advocate it. We have worked for it in many respects.

I believe that what we are talking about as bidding situations here, are so-called advertised bids where everyone is permitted to bid.

I am aware that there are a number of cases where those who are considered as potential contractors or suppliers are limited in one way or another.

Attention has been given to these in other activities but not in this report.

I am sure that there is no inconsistency between the findings and the recommendations of the Small Business Committee and this report.

You see, this report purports to cover only a relatively small percentage of Federal Government procurement. The total amount of Federal Government procurement that is covered by this report is only in the neighborhood of 16 percent of the total Federal Government procurement.

And it may be less than that actually. This is an approximate figure.

Senator SPARKMAN. I don't have the figures in mind now with reference to the percentage of our procurement that is done on a competitive bid basis as against that that is done on either a negotiated basis or a limited bid basis where just a few suppliers are invited to come in and participate. But I do know that it has been a continuing fight with us to try to get the procurement agencies of the Government to use open competitive bidding, and I rather feel that it may be the best cure for these identical bids.

Thank you, Mr. Chairman.

Chairman PATMAN. May I add one thing to what Senator Sparkman said.

Suppose you have identical bids from a half dozen companies, of which one was a real big one and the other one smaller and so forth. Suppose you had the policy of giving it to the smallest company making the identical bid, wouldn't that have a tendency to break this up, Judge Loevinger?

Mr. LOEVINGER. The wisdom of this policy is subject to debate, certainly, but this is a suggestion that has been made, and it seems to me that there is much to recommend it, this may very well be an appropriate suggestion.

Again, it depends somewhat on the fields, the character of commodity you are talking about, but I think there is much to commend such a suggestion.

Chairman PATMAN. I think it would break them up overnight, Judge; I hope you try it.

Senator Pell, did you have anything?

Senator PELL. No.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Judge Loevinger, I came back because I had done what I could do at the Appropriations Committee and I wanted to take a little issue with you, if I may, with respect to the contribution that could be made by a revision of the antitrust laws to our economic situation.

I cannot agree there is no place in an improved economy for a revised concept of the antitrust laws and so I would like your judgement upon these two points: One, we have run into a situation which would indicate that if you really are going to compete with state trading on the part of Communists, you unquestionably have to find some

way of getting American concerns to be able to act in concert, if the Government wishes them to.

Now, that is particularly pertinent to the oil situation. Is there any way right now that if the Government desired a group of American oil companies to cooperate with it in meeting the Russian challenge in the oil field which is very important in Europe, if they could do so?

Mr. LOEVINGER. Senator Javits, I think your real quarrel is with Senator Proxmire; he was attacking me during your absence because we weren't more vigorously seeking to induce greater competition in the oil industry.

Now, regardless of what the various political or economic theories may be, I submit we cannot be at once more and less competitive.

We have got to seek either one or the other solution.

There is, of course, the Webb-Pomerene Act which permits independent enterprises to establish common associations with exemption from antitrust rules for export trade.

I don't know that this has been tried. I think that the question is a difficult one to answer in abstract terms. The oil industry is an extraordinarily complex industry. There are many aspects of it that are already subject to Government control, and to limitations of competition by various governmental measures.

There are a number of provisions under existing law that permit combinations to be undertaken with protection against charges of antitrust violation.

We have had, as a matter of fact, some months ago, extensive conferences with representatives of the Defense Department and the Interior Department, and established an Oil Industry Committee which has been approved by the Attorney General under the Defense Production Act, I believe that is the statutory authority, and which does, in fact, meet and engage in certain activities related to our national defense.

Senator JAVITS. Well, now, may I interrupt you to say that the authority for that has expired?

That statute—that is, the section of the law has been repealed and the committee is now functioning under the authority which you did once have. There is no longer any such authority.

Mr. LOEVINGER. My impression was that the act had been extended for a year.

Senator JAVITS. No.

The authority of the Attorney General to approve a combination of the act; that is, the general authority, has been repealed. It's now subject to approval only for a specific group of procurement contractors, and as a matter of fact, I am waging a little campaign to get the authority restored, but the committee you speak of is functioning under your permissive authority which you had and gave them at the time so if they broke up and you had to have a new one, you could no longer give them any such immunity.

Mr. LOEVINGER. Well, the act—I believe you are correct. There has been the expiration of one of the provisions in the Defense Production Act.

Actually, what has taken place recently is not the formation of a new committee or a new agreement, but a modification of the prior agreement.

You are correct in that, Senator.

Senator JAVITS. Now, Senator Proxmire and I have no differences on this; we may have on other things because I am not talking about general competition.

I only asked you the specific question, If the Government wants a group of American companies to combine for the purpose of doing a job the Government wants done, that is a very different thing from general competition. Does the Government have such authority?

That is the question I ask.

Mr. LOEVINGER. I don't believe I can answer that, Senator. I think that it is too general. There is no general authority on the part of any agency to authorize combinations in a sort of carte blanche fashion; there are a number of specific authorities.

Senator JAVITS. Is there authority to cause the oil companies to combine to cooperate with the Federal Government, existing authority today, in order to meet the Russian challenge to the oil supplies of Europe?

Mr. LOEVINGER. There is no authority to force them.

Senator JAVITS. Is that specific?

Mr. LOEVINGER. Or to cause them to combine.

Senator JAVITS. Is there any authority to give them immunity from the antitrust laws at the Government request?

Mr. LOEVINGER. It depends on what they want to do.

Senator JAVITS. I think my question is very specific, Judge.

Can you give the oil companies, who at the Government's request will combine with it to act in respect of Russian supplies of oil to Europe, freedom from antitrust prosecution by law?

Mr. LOEVINGER. To act now, to do what?

Senator JAVITS. To buy together, to sell together, to run their tankers together, to do any act which would be a violation of the antitrust laws, unless they did have some protection.

And this is at the Government's request, the U.S. Government's request; can you do it?

Mr. LOEVINGER. I guess I am just not prepared to give you an answer because no agency has ever requested this of us.

Senator JAVITS. All right.

In other words, you cannot give us the answer now. Will you supply it for the record?

Mr. LOEVINGER. All right.

(The information referred to appears in the appendix at p. 952.)

Senator JAVITS. I might tell you, Judge, I am not trying to lead you into any controversies, but I do think we are very materially lacking with equipment to deal with this situation and the antitrust laws which are the set of laws which are materially in the way of really getting American business to do its part in what I think needs to be done, that is the only point of my question.

I have just one other question, and I am grateful to the Chair for giving me this other opportunity.

Now, in respect of our small business problems—

Senator PROXMIRE. If the Senator would just yield at this point on a particular question, which is very interesting. It is my understanding we do have a consortium of American oil companies operating to-

gether in the Near East. We have discussed it a number of times on the floor.

What I would like to have very much, if these consortia are permitted in the future, that the public be allowed to know about them in full so we know who is involved and what authority is given and so forth, and if not, why this is not good public policy to make this a public record.

Mr. LOEVINGER. This, of course, is the problem with sanctioning such things. It becomes almost impossible to follow them to know what is going on, and, therefore, in general, the Government policy has been throughout the years to be very cautious about either through legislative or administrative action sanctioning anticompetitive combinations of business.

Senator PROXMIRE. I understand; the staff informs me there have been times in the past where the identities and authorities and so forth should not have been made public, and there are—there is some feeling this should be made public, or if not, we should be told exactly why not.

Mr. LOEVINGER. I don't know. There is still pending a case in the Antitrust Division involving the biggest oil companies in the country, and an alleged cartel or restraint of trade arrangement in the Near East.

Senator PROXMIRE. Thank you, Senator.

Senator JAVITS. I might just say to my colleague that there are certainly techniques for supervision.

For example, I have myself suggested one. I just don't think that the Department of Justice, whether under this Attorney General or the preceding or any other Attorney General, has been inventive enough.

For example, you can appoint a special master in a court proceeding to supervise any agreement and get yourself completely informed at all times, even with the power of investigation and subpoena. I deeply feel that our antitrust laws are not at all abreast of our international world situation but are just operating in a vacuum which extends from 1888 until today.

And I think it is high time we get to it and find out what to do in our national interest.

I would like to ask you just one question about the domestic field. During the war it was possible for small contractors to combine under the York plan in order to jointly bid on Government procurement and get business accordingly.

Is any such thing possible now in respect of export trade, in which small business hardly participates?

Mr. LOEVINGER. Yes.

Small business can form Webb-Pomerene export associations just as well as big business.

Senator JAVITS. As a practical matter from your experience in the Department, is the Webb-Pomerene law effective and efficient enough for that purpose, because I have heard it said that it is not. It is not congenial to that kind of operation.

Mr. LOEVINGER. It isn't widely used. I don't know the reason. I suspect the reason is partially because the big companies don't really need it, and the small companies are relatively uninformed and unsophisticated about this kind of thing.

Senator JAVITS. So you feel we have adequate machinery as we are going to consider the trade bill; and it is a very important question, only 5 percent of American companies engage in export trade.

Do you feel we have the legal machinery then which is necessary to enable small business to cooperate for that purpose in the export field, but it hasn't used it?

Would that be your answer?

Mr. LOEVINGER. I wouldn't want to go so far as to say the machinery is wholly adequate, Senator Javits. I have not studied the Webb-Pomerene Act to see whether or not it can't be improved or changes made in it without saying this is so; it may be so. We would have to examine it to say that.

Senator JAVITS. Would you be good enough to do that. I don't want to tax you too much, but it is important, as you can see, because we are going to pass, I hope, a new trade bill tremendously expanding, we hope, American trade.

(The material referred to appears in the appendix at p. 952.)

Yet we know that only 5 percent of American companies actually participate in export trade, and certainly if we can give a legal help to expanding it, and broadening the participation, this is very good.

Now, the Export-Import Bank under Harold Linder is doing a magnificent job in making financing and credit guarantees available. If we have any hesitations on the legal side, let us at least know what they are; and if Congress looks to act, our Small Business Committee or even this committee might very well be induced to make some recommendations to the subject.

Mr. LOEVINGER. Let me say this, Senator, basically what is needed, in my judgment, is not less but more competition.

The Webb-Pomerene Act, whether in its present or in a revised form, is a means for establishing what the Europeans call export cartels.

Now, there is some feeling in Europe that we should be moving away from rather than toward the encouragement of export or import cartels.

As you are undoubtedly aware, within the last 10 years there has been a tremendous movement within the European community itself in the direction of our form of competitive economy, rather than toward the 19th century European cartel economy.

It seems to me that this is an inappropriate time for the United States to start leading the way back toward the cartel economy of 19th century Europe. Europe is now moving toward the competitive economy of 20th century America. And I think we should encourage this and lead the movement in that direction.

I think that a movement toward restriction or limitation, toward more cartels, toward more combination is a backward movement.

Senator JAVITS. Judge Loevinger, you will forgive me if I disagree with you 100 percent for this reason. You are truly living in the past. Ninety-five percent of American small business is excluded from the export trade. The cartel is in the 5 percent which is included. We have got to find techniques to let the small fellow get into it. That is real competition.

You are not restraining competition today, you are allowing a monopoly because you are not allowing the small fellow to have some of

the advantages of bigness which he might get by cooperation under complete supervision, and I have had the opinion that the Antitrust Division is living in the past, and you prove it to me, because if you think that we are going to a cartel system, if we try to find ways in which we are going to get 95 percent of American business firms to participate in the field from which they are excluded, you and I differ 100 percent.

Chairman PATMAN. Have you finished?

Senator JAVITS. I am finished.

Chairman PATMAN. May I invite the attention of the gentlemen of the committee—and I am not doing this to lobby with you, although I don't think I would violate any law if I did; but you would probably construe it as lobbying by a House Member with the Senators—that this is a great anniversary. August 22, 1961, the House of Representatives—1 year ago today—passed H.R. 8603, the identical bidding bill, and it is now in the Senate and has been for a year before the Government Operations Committee and the Appropriations Committee, and no action has been taken on it, and I just want to ask these gentlemen here who are members of this committee and who initiated this matter, to do something about the passage of this bill, and I suggest that under your rules, you can do most anything that is germane; you could consider an amendment providing that, in the event of identical bids, the policy be adopted of giving the award to the smallest concern making the identical bid. And then I think you would break up this identical bidding.

Senator PROXMIRE. I think that is an excellent suggestion. I can't see anything really wrong with it although maybe there is. But I think you would break up identical bidding in a hurry.

Chairman PATMAN. You gentlemen, I hope, won't overlook the fact this bill number is H.R. 8603. It was passed a year ago. [Laughter.]

And I hope you do get action on it.

Senator JAVITS. He is lobbying.

Chairman PATMAN. Yes, I am lobbying.

Any other questions before we conclude?

This brings to a close the committee's hearings on the state of the economy and on policies for achieving full employment. We have a number of charts, tables, and notes which have been prepared by the committee staff, which were circulated to the members of the committee for their use.

I believe most of these have been admitted to the record at appropriate places. However, many of these have not been put into the record and I would like them to appear and without objection they will be placed in the record as an appendix.

I believe that the committee's hearings have been most informative and most useful.

We are indebted to the large number of witnesses who devoted their time and energies to preparing statements for us and who have come here to testify.

I particularly want to thank those members of the committee who have given their time to these hearings; several members have attended all or almost all of the sessions and raised very penetrating questions and the chairman feels indebted to them.

The committee will stand adjourned.

(Whereupon, at 12 noon, the committee stood adjourned.)



## APPENDIX

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AUGUST 22, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
House of Representatives, Washington, D.C.*

DEAR MR. PATMAN: I have been highly gratified and indeed flattered by the many comments, both favorable and critical, which have followed the proposal for the issuance of gold certificates against foreign-held dollars which I had the privilege of outlining before the Joint Congressional Economic Committee on August 13. This interest in turn has induced me to give some further thought to the problem.

It appears to me that many of the objections which have been raised against the plan could be met by *restricting the issuance of the certificates to foreign central banks*. In this way the volume of the certificates outstanding at any moment would not be affected, directly or indirectly, by private speculation. The certificates would offer no shelter to floating funds or to "hot money." They would function simply as an additional instrument of cooperation between central banks, alongside with the other measures which have been evolved with such a striking measure of success during the past few years.

In this sense the issuance of gold certificates against dollars, and perhaps also other currencies, could represent a practical step in the direction of some of the broader arrangements which have been suggested by many distinguished authorities, such as Dr. Rueff, Dr. Triffin, Mr. Bernstein, and Mr. Zolotas, in order to expand the mechanism of the International Monetary Fund. I would like to stress, however, that in my opinion the greatest merit of the gold certificate plan lies in the fact that such a device would strengthen beyond any possible doubt the power of the American monetary authorities to shape freely their policies, and that by the same token it would reemphasize the unique position of the dollar as the major key currency in the world.

It seems to me—and I daresay this view is widely shared among many people in Europe—that the difficulties which at present continue to beset the dollar, despite the encouraging improvement which has occurred in the basic components of the U.S. balance of payments, are to be viewed not only within the narrow context of gold reserves and gold flows but against the background of the enormous strength of the American economy. An economy that can boast an annual national product in excess of \$550 billion can take care of temporary balance-of-payment problems by its own efforts and strength. Surely, the support which the dollar is receiving through the concerted and enlightened action of the central banks of the free world is an outstanding example of what the West can accomplish when it stands united. At the same time, it is in the interest of all of us that the United States may continue to lead the free world from a position of strength in all respects. In my opinion, the issuance of gold certificates against dollar balances held by foreign banks, far from being an admission of weakness, would restore the ability of the U.S. Government to regain complete freedom in the conduct of its monetary affairs and to reassert the U.S. control over the price of gold which has existed for almost 30 years and which has served the world well. It would further reduce the role played over the gold market by private operators, and buttress rather than impair the functioning of the international gold exchange standard.

Altogether, monetary cooperation between the United States, Britain, and continental Western Europe has led to an increasing pooling of their gold and other convertible assets. Unless I am mistaken, the system would operate with greater safety if it would involve also the availability of a type of asset the value of which is stable under any and all conceivable conditions. Among other things it would at this stage relieve the management of Europe's central banks from the agonizing task of reappraising continuously its duties and responsibilities in terms of both national interest and international cooperation. So long

as the claims of the two sets of interests can be conflicting in a major degree, the choice is bound to be most difficult and tortured. Once the potential area of conflict between those claims is removed, it becomes once more practicable for each monetary authority to pursue wholeheartedly the path of international cooperation.

Domestic considerations should and will continue to play a major role in shaping national monetary policies, within the framework of freely accepted limitations and safeguards, such as those which are embodied in the articles of incorporation of the International Monetary Fund. The availability of gold certificates would be helpful on both counts. It would not involve a pledge impinging upon the unfettered freedom of decision of the U.S. Government on a subject which is so closely related to the exercise of sovereignty as the choice of the gold parity of the currency. It would simply insulate the dollar holdings of foreign central banks against the effects deriving from the use of that freedom, thereby discouraging gold movements which stem from the "precautionary motive" of central banks which after all are entrusted with the safeguard of their nations' basic assets.

In my appearance before the joint committee I emphasized the fact that the gold certificate plan was to be conceived largely as a temporary device, which was by no means a substitute for more fundamental methods of redress of the balance-of-payments position. I still hold that opinion, and would not wish to overrate unduly the longrun remedial effects of any such plan. At the same time, further reflection has led me to think that the availability of such instrumentality to central banks would be likely to strengthen also two major features of an effective international gold exchange standard. The link between the dollar, i.e., the key currency of the international system, on the one hand, and gold on the other, would become emphasized, while avoiding the rigidities which would affect unfavorably international liquidity. The special position of the dollar as the center of gravity of the system would become strengthened. The various nations of the free world would be enabled to hold each other's currencies in almost unlimited amounts, thereby pooling to the greatest practical extent their gold and convertible assets. And while this state of affairs would provide an additional cushion against the vagaries of "hot money" and the adverse impact of psychological factors, it would give no incentive to monetary irresponsibility, since it would put, so to say, a price tag upon the freedom to devalue. Although it might add up to a significant advance in the process of constant adaptation which is being evolved in cooperation between governments, central banks, and the International Monetary Fund, in response to the ever-changing stresses and pulls of the world economic configuration.

I am attaching herewith, for such use as the committee may wish to make of it, a fuller elaboration of my proposal on this subject, giving also my views on several other proposals which have been advanced for improving the gold and international liquidity situation.

Deepest regards and thanks for the consideration given.

ETTORE LOLLI.

#### THE DOLLAR AND GOLD

##### SOME CLARIFICATIONS ON THE PROPOSAL OF THE ISSUANCE OF GOLD CERTIFICATES AGAINST DOLLARS HELD ABROAD

\* \* \* \* \*

The problem of gold and of international liquidity is not new, and many solutions have been proposed by economists and financiers from remote to present times.

The proposal submitted to the Joint Economic Committee of the Congress of the United States in the hearings of August 13, 1962, is, however, different from the general plans for the solution of the problem of international liquidity; and it is also essentially different from the mere "exchange guarantee" or "gold clause" for international debts.

In order better to evaluate the particular characteristics of the proposal, it is advisable to review briefly the principal "plans" presented recently. This review is contained in a short appendix attached to this memorandum.

It is clear that the proposal for issuance of gold certificates made before the Joint Committee of the U.S. Congress is not an international plan, since it concerns only one country, the United States. Furthermore, it is not a normal exchange guarantee offered on dollar balances held abroad, because it is not auto-

matically extended to all these balances but only, if at all, to those dollar balances for which conversion into gold is requested (therefore only through the central banks). Finally, it differs from the Stamp proposal which considers the issuance by the Fund of gold certificates, since the latter create new international liquidity, whereas the gold certificates originating from the gold certificate proposal would leave the total liquidity unchanged. *This proposal has the only scope of taking away the psychological pressure from the dollar.* It does not alter in any way the existing situation and does not cause any of the inconveniences claimed in the first hasty criticisms against it. It is an expedient to permit what is practically equivalent to a conversion into gold of dollar balances held abroad, even for amounts in excess of the gold available.

The essential characteristics of the gold certificates issued according to the proposal are the following:

(a) The certificates do not bear interest and are, namely, in all respects comparable to gold ingots;

(b) The issuance of the certificates sterilizes an equal amount of dollars. This is an essential condition like the first one. The dollars collected against the gold certificates should not remain at the disposal of the U.S. Treasury, but should be put out of circulation.

In order to better exemplify our idea, we report below in its essential parts the wording that should appear on the certificates:

"The Treasury of the United States, at its option, will pay at sight to the bearer of this certificate 1,000 ounces of gold or its equivalent in dollars at the time of its presentation."

The certificate represents a quantity of gold, but it is payable *either in gold or else* in its dollar equivalent. It is true that the gold represented by the certificate may not exist in the deposits of Fort Knox but, for practical purposes, this has no importance. Nobody in fact takes materially away the gold from Fort Knox. At the moment when a country should need to make use of its gold reserves, and therefore request from the United States the payment of its gold certificates, it would be exactly the same to obtain gold or dollars at the rate current at that time.

Provided that the dollars against which the gold certificates are issued, are immediately put out of circulation, such a practice would not change anything in quality or in quantity compared to the present international monetary system; it would have instead the beneficial effect of eliminating once and for all and in a definite way any doubt about the dollar as a reserve currency. And, once this doubt is eliminated, any pressure on the dollar would automatically disappear, along with all the motives or pretexts which now lead some people to sustain the necessity of its devaluation. This would naturally not prevent the U.S. Government from continuing with its present policy meant to reequilibrate its balance of payments.

The criticisms made against the proposal appear to a great extent inconsistent. The criticisms by Mr. Dillon and Mr. Hayes can be briefly summarized in the following points:

(a) The step is not necessary since the Government is determined not to devalue the dollar;

(b) One would create the impression that the United States does not desire to reequilibrate its balance of payments;

(c) An incentive would be given to the flight of American dollars abroad in search of the guarantee;

(d) The international monetary market would be upset because the holders of other currencies would be inclined to change them into dollars.

It is appropriate, first of all, to clarify that the proposal is *not an exchange guarantee extended* to the dollar holdings of all foreigners, but rather the conversion of dollars into gold certificates, on demand, probably limited to those coming from central banks. Nothing more, namely, than what is being done at the present time when the dollars of the foreign central banks are converted into gold; with the only difference that, with the introduction of the clause "the U.S. Government will pay \* \* \* gold or the current equivalent in dollars," the issuance of the certificates does not automatically cause a reduction of the American gold stocks.

Having stated the above, the criticisms can be examined separately.

(a) It is said that the step is not necessary because the U.S. Government has no intention of devaluing. Actually it is the very assumption that one wants to maintain unchanged the parity of the dollar which makes this step all the more

useful. In fact, if the parity of the dollar is not changed the step does not, and will never, result in any harmful consequence or cost for the United States. And, at the same time, by eliminating every psychological pressure on the dollar, it will make it easier to maintain the determination to avoid devaluation.

(b) The intention of the Government of the United States to reequilibrate its balance of payments in no way depends on the possibility offered to the central banks to change into gold a larger part of their dollar reserves. The step does not prevent in any way the U.S. Government from continuing its policy, whichever it is. Due to the increasing expansion of international commerce a parallel expansion of the international reserves is necessary; and since there is not sufficient gold, it is inevitable that one turns more and more to the foreign currency reserves, and the dollar is undoubtedly the main one. The proposed step has the only scope of making its functions as a reserve currency stronger and to stabilize the huge mass of dollars held for this purpose by the central banks of other countries.

(c) If the certificates were to be granted only in favor of the central banks, private speculators would have no possibility to interfere.

(d) It seems to us that the criticism that the international monetary market would be upset is the only criticism that may have some ground. Undoubtedly the possibility of converting dollars into gold certificates could lead the central banks to prefer the dollar to other reserve currencies, and especially the pound sterling. One should not forget, however, that the dollars changed into gold certificates become noninterest bearing, the same as the gold itself, whereas the currency holdings yield a not negligible interest. Therefore, the problem would arise only in the case of fear for the devaluation of other currencies—exactly as it happens in the present system.

In any case, nothing would prevent also Great Britain, and perhaps the other nations whose currencies function as international reserves, from issuing similar gold certificates, provided the sterilization of the sums collected against such certificates is strictly followed. As a matter of fact, we may say that the generalization of the custom of issuing such gold certificates could represent an alternative plan, even more simple than the many presented, efficiently to stabilize the international monetary situation. In effect, in view of the fact that balances held in a nonguaranteed currency yield interests, whereas their conversion into gold certificates makes them nonyielding, the various central banks would naturally be inclined to hold these balances in a foreign currency, in order to earn interests, till no suspicion of a devaluation arises. An intensification of the conversion of foreign currency holdings into gold certificates would point to the beginning of such suspicion and would sound as an alarm for the countries concerned, which would be led to take the necessary steps of economic policy with the object of correcting the situation. But, in the meantime, the possibility of converting the currency holdings into gold certificates would avoid a crisis of mistrust which is one of the main factors in the international monetary situation.

#### APPENDIX

##### BRIEF REVIEW OF PRINCIPAL RECENT PLANS ON GOLD AND INTERNATIONAL LIQUIDITY

1. It should be noted first of all that by "gold standard" a monetary system is intended in which paper currency is positively and at any time convertible into gold; and by "gold exchange standard," on the other hand, one intends the present system based on predetermined gold parities without, however, the possibility of actually converting the paper currency into gold (except for a few imperfect exceptions, the most important of which is undoubtedly the convertibility of the dollar in respect of central banks, a convertibility which is precisely the subject of the present discussion since it is imperiled by the scarcity of gold reserves as compared to the aggregate of convertible balances).

2. *The Rueff proposal.*—This outstanding economist is of the opinion that the present international monetary instability derives principally from the "monetary duplication" of an inflationary nature, which is a consequence of the function of international monetary reserves attributed to certain currencies (dollars, pounds sterling, etc.), which in their turn are issued against gold. In other words, Rueff supports the return to the pure gold standard. The difficulty, however, is that the *solution* would not *solve* the problem, but would instead *aggravate it*, because it would restrict the already limited existing liquidity.

Rueff's proposals are supported also by Heilperin, a Swiss professor, who has been handling this problem for many years.

3. *The Triffin plan*.—This plan which has raised many sharp polemics, takes up again Keynes' idea to create a World Central Bank, having a nominal currency of its own (the "bancor"). Triffin, however, does not entirely abolish the function of gold, but he links it to a new form of international reserve consisting of deposits with IMF with a guaranteed rate of exchange and interest bearing. These deposits would be made up by compulsory payment of a fraction (20 percent is suggested) of the reserves of each country, as well as by other voluntary payment. The part of the deposits which exceed 20 percent of the total national reserves could, however, be withdrawn in gold at any moment. The countries with a surplus in their balance of payment would go on with the compulsory payment of 20 percent of the increase in their reserves, whereas the countries with a deficit could utilize for their needs that part of their initial payment which has become excessive in respect of their compulsory deposit. The availability of the Fund, and therefore its credit capacity, would in this way be automatically increased in proportion with the increase of the world reserves.

The Triffin plan has undergone many criticisms, some of which are justified (especially, for example, the one by Angell). It has also met opposition, almost preconceived, which reflects, in our opinion, above all the difficulties of the "psychological adjustments" necessary to face problems of such wide dimensions.

4. *The Zolotas plan*.—According to Professor Zolotas, governor of the Bank of Greece, it is not necessary to change the present "gold exchange standard" system, but it is sufficient to strengthen it with some supplementary agreements.

In the first place the IMF should conclude "standby" agreements with the treasury departments and the central banks of the various participating countries, for the purpose of automatically obtaining supplementary credits from countries with a surplus balance of payment. These credits would be used by the Fund for the purpose of granting loans to those countries having a deficit.

Furthermore, Zolotas proposes that the United States and Great Britain, whose currencies are used as international reserves, should accumulate large amounts of other currencies convertible between them, to be used for operations on the open market to counteract short-term speculative operations.

Finally, all countries having a convertible currency should guarantee the gold exchange on the amounts of their currencies held by central banks of other countries. This, together with the payment of preferential interest rates to official foreign deposits, would encourage the various countries to maintain their reserves in foreign currency and not request their conversion into gold.

5. *The Stamp plan*.—This plan, which is very simple, contemplates the possibility that IMF issues a limited amount of certificates (a figure of \$3 billion for 12 months is suggested) with a value expressed in gold, but not automatically convertible into gold. The members of the Fund should commit themselves to accept these certificates, in exchange for national currency, from the Fund itself or from other central banks. The proceeds of these certificates would be used to grant aid to underdeveloped countries.

The Stamp plan also considers, alternatively, the possibility that the Fund obtain substantial "standby" credits from the various countries in a mechanism which has a similarity to that of the Triffin plan and which also includes the gold guarantee for credits toward the Fund.

6. *The Bernstein plan*.—Bernstein, like Zolotas, belongs to the group of those who support the validity in substance of the present system with only a few necessary marginal modifications. Bernstein proposes, like Zolotas, the concession by members of the Fund of substantial "standby credits" from which the Fund could draw whenever it becomes necessary.

Besides, Bernstein also proposes to create, side by side with the Fund, a new collateral "stabilizing" organization in which all the members of the IMF should take part. Against these new contributions by the members, the stabilizing Fund would issue interest-bearing certificates with a given maturity, in the currency of the lending country and with *exchange guarantee*. The quotas subscribed by the various countries would be paid in only when such countries showed surpluses in their balance of payment.

It is to be noted that also in the Bernstein proposal, one finds again some of the essential points of the Triffin plan even though in a more simple mechanism.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
House of Representatives,  
Washington, D.C.*

DEAR CONGRESSMAN PATMAN: In the course of my testimony before the Joint Economic Committee on August 20 and 22, 1962, a number of questions were asked of me. It was suggested that I undertake to answer as many of them as I could when I received a copy of the transcript. The following answers are responsive to each of the questions which I feel qualified to answer.

At page 1385 you asked whether I would attribute some of our balance of payments problems to the large volume of imports of automobiles and steel in recent years. It seems to me that one of the sources of our balance of payments difficulties has been the fact that there has been a substantial increase in imports and decrease in exports of automobiles and steel and that this expansion of net imports may have been due in large part, as you suggest, to the failure of the domestic manufacturers of automobiles to be competitive in design and of steel to be competitive in price with foreign producers.

At pages 1392 and 1393 you propounded several questions relating to the activities of tax-free foundations. You asked more specifically whether I saw anything contrary to the spirit and objectives of the antitrust laws a situation where funds accumulated by tax-free corporations are used to finance the acquisition of other corporations. The fact that tax-free foundations may be nominally nonprofit organizations does not suggest that they cannot violate the antitrust laws. If such foundations are in fact engaged in competition with other business enterprise in fields where the amount of capital available is an important factor then their tax exemption may confer a competitive advantage upon them. We have received some complaints alleging such a situation to exist. If these practices are widespread, the competitive advantages of tax-free foundations may raise questions of national policy which Congress should explore.

At page 1393 you asked whether we are following a mild program of antitrust enforcement which leaves untouched firms dominant in their industries so long as they do not become involved in collusive arrangements; and at page 1394 you asked what program we have for dealing with giant firms dominant in major domestic industries. Contrary to the impression that some seem to have, the fact and degree of economic dominance are not ordinarily self-evident phenomena. The Antitrust Division does not have the resources for a complete and continuing survey of the national economy and does not seek to make such a survey. However, the Antitrust Division does collect and analyze the available data from other sources that are relevant to economic concentration, and does make its own investigations in specific fields where it appears that there may be activity inconsistent with the antitrust laws. We have already instituted some suits based upon alleged illegal aggregation of economic power and we will institute such additional suits of this kind as the evidence we are able to secure may warrant. Our program in this field is to enforce the mandates of the antitrust laws as those laws are construed by the courts. There are, of course, those who believe that the antitrust laws do not go far enough in forbidding economic concentration of power. Obviously our mandate is simply to enforce existing law and our program is to do that—fairly, vigorously, and effectively.

With respect to the "Attorney General's Report on Identical Bidding in Public Procurement," you urged at pages 1618 and 1619 of the transcript that further reports include in table II the details of all bids filed when identical bids are reported. We gave serious study to the listing of all bids, identical and disparate, relating to each item of procurement in preparing the reports and concluded that in the interest of achieving one of the major objectives of

the Executive order, the publicizing of the identical bids, it would be more effective to limit the published details of the bidding to identical bidders. If we had included the names of all bidders, table II would have required 672 printed pages instead of the 278 pages in the present report. However, we share your desire to make the identical bid reports as complete as possible and will reconsider the matter in setting up the format of the next report.

At page 1620 of the transcript you asked for "some indication of the contents of the 123" identical bid cases which were excluded from the report because they required separate treatment. Of the 118 Federal cases requiring separate treatment, 115 were cases submitted by the Department of Agriculture, most of which are discussed in chapter VI of the report beginning on page 24. Thus, while most of the cases of identical bidding affecting the procurement of agricultural commodities by the Department of Agriculture for the school lunch program and price support programs are discussed in chapter VI, the bidding details are not incorporated into tables I through III and for that reason they are listed as "rejected" cases in table D, page 16.

The three remaining Federal cases of identical bidding excluded from the report were cases submitted by the Military Petroleum Supply Agency covering the procurement of estimated petroleum and petroleum products requirements for a 6-month period for all service installations. The complex character of the procurement arising out of the large number of both bidders and line items of procurement necessitated the development of special processing techniques to accommodate these reports to our machine processing operations. Consequently, these reports were not assimilated for machine processing in time to meet the deadline for publication of the report. They will, however, be incorporated into the next report to be published.

Five identical bid cases reported by State and local agencies were listed in table D as having been excluded from the report because they required separate treatment. These cases involved the procurement of several types of services which necessitated the development of a method of presentation which was not completed in time for publication. These cases will be included in the next report.

You asked, at page 1621 of the transcript, for a memorandum showing a breakdown of the 115 Federal cases listed in table D as having been excluded from the report because the bids were not identical after evaluation. You also indicated that you were puzzled by the fact that so many bids which the procurement agency thought were identical were found by my staff not to be identical. The explanation for the rejection of these cases can be found in the definition of an identical bid in paragraph 1 of Executive Order 10936 which requires the reporting of bid proceedings to the Attorney General:

1. Whenever, in connection with a procurement of property or services exceeding \$10,000 in total amount and made pursuant to an advertisement or other public invitation for bids, a department, agency, or instrumentality of the Government shall hereafter receive two or more bids—

(a) Which are identical as to unit price or total amount, or

(b) Which, after giving effect to discounts and all other relevant factors, the department, agency, or instrumentality shall consider to be identical as to unit price or total amount.

Thus the Executive order requires the submission of reports when there is identical bidding either in the gross or the net amount of the bids. It was determined, however, that as a matter of policy we would publish only those bids which were found to be identical in price after evaluation. Consequently, those cases which were reported under the Executive order because they were identical as to the gross price bid were excluded from the published report if the bids were found to be nonidentical after evaluation by the agency.

Senator Javits also requested our recommendations as to whether the Webb-Pomeroy Act should be amended. We still have this matter under consideration and will communicate with you as soon as it is resolved.

Sincerely yours,

LEE LOEVINGER,  
Assistant Attorney General, Antitrust Division.

CONGRESS OF THE UNITED STATES, JOINT ECONOMIC COMMITTEE

Letter from Representative Wright Patman, chairman, Joint Economic Committee, to Hon. William McChesney Martin, Jr., chairman, Board of Governors, Federal Reserve System, requesting that condensation of the minutes of the meetings of the Federal Open Market Committee in 1960 be made public

AUGUST 14, 1962.

HON. WILLIAM MCCHESENEY MARTIN, JR.,  
*Chairman, Board of Governors, Federal Reserve System,  
Washington, D.C.*

DEAR CHAIRMAN MARTIN: During the committee's hearings on June 1 and 2, 1961, on the annual report of the Board of Governors of the Federal Reserve System for the calendar year 1960, it quickly became apparent that neither members of the general public nor experts on monetary policy matters could adequately determine what policy decisions had been reached by the Federal Open Market Committee during the year 1960, nor ascertain the reasons for such decisions on the basis of the brief and vague summaries of that Committee's meetings which were published in the Board's annual report.

Accordingly, on June 2, 1961, while you were testifying before the committee, I requested that you submit to the committee for its information and use copies of the full minutes of the meetings of the Federal Open Market Committee which that Committee is required by law to keep.

Further, at your suggestion I wrote you a letter on June 14, 1961, renewing my request that you submit copies of those minutes for the year 1960, along with certain other materials specified in that letter.

In neither of my requests, nor at any time, was there any suggestion or understanding that the committee would treat as confidential these minutes. However, when these minutes of the meetings were delivered to my office they were accompanied by a letter from you which contains a statement that: "The Open Market Committee is prepared to make these minutes of its meetings held in 1960 available to the Joint Economic Committee on the understanding that they will be treated as confidential." In other words, it appears that in complying with my request for copies of the minutes you sought to impose a restriction upon the committee's use of these minutes.

While I do not acknowledge that you are privileged to restrict the committee in its use of the requested materials, I adopted a procedure for making the essence of the Open Market Committee's proceedings public, while at the same time avoiding making revelations of the kind which you indicated in your letter might be objectionable. Specifically, this was to have two competent and disinterested scholars in the field of monetary operations prepare a condensed report giving in their own words descriptions of the issues discussed at each of the meetings and the conclusions reached at each meeting. This report, prepared by Dr. John G. Gurley, professor of economics, Stanford University, and Dr. Asher Achinstein, senior specialist, Legislative Reference Service, Library of Congress, is also prepared in a manner which minimizes identification of particular participants in the Open Market Committee meetings, and minimizes the possibility that policy positions taken can be attributed to particular participants.

Last week I distributed, on a confidential basis, a copy of the Gurley-Achinstein report to each member of the Joint Economic Committee, indicating that after the committee's present series of hearings is completed I intended to take up with the committee the question of making this report public. However, it is apparent that a copy of the Gurley-Achinstein report has fallen into the hands of a newspaperman, as extracts from the report appeared in news items in the New York Times yesterday and again today, and possibly others will appear in the days to come. This premature disclosure of the contents of the report in the press has raised the question of immediate release of the report to the press generally.

Accordingly, the committee met this morning and adopted by majority vote the following resolution:

"That the presently confidential joint committee print entitled "How Policies of the Federal Reserve System Are Determined" be submitted in a letter by the chairman to the Chairman of the Board of Governors of the Federal Reserve System, with the request that he allow us to make it public because, in our view, the material in it is in the public interest and in the public interest it ought to be made public; that this be done promptly; and that until a resolution of the matter is had, the Joint Economic Committee print be kept confidential."

In addition, it was also agreed that I would inform you that Senator Bush does not concur in the view that it would be in the public interest to make the Gurley-Achinstein report public; while Senator Javits and Mr. Curtis reserve judgment on this question until they learn your reasons for objecting to making it public, if you do object.

A copy of the Gurley-Achinstein report is enclosed. An early answer to the committee's question will be appreciated.

I am,

Sincerely yours,

WRIGHT PATMAN.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
OFFICE OF THE CHAIRMAN,  
Washington, August 16, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.*

DEAR MR. CHAIRMAN: This will acknowledge receipt of your letter of August 14 enclosing a copy of the Gurley-Achinstein report and requesting concurrence of the Federal Open Market Committee to its publication by the Joint Economic Committee in the public interest.

We are having a meeting of the Federal Open Market Committee on August 21, and this matter will be placed on the agenda for that meeting so that we can give you as prompt a reply as possible.

Sincerely yours,

WM. McC. MARTIN, Jr.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
Washington, August 21, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.*

DEAR MR. CHAIRMAN: This refers to your letter of August 14, 1962, transmitting a copy of a proposed joint committee print entitled "How Policies of the Federal Reserve System Are Determined" and quoting a resolution adopted by your committee to the effect that this print be submitted to the Chairman of the Board of Governors of the Federal Reserve System with the request that your committee be allowed to make it public.

In my letter of July 21, 1961, transmitting to your committee the minutes of the Federal Open Market Committee for 1960, there were set forth in some detail the reasons for which the Open Market Committee is convinced that the public interest would not be served by publication in whole or in part of detailed minutes of meetings of the Committee. The question whether it would be in the public interest to publish the joint committee print which purports to contain an analysis and condensation of those minutes obviously involves considerations that require careful study by the members of the Open Market Committee.

Upon receipt of your letter, I immediately had the copy of the document transmitted by you reproduced and distributed by airmail to each member of the Open

Market Committee. However, the members of the Committee did not receive copies of the report in time for more than cursory reading before the regular meeting of the Open Market Committee today (August 21, 1962).

Moreover, the last paragraph of chapter I of the report appears to indicate that a last chapter of the report has the purpose of highlighting "the main points brought out by the minutes with respect to the actions of the committee in 1960," and of briefly discussing "them from the point of view of the achievement of a more effective monetary policy." Yet, the joint committee print in the form enclosed with your letter does not include such a final chapter. If it is your committee's plan to include such a chapter in the proposed print, it would be helpful to the members of the Open Market Committee also to have an opportunity to review the galley proof of that chapter.

For the reasons here indicated, the Open Market Committee at its meeting today concluded that it would be desirable to carry over until its next meeting, to be held on September 11, the question raised in your letter concerning general publication of the proposed Joint Economic Committee print. Promptly following that meeting, you will be advised of the committee's views.

Sincerely yours,

WM. MCC. MARTIN, Jr.

#### MEMORANDUM

To: Hon. Wright Patman.

From: Wm. Summers Johnson.

Attached are notes and tables which may be helpful in interrogating witnesses.

#### INDEX

Tables relating to alternative methods of reducing taxes by Roy Moor :

Unemployment rate, GNP, and Federal surpluses and deficits in terms of two budgets, 1950-61.

How a given reduction in taxes would be distributed among various income classes under alternative methods.

Percentage increase in taxable incomes, after taxes, of the different income classes under various methods of making a \$6 billion reduction in individual income taxes.

Average tax savings per individual under various methods of making a \$6 billion reduction in individual income taxes.

Rules of thumb on revenue losses under various tax cuts.

Monetary and international statistics by William Moore :

Comparative yields on long-term Government bonds in 1962.

Changes in cost of living in selected countries, 1953-62.

Restrictions upon international capital transfers in selected countries.

Analysis of cash flow to corporations by James Knowles :

Summary.

Corporate profits in historical perspective.

The share of corporate business in the gross national product, 1929-61.

Measures of corporate cash flow as a share of national output and incomes, 1929-61.

#### *Unemployment rate, GNP, and Federal surpluses and deficits in terms of 2 budgets, 1950-61*

[Dollars in billions]

Calendar year	Unemployment rate (percent)	Gross national product	Administrative budget	National income and product budget
1950	5.3	284.6	-0.4	2.2
1951	3.3	329.0	-3.4	6.4
1952	3.1	347.0	-5.8	-3.9
1953	2.9	365.4	-9.2	-7.4
1954	5.6	363.1	-3.7	-5.8
1955	4.4	397.5	-2.8	3.8
1956	4.2	419.2	3.8	5.7
1957	4.3	442.8	.6	2.0
1958	6.8	444.5	-7.1	-2.4
1959	5.5	482.7	-7.0	-1.8
1960	5.6	503.4	2.0	3.3
1961	6.7	518.7	-5.3	-3.8

*How a given reduction in taxes would be distributed among various income classes under alternative methods*

[In cumulative percentages]

Income class	Number of taxable returns	Cut in new 1st bracket <sup>1</sup>	Increased exemption	Cut in present 1st bracket	Cut in all brackets <sup>2</sup>	Increased corporate dividends <sup>3</sup>
Under—						
\$0,000.....	39	25	25	20	13	8
\$10,000.....	88	85	81	82	60	22
\$20,000.....	98	97	95	97	84	42
\$50,000.....	99	99	99	99	94	67
Over \$50,000.....	100	100	100	100	100	100

<sup>1</sup> Assumes new 1st bracket would be from \$0 to \$1,000.

<sup>2</sup> Assumes equal percentage point cut in all brackets.

<sup>3</sup> Assumes that a cut in corporate income taxes or an increase in capital consumption allowances would result in some increase in dividends.

*Percentage increase in taxable incomes, after taxes, of the different income classes under various methods of making a \$6,000,000,000 reduction in individual income taxes <sup>1</sup>*

Adjusted gross income classes	Reduce rate in half 1st bracket 7.5 percentage points	Increase personal exemption \$200	Reduce 1st bracket rate 4.6 percentage points	Reduce each individual rate 3 percentage points
	Percent	Percent	Percent	Percent
\$0 to \$5,000.....	3.0	2.8	2.3	1.5
\$5,000 to \$10,000.....	2.2	2.2	2.3	1.8
\$10,000 to \$20,000.....	1.5	1.4	1.4	2.4
\$20,000 to \$50,000.....	.8	1.2	.9	3.0
Over \$50,000.....	.1	.6	.5	3.3
Total revenue loss (billions).....	\$5	\$6	\$6	\$6

<sup>1</sup> Estimated for 1962 on basis of 1960 data of Internal Revenue Service.

*Average tax savings per individual under various methods of making a \$6,000,000,000 reduction in individual income taxes <sup>1</sup>*

Adjusted gross income classes	Reduce rate in half 1st bracket 7.5 percentage points	Increase personal exemption \$200	Reduce 1st bracket rate 4.6 percentage points	Reduce each individual rate 3 percentage points
\$0 to \$5,000.....	\$75	\$76	\$60	\$42
\$5,000 to \$10,000.....	142	132	148	114
\$10,000 to \$20,000.....	142	168	175	288
\$20,000 to \$50,000.....	150	300	185	762
Over \$50,000.....	112	300	138	1,690
Total revenue loss (billions).....	6	6	6	6

<sup>1</sup> Estimated for 1962 on basis of 1960 data of Internal Revenue Service.

## RULES OF THUMB ON REVENUE LOSSES UNDER VARIOUS TAX CUTS

## TAX LOSS

Change in exemption level.....	For each increase of \$100 from the present per capita exemption level of \$600, the aggregate revenue loss is approximately \$3 billion per year.
Reduce individual income tax rates across the board.	Each 1 percentage point reduction in the individual income tax rates involves an aggregate revenue loss of approximately \$2,000,000,000 per year.
Reduce present 1st bracket rate.....	Each 1 point reduction in the 1st bracket rate, presently 20 percent, involves an aggregate revenue loss of approximately \$1,300,000,000 per year.
Splitting 1st bracket and reducing rate in new 1st bracket.	If a new 1st bracket were created equal to one-half the present 1st bracket range, the aggregate revenue loss for each 1 point reduction from the 20-percent rate in the new 1st bracket involves an aggregate revenue loss of approximately \$800,000,000 per year.
Reduction in corporate rate.....	Each 1 percentage point reduction in the present 52-percent corporate rate involves a revenue loss of approximately \$500,000,000 per year.

## COMPARATIVE YIELD ON SELECTED LONG-TERM GOVERNMENT BONDS INCLUDING RECENTLY OFFERED 4¼ PERCENT, AUGUST 15, 1987-92

In its financing in the last week of July, the Treasury offered a long-term bond callable August 15, 1987, and maturing August 15, 1992, bearing a coupon of 4¼ percent, offered at 101 to yield 4.19 percent. In the announcement the Treasury indicated an outside limit of \$750 million of these bonds. Subscriptions for them came to \$316 million and they were allotted in full.

There is no outstanding bond against which the comparative yield of this issue may be measured directly, but the accompanying table shows yields on four other issues of long-term bonds. Of these four, perhaps the best comparison would be with the 3½ percent due February 15, 1990, since the maturity on this issue lies between the call date and the due date on the new issue. On July 30 it was quoted at 4.14-percent yield.

Direct comparison of yields must take account of the fact that each of the four previously outstanding issues are selling below par, which to certain investors, has an added attraction since the bonds are redeemable at par if the proceeds are used for the payment of Federal estate taxes.

Prices and yields of selected long-term Government bonds <sup>1</sup>

[Price decimals are 32ds]

Date	3¼ percent, May 15, 1985		3¼ percent, Feb. 15, 1990		3 percent, Feb. 15, 1995		3¼ percent, Nov. 15, 1998		4¼ percent, Aug. 15, 1987-92	
	Price	Yield	Price	Yield	Price	Yield	Price	Yield	Price	Yield
<b>Weekly:</b>		<i>Percent</i>		<i>Percent</i>		<i>Percent</i>		<i>Percent</i>		<i>Percent</i>
1988										
May 4	90.16	3.88	92.24	3.93	87.10	3.68	91.16	3.94		
May 11	91.10	3.82	98.02	3.92	87.24	3.65	91.28	3.92		
May 18	90.22	3.86	91.28	3.99	86.22	3.71	90.22	3.99		
May 25	90.26	3.85	91.30	3.98	86.20	3.72	90.22	3.99		
June 1	91.06	3.83	92.04	3.98	86.22	3.71	90.28	3.98		
June 8	91.12	3.82	92.12	3.96	86.28	3.70	91.04	3.96		
June 15	91.10	3.82	92.08	3.96	86.22	3.70	91.02	3.97		
June 22	90.28	3.85	92.06	3.97	86.20	3.71	90.28	3.98		
June 29	89.30	3.92	90.18	4.07	85.00	3.81	89.10	4.07		
July 6	89.04	3.98	89.28	4.12	84.14	3.84	88.20	4.11		
July 13	88.28	4.00	90.06	4.10	85.00	3.81	89.00	4.08		
July 20	88.28	4.00	90.02	4.11	85.06	3.80	88.28	4.09		
<b>Daily:</b>										
July 23	88.28	4.00	90.04	4.10	85.08	3.79	88.30	4.09		
July 24	88.24	4.01	90.00	4.11	85.05	3.80	88.27	4.09		
July 25	88.24	4.01	89.30	4.11	85.04	3.80	88.24	4.10		
July 26	88.26	4.00	90.02	4.11	85.06	3.80	88.26	4.09		
July 27	88.24	4.01	89.24	4.13	84.30	3.81	88.18	4.11		
July 30	88.22	4.01	89.18	4.14	84.24	3.82	88.10	4.12		
July 31	88.22	4.01	89.16	4.14	84.24	3.82	88.08	4.13	‡(101.00)	‡(4.19)
Aug. 1	88.24	4.01	89.22	4.13	84.30	3.81	88.14	4.12	‡100.28	‡4.19
Aug. 2	89.02	3.99	90.08	4.09	85.10	3.79	89.00	4.08	‡101.01	‡4.18
Aug. 3	89.00	3.99	90.06	4.10	85.10	3.79	88.30	4.09	‡101.14	‡4.16
Aug. 6	89.02	3.99	90.04	4.10	85.10	3.79	88.26	4.09	‡101.08	‡4.17
									‡101.04	‡4.18

<sup>1</sup> On bid bases as reported to the Treasury by the Federal Reserve Bank of New York.

<sup>2</sup> Offered price and yield.

<sup>3</sup> When issued.

*Changes in cost of living selected countries, 1953=100*

	Germany	Italy	Netherlands	United Kingdom	France	Japan	United States
1953.....	100	100	100	100	100	100	100
1954.....	100	103	104	102	100	106	100
1955.....	102	105	106	106	101	104	100
1956.....	104	109	108	112	103	105	102
1957.....	107	110	115	115	106	108	105
1958.....	109	113	117	119	121	109	108
1959.....	110	113	118	120	129	110	109
1960.....	111	115	121	121	134	115	111
1961:							
I.....	113	117	122	123	136	118	111
II.....	114	117	122	124	136	119	111
III.....	115	118	123	126	137	123	112
IV.....	115	119	124	127	140	125	112
1962:							
January.....	117	120	125	128	142	126	112
February.....	117	121	125	128	142	126	112
March.....	118	122	126	129	142	127	113
April.....	119	122	127	130	143	128	113
May.....					130		

Source: International Financial Statistics, July 1962.

#### RESTRICTIONS UPON INTERNATIONAL CAPITAL TRANSFERS IN SELECTED COUNTRIES

Incoming and outgoing capital payments by residents and nonresidents are subject to a wide variety of controls, licensing, and restrictions in various countries. The following comment covers only selected European countries, Japan, the United States, and Canada. It is not necessarily representative of the range or complexity of such regulations.

In the case of the United States and Canada there are no restrictions (except the more or less academic one of the United States requiring licenses for transfers to or from the mainland of China and North Korea).

In Switzerland transfers of capital may be made freely except with respect to a "controlled area" involving Bulgaria, Czechoslovakia, Rumania, etc., in which case licenses are required. It is sometimes said, however, that, because of the type of banking system which prevails in Switzerland, "moral suasion" may on occasion be actively employed as an effective instrument of national policy.

In Germany there are virtually no restrictions except for the important one that nonresidents may not own domestic treasury bills without an individual license.

In general, the United Kingdom and Sweden require approval of transfers but such approval is normally granted subject to stated regulations.

The significant thing about countries which, unlike Canada and the United States, do have systems of controls is the more or less elaborate specifications which tend to make it difficult to tell without exhaustive analysis just how much the restrictions really restrict and how much of possible transfers fall into an exempt category. Illustrative of the complexity of controls which may or may not be restrictive but challenge analysis are the cases of France and Japan.

Descriptions given in the reports of the International Monetary Fund on the capital controls in this selected group of countries as of the end of the first quarter of 1962 follow.

#### France

Most outward transfers of capital by residents require approval. Transfers in respect of legacies, dowries, and, subject to certain time limitations, emigration of foreign nationals, are permitted freely without special authorization. Capital assets abroad belonging to or acquired by residents are not subject to repatriation or surrender. Residents of foreign nationality may dispose freely of their assets abroad. Residents of French nationality are permitted to reinvest such assets either in quoted securities in accordance with a general authorization or in other investments under individual license. Subscriptions to new issues may be made only by using the proceeds from sales of securities already owned by residents of French nationality. Exchange proceeds from sales of foreign securities expressed in foreign currencies and owned by resi-

dents of French nationality (so-called *devises-titres*) may be sold at a free market rate to other residents of French nationality, who in turn may use the exchange only to purchase securities quoted in foreign markets.<sup>1</sup>

The following operations and transactions related to nonresident investments may be made freely, provided that the investment is financed in accordance with the prescription of currency regulations applicable to the country of residence of the foreign investor: (1) spot and forward purchases on stock exchanges in France of specified French securities<sup>2</sup> officially quoted on those stock exchanges; (2) subscriptions to an increase in the capital of a French company, provided that its shares are officially quoted on a stock exchange in France; (3) subscriptions, at the time of issuance, to short-term or long-term securities and bonds issued by a French public service organization or by a private enterprise having its head office in France, provided that the securities issued by a private enterprise are officially quoted on a stock exchange in France; (4) acquisition on a spot basis through the intermediary of a notary public of immovable property or rights to such property located in France; and (5) loans to residents in accordance with certain prescribed conditions (the exchange of letters between a lender and a borrower must explicitly stipulate that repayment will be made directly by the borrower to the authorized bank whose services were used in financing the operation, in order that the transfer of funds may be made in accordance with the regulations). The liquidation of these investments and the transfer of proceeds accruing from their liquidation may be made freely.

The import of French and foreign securities on behalf of residents or non-residents is free, provided that it is carried out through the intermediary of an authorized bank. The export of French securities held in France is permitted if they are at the free disposal of a resident of the area of convertibility. The export of foreign securities on behalf of residents of foreign nationality is permitted only when such securities were held by them prior to September 10, 1939, or were acquired with a permit after that date. Immovable property and French securities in France belonging to nonresidents may be transferred between residents of all countries in the area of convertibility or between residents of the same bilateral country. Foreign securities held in France by nonresidents may be transferred between nonresidents irrespective of their country of residence.

### Japan

Foreign investments in Japan are generally subject to approval, mainly in accordance with the Foreign Investment Law (Law No. 163 of May 10, 1950). All acquisitions of stocks, debentures, beneficiary certificates, and claims in the form of loans by foreign investors are subject to individual license if a guarantee for remittance of income or principal is desired. However, acquisitions of stocks in the securities market are generally approved up to 15 percent of the stock of any corporation not classified as a restricted industry and up to 10 percent of the stock of any corporation classified as a restricted industry.<sup>3</sup> All these acquisitions must be made against the yen proceeds from the sale of foreign exchange or its equivalent. Stocks in the form of stock dividends on earned surplus or revaluation of assets may be acquired freely, but application for remittance rights must be made within three months from the date of acquisition. The following are deemed to be the same as the yen proceeds from the sale of foreign exchange, if they are reinvested in Japan: proceeds from the redemption after maturity of debentures, beneficiary certificates, or claims in the form of loans; dividends on stocks; interest on debentures or on claims in the form of loans; distributed profits of beneficiary certificates; receipts from technological assistance contracts; and proceeds from sales of stocks, debentures, and beneficiary certificates.

In the event of expropriation or compulsory sale of a foreign investment, the amount paid on account of expropriation may be repatriated freely.

For the purpose of facilitating new foreign investment, the following two formulas have been established: (1) Since July 21, 1959, applicants have been able to obtain "conditional approval" under the Foreign Investment Law for a foreign investment in Japan. For investments so approved, the remittance of principal and earnings is guaranteed, subject to the condition that the Government can temporarily defer the remittance if Japan's balance-of-payments

<sup>1</sup> The system of *devises-titres* was abolished with effect from April 1, 1962.

<sup>2</sup> Securities expressed in foreign currencies and issued by French companies or organizations are considered as foreign securities.

<sup>3</sup> Restricted industries include waterworks, railways and other transportation, electric and gas utilities, and banks.

situation so requires. (2) A "prior designation" procedure under the Foreign Exchange and Foreign Trade Control Law has also been operative since July 21, 1959. For a foreign investment so designated by the authorities at the time the investor acquires an equity investment (stocks, debentures, and beneficiary certificates) or concludes a technological assistance contract, the remittance of earnings and principal will be automatically approved, subject to the condition that the remittance can be deferred temporarily if Japan's balance-of-payments situation so requires.

Proceeds of liquidated stocks, debentures, and beneficiary certificates may be remitted after two years from the date of acquisition. Proceeds from sales of stocks, debentures, and beneficiary certificates sold within two years from the date of acquisition are deposited in Nonresident Yen Deposit Accounts, balances on which can be transferred to another nonresident in return for foreign currency. Rights to the allotment of newly issued stocks may be sold if the issuing company gives its consent, or the value of the rights can be realized by selling the stocks with rights and purchasing the same stocks without rights or purchasing other stocks. (This constitutes a preferential treatment of foreign investors since, under the Japanese commercial code, the right to the allotment of newly issued stocks may not be sold.)

Investors who obtain a license or approval to acquire an equity investment with yen from a Nonresident Yen Deposit Account may have the income remitted and the principal credited to a Nonresident Yen Deposit Account.

All other capital transactions and transfers having an exchange control aspect are subject to individual license, although in practice, for most transactions, an exchange license is not required for foreign investment in Japan if the investor desires neither remittance of income or principal nor credit to a Nonresident Yen Deposit Account.

Transfers of capital abroad and investments abroad by residents are subject to approval.

Securities acquired with approval under the Foreign Investment Law may be imported and exported freely.

#### *Belgium-Luxembourg*

All capital transactions may be carried out freely through the free market or by settlement in Belgian or Luxembourg francs through the Financial Account of a nonresident. In addition, incoming capital may be received in convertible currencies through the official market or in Belgian or Luxembourg francs to the debit of a Convertible Account. The exchange control authorities may guarantee the repatriation of approved foreign investments made in Belgium-Luxembourg. In that case, capital brought in through the official market may be repatriated through that market. All transactions in securities by residents or nonresidents are free, but the financial settlement of such transactions must conform to the general regulations.

#### *United Kingdom*

Transfers of resident capital to countries outside the Sterling Area require approval, which normally is granted for commercial investment that promises to produce clear and commensurate benefits to U.K. export earnings and thus to the balance of payments in the short term. Permission may be obtained to invest foreign currency capital receipts in marketable securities expressed in foreign currency, but any such receipts in a specified currency (see footnote 2) which have not been invested within six months must be sold to an authorized bank.

Repayments abroad due to a nonresident in respect of matured capital obligations are permitted freely; otherwise, repayments non-resident-owned capital may be credited only to Blocked Accounts (see section on Nonresident Accounts, above). However, residents of Denmark, Norway, and Sweden may transfer their funds freely to their respective countries. Persons resident outside the Sterling Area who make direct investments in the United Kingdom must provide one of the specified currencies or sterling from an External Account. Capital directly invested by a nonresident after January 1, 1950, in projects approved by the exchange control authorities may be repatriated at any time, together with profits thereon.

Nonresidents may buy sterling securities on a recognized stock exchange in the United Kingdom against payment from an External Account; or, if the securities cannot be redeemed under any contractual provision within five years from the date of purchase and are not optionally payable in dollars or, in respect of securities issued on or after June 23, 1961, are not optionally payable in any other for-

foreign currency, they may be purchased with sterling from a Blocked Account. Nonresidents may sell sterling securities in the United Kingdom, provided that the proceeds are credited to a Blocked Account or reinvested in a Sterling Area security having at least five years to maturity (special facilities apply to residents of Denmark, Norway, and Sweden). Interest, dividends, etc., from such securities and the proceeds at maturity of any that are redeemable may be remitted to the country of residence of the owner or credited to any External Account.

Nonresidents may purchase officially quoted nonsterling securities with sterling from an External Account. Such securities may not be resold on a stock exchange in the United Kingdom, but may be exported.

Residents may sell outside the Sterling Area a security expressed in foreign currency and reinvest the proceeds in other marketable securities expressed in foreign currency; however, if the security sold is a U.S. or Canadian dollar security, the securities purchased must be U.S. or Canadian dollar marketable securities. Residents of the United Kingdom are required to obtain permission to acquire foreign currency securities from residents of other parts of the Sterling Area.

#### *Sweden*

Investments in Sweden by nonresidents are subject to approval. Such approval is normally granted where direct investments are concerned. Transfers from Sweden on account of dividends and other earnings on investments, interest on loans, and contractual amortization of bonds and debentures are permitted freely. Inheritances due to nonresidents may also be transferred. The repatriation of other non-resident-owned capital is subject to approval, which is, however, usually granted. Emigrants may transfer abroad up to the equivalent of SKr100,000 for each person, on special application.

Requests by residents to transfer capital abroad for direct investment are considered on their merits and are in most cases approved. Residents may, on special application, transfer capital abroad for the purchase for recreational purposes of real estate of a maximum value of SKr50,000. Transfers of capital abroad for portfolio investment are permitted only exceptionally.

Securities may be imported into Sweden through the intermediary of an authorized bank; however, their disposal is subject to approval. The export of securities is, in principle, also subject to approval.

Residents of Sweden who own foreign securities—other than those representing a direct investment—are permitted to use within six months the proceeds from the sale of these securities abroad to invest in other foreign securities denominated in a currency of the convertible area or in Swedish kronor; these proceeds may not, however, be transferred to another resident (other than an authorized bank). Residents are permitted to buy from and sell to other residents such foreign securities held in Sweden.

#### *Canada*

No exchange control obligations are imposed on capital receipts or payments by either residents or nonresidents.

#### *Germany*

There are virtually no restrictions on imports or exports of capital by residents or nonresidents, and such transactions may be carried out freely without an individual license. However, domestic money-market paper (Treasury bills, etc.) and domestic fixed-interest-bearing securities—if in the later case the contracts contain an obligation to reacquire the securities later at a definitely fixed price—may not be sold to nonresidents without an individual license. All capital movements to or from foreign countries exceeding DM500 or the equivalent in foreign currency must be reported when a maturity of 12 months or more has been fixed at the time of concluding the contract. Securities of all types may be imported or exported freely.

#### *Switzerland*

Transfers of capital from countries in the sector of controlled payments require licenses if they are made through the sector of controlled payments; transfers of capital to such countries do not require licenses. Transfers of capital to and from other countries may be made freely, except that certain outgoing transfers of capital exceeding Sw F 10 million each require permission.

Nonresident accounts related to the sector of controlled payments may be grouped as follows: (1) accounts related to Bulgaria, Czechoslovakia, Greece, Hungary, Poland, Rumania, Turkey, and Yugoslavia, which are centralized with the Swiss National Bank, and (2) the "decentralized" group, comprising accounts that may be held with the Swiss National Bank and with authorized banks in Switzerland. The accounts of the second group are of two kinds: the accounts of Eastern Germany and Iran, which are transferable only to other accounts of the same nationality, and the accounts of the United Arab Republic, which are subject to special treatment.

#### *Denmark*

Residents have an obligation to repatriate proceeds realized from assets abroad. Transfers abroad may be made by residents to pay interest on, to redeem, or to repurchase the transferor's own bonds, to lend amounts not exceeding DKr 200,000 to subsidiary companies, etc., or to a member of the resident's family, and to buy foreign securities that do not represent direct investments in foreign commercial or industrial enterprises, provided that the securities are acquired on the basis of a subscription right to shares or the like owned by the resident concerned or the resident furnishes proof that he has repatriated a corresponding amount within the last 12 months from the sale of foreign securities to a nonresident. Permission from the National Bank is required for most other transfers abroad of a capital nature by residents.

Danish emigrants are granted an exchange allowance of up to DKr 40,000 a year for each person during the first three years after emigration. Funds exceeding this amount must be credited to a Capital Account in the name of the owner and may be transferred abroad after three years.

Direct investment in Denmark by nonresidents may be made without any special license if the transaction concerns industry, commerce, handicrafts, hotel business, or transportation, and if the investment does not increase total direct foreign investment in the enterprise concerned by more than DKr 40,000 in each calendar year. Other direct investment by nonresidents requires permission, which is granted liberally. The purchase by a nonresident of real property in Denmark usually requires a special license from the Ministry of Justice. A nonresident who is or has been a Danish national may freely purchase or subscribe to securities expressed solely in Danish kroner which do not represent direct investment. Other nonresidents may purchase or subscribe to bonds that are quoted daily and are expressed solely in Danish kroner, when the funds have been obtained from the liquidation of investments in Denmark. They may purchase or subscribe to shares that are quoted daily and are expressed solely in Danish kroner, when the funds have been obtained from the liquidation of Danish shares or when the acquisition is made on the basis of subscription rights to shares. Nonresidents may grant credits within certain limits to residents to finance purchases of commodities abroad and to finance the granting of credits for exports. They may, further, grant loans up to DKr 200,000 per borrower in a calendar year to commercial and industrial enterprises connected with the lender as subsidiary companies, branches, etc., or to members of their families.

Transfers of proceeds from the sale or liquidation of all sorts of investments and other funds in Denmark owned by nonresidents other than newly emigrated Danish nationals are permitted freely, irrespective of when and how the original investment was acquired. Interest and repayment of principal on authorized loans, credits, and deposits received from persons and firms who were nonresidents at the time of receipt may be paid freely.

Inheritances may be transferred freely to any country without limitation. Individual payments as gifts to persons who are not relatives of the donor may not exceed DKr 2,000.

Imports and exports of securities require permission from the National Bank. Bona fide imports of Danish securities payable only in Danish kroner are permitted. Exports of Danish and foreign securities owned by nonresidents are normally permitted also. Danish securities held in Denmark and belonging to nonresidents may be sold freely to residents. Foreign securities held in Denmark and belonging to nonresidents may be sold to residents only with the National Bank's permission.

*Italy*

In accordance with the provisions of Law No. 43 of February 7, 1956, the repatriation of capital invested in the establishment or expansion of productive enterprises and the transfer of income thereon are not restricted. For other registered investments, the original capital may be repatriated after a minimum period of two years. All other foreign capital may be repatriated freely through Capital Accounts (see section on Nonresident Accounts, above).

Italian companies may freely take up participations in foreign companies and purchase foreign shares, provided that such investments are in their lines of business and are intended to facilitate the expansion of the firms' activities abroad. Residents may make other investments in countries of the European Economic Community in accordance with the Community's program of liberalization of capital movements (direct investments and their liquidation, movements of personal capital, short-term and medium-term commercial credits, etc.). In addition, specified financial institutions may buy and sell stocks and bonds issued and payable abroad; and all residents, without distinction, may buy and sell bonds issued by international financial organizations in which Italy participates as a member country. Other investments abroad by residents are subject to approval, which is granted only when such investments are considered economically advantageous.

The export of securities is not permitted, except of those which are owned by nonresidents and have been purchased against U.S. dollars, Canadian dollars, or externally convertible European currencies, or against funds on a Foreign Account or Capital Account.

*Netherlands*

Inward and outward capital transfers and the shifting of foreign-owned capital within the Netherlands from one asset to another are subject to control, but general licenses have been granted for most types of capital transaction.

New capital investments in the Netherlands by nonresidents are in general permitted only if made in convertible currencies. All authorized capital transactions, other than transactions in securities, take place at the official exchange market rates. All payments in respect of transactions in securities are channeled through a free market, where payments and receipts must be either in guilders through K Accounts or in convertible currencies through "reinvestment" accounts (see below). In addition, nonresidents may debit their Convertible Guilder Accounts to pay residents for transactions in securities.

Residents may buy foreign securities from, or sell them to, other residents. Residents may sell securities abroad against any foreign currency. The exchange so acquired must be deposited with an authorized bank or securities broker in the Netherlands and may be sold or retained. If convertible currencies are acquired, a "reinvestment" account may be credited. "Reinvestment" accounts may be used to buy securities officially quoted either in the Netherlands or abroad.

Nonresidents may have their securities, Netherlands or foreign, exported to them, except securities held in W-deposits.

Emigrants may avail themselves of the same facilities as travelers (see section on Payments for Invisibles, above), i.e., export up to f. 14,250 for each person. Emigrants acquire the status of nonresidents upon leaving the Netherlands, provided that they have declared their intention to settle abroad for more than three years; they may then have remitted to them the total of their assets in the Netherlands.

## CORPORATE PROFITS

## SUMMARY

The so-called profit squeeze is not found to exist.

In the first place the significant measure of profitability is not profits alone but total after tax income—including depreciation. In other words, the significant income measure is not profits but the total income to capital.

Second, as has been previously pointed out, income to capital is a function of the rate at which capital is used. At low rates of capacity utilization, corporate incomes are low; and at high rates of capacity utilization, corporate incomes are high. Furthermore, the income to capital varies much more widely than does volume of production.

The attached memorandum finds that the income to capital has not been squeezed in recent years, but rather, the converse. Since 1956, the total income

to capital has been substantially higher than would be expected from the average relationship between corporate incomes and capacity utilization which has prevailed over the span of years 1929-50. Moreover, the attached analysis does not take into account the shortened depreciation guidelines announced by the Treasury last month. The effect of these new guidelines will be substantially to increase income to capital, although, most probably, to reduce corporate profits, since relatively less of the cash flow to corporations will be counted as profits and relatively more will be counted as depreciation.

One minor refinement in the formula which has been derived for the average relationship between corporate incomes and capacity utilization might be noted: Historically, it is found that corporate incomes are determined not solely by the rate at which capacity is used, but, also, to a lesser extent, by the rate at which output is increasing. In other words, corporate incomes tend to be higher when output is increasing very rapidly than when capacity is used to the same degree, but there have been no recent increases in output.

#### CORPORATE PROFITS IN HISTORICAL PERSPECTIVE

One of the most widely discussed aspects of the state of the economy is the so-called profits squeeze. In using this phrase, observers commonly have referred to a decline in corporate profits, after taxes, as a percentage of the gross national product—from about 8 percent in 1950 to about 4.5 percent in 1961. The reduction in this ratio is then used as an explanation of the reduced level of investment, which, in turn, is then used as an explanation for the lack of vigor in the economy in recent years. From the initial premise that corporate profits have been squeezed, there has developed a whole complex of arguments for changing the income shares in favor of corporate profits, as a means of encouraging increased investment.

It is the purpose of this brief analysis to develop a consistent procedure for measuring the magnitude of corporate cash flow after taxes of corporations, and then to use this procedure to test whether corporate cash flows are indeed lower in relation to economic conditions than would be consistent with past relationships existing prior to 1950.

At the very outset, it must be pointed out that the usual procedures of dividing corporate profits, after taxes, by the GNP, is not a valid measure of whether the corporate income share is too high or too low, or is rising or falling. There are four reasons for this:

(1) Corporate profits, after taxes, are net of depreciation while the GNP is, on the other hand, as the name indicates, gross of depreciation;

(2) Corporations account in good years for about half the GNP, and significantly less than this in recession years, so that dividing profits by GNP means that much economic activity is included in the denominator of the fraction which does not relate directly to the profits in the numerator of the fraction;

(3) A corporation can pay dividends or make investments in its business out of its total cash flow regardless of whether or not this appears on its books in the form of profits, after taxes, or in the form of tax free charges for depreciation on capital. From the standpoint of investment analysis it is this cash flow to the business that counts, not the form in which it is received; and

(4) The cash flow of a corporation is influenced not merely by the level of the GNP in a particular year, but also by the difference between the GNP and what it would be at high levels of employment—which we call potential GNP—and by the speed with which economic activity is changing; i.e., is the economy growing rapidly, slowly or falling.

An inspection of the ratios of profits and corporate cash flows to actual and potential GNP, which are shown on the accompanying chart, reveal two points:

(1) Profits fluctuate very much more widely than does GNP;

(2) There appears to be a modest downward trend in the ratio of corporate profits to the GNP over the period from 1929 to date; but

(3) There is little evidence of a decline in the cash flow ratio, except for comparison with 1929, which seems out of line with all the following years.

Not quite so obvious from the chart, but which can be detected if one examines the data carefully by statistical means, is the fact that the various corporate profits ratios tend to be highest (and tend to rise the most over the

preceding year) in those years when the GNP itself is rising most rapidly. The reverse becomes true when the GNP is falling. In fact, when GNP is either stationary or rising only moderately, corporate profits tend to fall as a ratio to GNP. In brief, the record suggests that corporate profits are particularly sensitive to the speed with which the economy is moving and to the degree to which the economy's productive resources of labor and capital are currently being utilized. High employment and a rapid rate of growth is accompanied by high profits, and contrariwise, widespread idle labor and capital and a low rate of growth mean low profits. A test was made by standard least squares statistical procedures as to the relationship between the corporate cash flow and actual and potential gross national product. The data were fitted for the years 1929-41, and the years 1947, 1948, and 1949 inclusive, giving a total of 16 years in all. (Periods of price controls and the excess profits tax are omitted.) From this procedure was derived a formula as follows:

Calculated corporate cash flow equals \$1 billion, plus .0945 (potential GNP), plus .22 (actual GNP minus potential), plus .09 (GNP of the current year minus GNP of the previous year).

Using this formula, corporate cash flows were calculated for each of the years 1929 through 1961. This calculated corporate cash flow was then divided by the actual GNP for each year. The resulting ratios are plotted with a dashed line in the lower panel of the chart. It will be noted that the calculated and actual ratios of cash flow to GNP follow each other very closely for most of the years up through 1955, except for the years of World War II and the Korean rearmament when excess profit taxes were in force for corporations and various restrictions existed on prices, production, etc., which would limit the corporate cash flow to less than usual levels.

Toward the end of the period, after the tax code changes of 1954 began to be effective, the actual corporate cash flow tends to run somewhat above the computed level year after year. The fact that this gap is consistent rather than a random alternating pattern of pluses and minuses is significant. It tends to indicate that some new and consistent factor has entered into the situation, such as occurred during World War II and the Korean period. One factor that might account for this consistent excess of the actual over the computed corporate cash flow is the accelerated amortization procedures authorized for private businesses, including corporations, under the tax revisions of 1954.

The gap in recent years has amounted to about 0.9 percent of gross national product, or in dollars to about \$4 billion at prevailing prices of these years. How much of this \$4 billion, approximately, can be accounted for by the accelerated amortization procedures authorized in 1954? The Secretary of the Treasury has recently stated that the Treasury believes these provisions to have added about \$2.5 billion to business charges for depreciation over and beyond what would have been taken under the code prevailing prior to 1954. Apparently this does not include depreciation for corporations which reported losses and it does include depreciation for both corporate and noncorporate business.

It may be estimated, therefore, that probably about \$2 billion in additional depreciation charges have been claimed by corporate businesses as a result of the 1954 changes in the tax code. This would amount to about one-half of the \$4 billion gap between actual and computed corporate cash flow for the last 3 years revealed by this analysis.

It may well be that the Treasury's estimates are too conservative and that more of the \$4 billion is due to accelerated depreciation. It may also be that the formula is producing too low an estimate of the calculated cash flow and, hence, too large a gap between actual and computed. However, an inspection of the performance of the formula over the entire period casts severe doubts on this possibility—in fact, one might well have a suspicion that a formula of this type fitted over this particular span would tend to have an upward bias and would tend in recent years to overestimate rather than underestimate the calculated corporate cash flow. The formula tends to underestimate in 1929, then to overestimate slightly at the cyclical peak in 1937, in 1941, 1946, 1947, and again in 1954-55. In a word, it appears that, if anything, the formula seems to have a slight upward tilt.

Another possible explanation of part of this \$4 billion gap would be that some industries have, under the pressure of competition and reduced business volume of recent years, managed to reduce their costs relative to their prices and hence to have improved modestly their profit margins. In any case, it will

be noted that the unexplained gap is a very small sum indeed compared to a total cash flow of about \$50 billion a year.

On the basis of this analysis, the corporate cash flow in recent years has been, if anything, high by historical standards, rather than low as many have suggested. Furthermore, at least part of the excess in recent years can be accounted for by the change in depreciation schedules in 1954. It also suggests that the ratio of corporate cash flow to GNP would be higher if the economy were growing vigorously and resources were being used more nearly in line with optimum conditions such as are measured by the potential GNP.

This analysis does not take into account any impact on corporate cash flows from the newly announced revision in Bulletin F which provides new guidelines for business deductions for depreciation under the tax code. These provisions would apparently have a potential at present levels of investment and GNP of adding perhaps as much as \$3.5 billion to corporate depreciation charges. This would add between \$1.5 and \$2 billion to the total corporate cash flow, allowing for the effects on corporate profits and tax liabilities. On this basis, the gap of \$4 billion between actual and calculated, that has appeared in recent years, would be enlarged by about one-half, and a 7-percent investment credit, if enacted, would further expand this excess.

Analysis of total corporate cash flow, therefore, provides little basis for attributing low investment in recent years to reduced profit margins, or to a "profits squeeze" in other words. What seems to have happened has been a lower volume of operations and a lower cash flow, but with the same or even higher profit margin, if, by "profit margin" we mean what is ordinarily meant—the margin that would be realized at a standard or optimum volume of operations.

*The share of corporate business in gross national product, 1929-61*

[Ratios derived from data measured in current prices]

Year	Ratio of national income originating in corporations to—		Ratio of national income originating in corporations plus their capital consumption allowances to—	
	Actual GNP	Potential GNP	Actual GNP	Potential GNP
1929.....	0.433	0.441	0.475	0.493
1930.....	.423	.366	.471	.407
1931.....	.371	.295	.427	.340
1932.....	.315	.213	.383	.259
1933.....	.309	.203	.377	.247
1934.....	.360	.256	.415	.295
1935.....	.372	.285	.423	.325
1936.....	.391	.301	.435	.370
1937.....	.414	.362	.456	.399
1938.....	.379	.307	.424	.343
1939.....	.397	.338	.440	.374
1940.....	.421	.379	.461	.415
1941.....	.448	.452	.454	.488
1942.....	.458	.497	.490	.532
1943.....	.453	.528	.486	.561
1944.....	.426	.504	.456	.536
1945.....	.396	.437	.417	.473
1946.....	.410	.414	.434	.439
1947.....	.447	.444	.474	.470
1948.....	.464	.468	.494	.498
1949.....	.447	.432	.480	.464
1950.....	.465	.471	.498	.504
1951.....	.496	.488	.499	.523
1952.....	.457	.475	.492	.511
1953.....	.463	.491	.501	.522
1954.....	.450	.442	.498	.485
1955.....	.463	.471	.510	.518
1956.....	.466	.461	.513	.508
1957.....	.458	.442	.507	.490
1958.....	.440	.404	.492	.451
1959.....	.457	.430	.508	.477
1960.....	.452	.421	.503	.466
1961.....	.444	.407	.497	.455

Source: U.S. Department of Commerce, and staff of the Joint Economic Committee.

*Measures of corporate cash flow as a share of national output and incomes, 1929-61*

[Ratios derived from data measured in current prices]

Year	Ratio of corporate profits after tax to—			Ratio of corporate cash flow <sup>1</sup> to—			Ratio of calculated <sup>2</sup> corporate cash flow <sup>3</sup> to—		
	Actual GNP	Potential GNP	National income originating in corporations	Actual GNP	Potential GNP	Gross income originating in corporations <sup>3</sup>	Actual GNP	Potential GNP	Gross income originating in corporations <sup>3</sup>
1929.....	0.080	0.081	0.184	0.122	0.124	0.256	0.111	0.113	0.234
1930.....	.027	.024	.065	.076	.066	.161	.072	.063	.153
1931.....	-.017	-.014	-.046	.039	.031	.092	.058	.046	.135
1932.....	-.058	-.039	-.185	.010	.007	.027	.024	.016	.063
1933.....	-.007	-.005	-.023	.060	.040	.161	.043	.028	.114
1934.....	.015	.011	.043	.071	.050	.170	.074	.052	.178
1935.....	.030	.023	.081	.081	.062	.192	.080	.061	.189
1936.....	.052	.044	.133	.097	.082	.222	.096	.081	.219
1937.....	.052	.045	.125	.094	.082	.205	.095	.084	.210
1938.....	.027	.022	.071	.072	.058	.169	.070	.057	.166
1939.....	.055	.047	.138	.098	.083	.222	.089	.076	.202
1940.....	.065	.058	.153	.104	.094	.236	.098	.088	.213
1941.....	.075	.075	.167	.110	.111	.228	.122	.123	.251
1942.....	.060	.065	.130	.092	.100	.187	.129	.141	.264
1943.....	.055	.063	.119	.083	.096	.171	.132	.152	.271
1944.....	.049	.038	.115	.079	.093	.173	.127	.150	.278
1945.....	.039	.044	.101	.070	.080	.168	.115	.130	.275
1946.....	.064	.064	.155	.088	.089	.203	.099	.100	.228
1947.....	.078	.077	.174	.105	.104	.221	.107	.106	.226
1948.....	.079	.080	.170	.109	.110	.220	.108	.109	.219
1949.....	.062	.060	.139	.095	.092	.198	.093	.091	.195
1950.....	.080	.081	.172	.113	.115	.227	.108	.110	.217
1951.....	.080	.063	.129	.083	.088	.187	.115	.121	.231
1952.....	.060	.051	.109	.085	.088	.173	.107	.111	.217
1953.....	.050	.062	.107	.088	.092	.176	.107	.111	.213
1954.....	.046	.045	.103	.080	.088	.182	.094	.098	.192
1955.....	.058	.059	.125	.104	.106	.204	.107	.109	.210
1956.....	.056	.056	.120	.104	.103	.202	.100	.100	.195
1957.....	.050	.049	.110	.100	.096	.196	.097	.094	.191
1958.....	.042	.039	.096	.083	.086	.190	.086	.079	.174
1959.....	.051	.048	.111	.101	.095	.199	.096	.090	.188
1960.....	.046	.043	.101	.087	.090	.183	.091	.085	.180
1961.....	.045	.041	.101	.086	.090	.197	.088	.080	.177

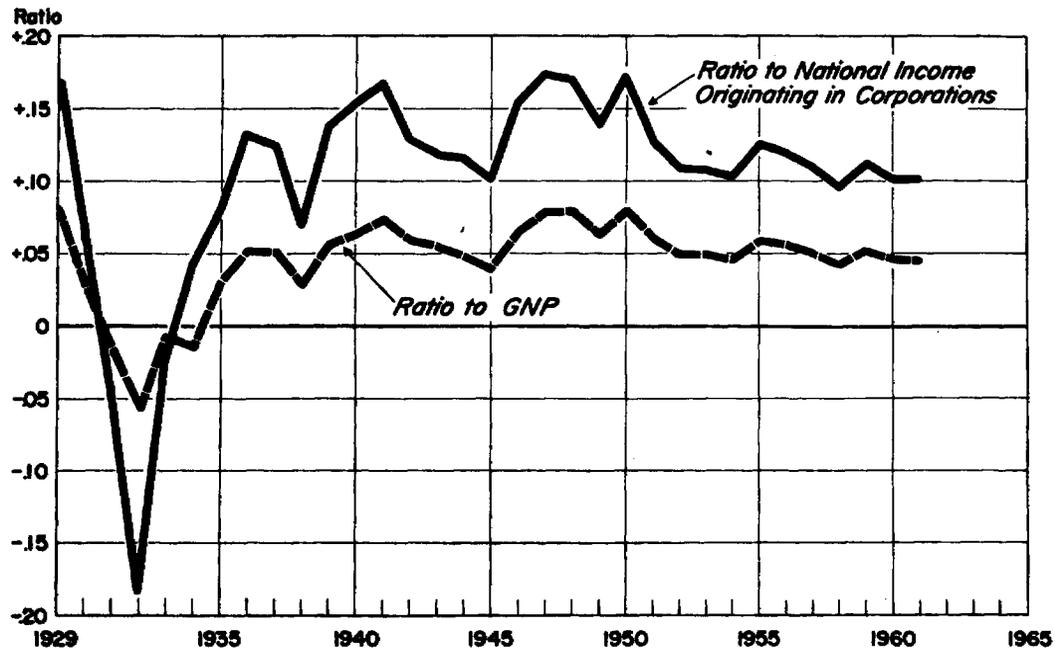
<sup>1</sup> Corporate cash flow consists of corporate profits after tax plus corporate capital consumption allowances.

<sup>2</sup> Gross income originating in corporations consists of national income originating in corporations plus corporate capital consumption allowances.

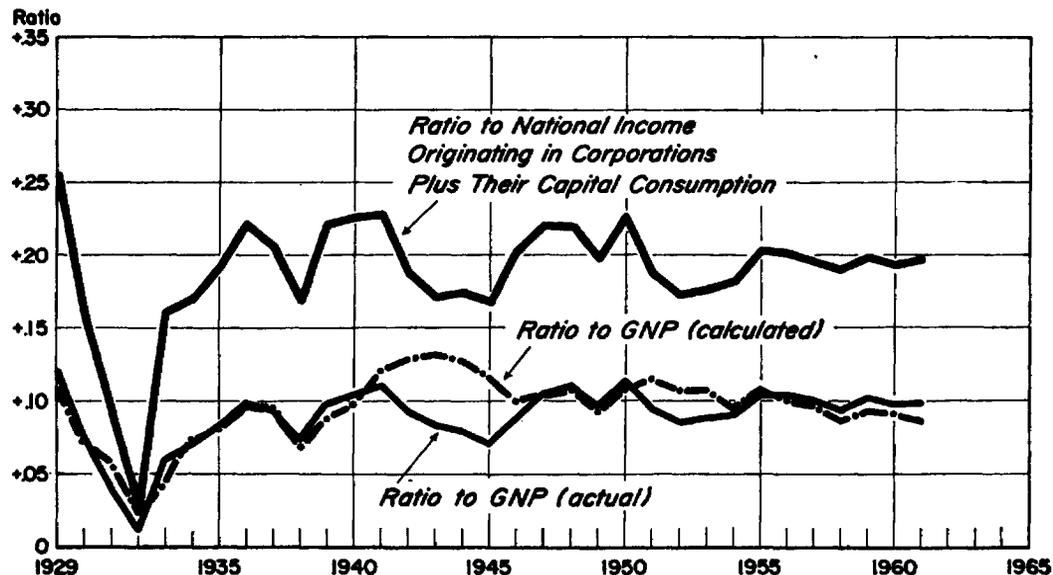
<sup>3</sup> Calculated corporate cash flow is derived from formula given in text on p. 3.

Source: U.S. Department of Commerce and staff of the Joint Economic Committee.

## Ratio of Corporate Profits after Tax to Gross National Product and to National Income Originating in Corporations



# Ratio of Corporate Profits after Tax plus Corporate Capital Consumption to Gross National Product and to National Income Originating in Corporations plus Their Capital Consumption



Source: U.S. Department of Commerce and Staff, Joint Economic Committee

BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM,  
Washington, D.C., August 9, 1962.

HON. WRIGHT PATMAN,  
Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.

DEAR MR. PATMAN: In reply to your letter of August 3, I am sending you tables on System transactions in U.S. Government securities by maturity class, System exchanges in Treasury refundings, and dealer sales and purchases of U.S. Government securities. The data on System transactions, shown in the enclosed table, cover operations in the first 7 months of 1962; corresponding figures for the months of 1961 were published in the Federal Reserve Board's annual report for 1961 (p. 132). The tables on System exchanges and dealer transactions cover the year 1961 and the period to date in 1962.

It should be pointed out that the figures on System transactions and those on dealer purchases and sales are not strictly comparable in two respects. First, System open market operations, particularly in the shorter maturity categories, frequently involve direct transactions with foreign official and international accounts as well as transactions with dealers. The former transactions of course are not reflected in the data reported by dealers. Secondly, the two sets of data differ slightly in respect to their timing. Thus, dealer transactions are reported in terms of the date when commitments to buy or sell were made, while System operations are recorded in terms of the date when securities purchased or sold were actually delivered—which may often be 1 business day following the commitment. For these reasons, inferences from the data concerning the System's "share" of total market activity cannot be precise.

Tables 3 and 4 show an unpublished breakdown of dealer transactions between purchases and sales. When the publication program on the Government securities market was initiated just over a year ago, it was with the understanding with the reporting dealers that data on purchases and sales would be published on a combined basis only. In this way it was felt that the public's interest in having adequate and prompt information on volume of trading in the market would be served. Accordingly, should the Joint Economic Committee want to make use of the data in a way involving their public release, it would be desirable for us to discuss the matter with those who voluntarily supply this information.

We shall, of course, be glad to try to answer any questions that the committee or its staff may have concerning technical or other aspects of the data.

Sincerely yours,

WM. MCC. MARTIN, JR.

*U.S. Government securities dealer sales and purchases (this table combines the data referred to as tables 3 and 4 in above letter)*

[In millions of dollars]

Month	Total	Within 1 year	1 to 5 years	5 to 10 years	Over 10 years
1961—January.....	33, 019	23, 363	8, 873	1, 193	490
February.....	24, 567	16, 617	6, 322	896	532
March.....	24, 512	23, 166	7, 089	1, 662	734
April.....	30, 450	23, 992	4, 124	1, 645	688
May.....	33, 413	24, 030	6, 685	2, 022	776
June.....	30, 424	25, 147	3, 841	974	514
July.....	35, 666	28, 814	5, 613	974	267
August.....	32, 069	26, 959	3, 720	952	450
September.....	28, 839	23, 665	3, 530	984	680
October.....	35, 488	29, 168	5, 341	874	404
November.....	33, 728	26, 893	6, 174	812	849
December.....	33, 052	26, 557	4, 557	904	1, 033
Total.....	386, 145	299, 609	65, 769	13, 320	7, 448
1962—January.....	37, 764	32, 502	3, 268	1, 415	579
February.....	35, 458	27, 363	5, 316	1, 707	1, 071
March.....	36, 838	29, 307	4, 764	1, 626	1, 240
April.....	33, 773	27, 000	3, 593	2, 277	902
May.....	37, 257	29, 420	4, 785	2, 506	544
June.....	35, 291	28, 497	4, 006	2, 060	699
July.....	35, 323	30, 588	2, 916	1, 329	490

NOTE 1.—Does not include redemptions of Treasury issues or transactions under repurchase agreements, reverse repurchase (resale) or similar contracts.

NOTE 2.—Does not include securities received on direct allotment from the Treasury or transactions under repurchase agreements, reverse repurchase (resale) or similar contracts.

## Total Federal Reserve credit and net free reserves by class of bank

[In millions of dollars]

	Total Federal Reserve credit <sup>1</sup>	New York	Net free reserves <sup>2</sup>			Total
			Chicago	Reserve cities	Country banks	
1950.....	18,567	60	-6	122	506	682
1951.....	23,916	31	-5	98	412	535
1952.....	23,753	-2	-11	-58	471	400
1953.....	25,752	117	-18	-31	296	364
1954.....	25,642	49	7	92	563	711
1955.....	25,002	2	-43	-169	377	168
1956.....	25,203	-33	-111	-366	305	-195
1957.....	24,786	-185	-48	-486	210	-509
1958.....	25,967	7	12	57	408	484
1959.....	27,627	-15	-63	-536	101	-513
1960.....	27,383	16	-59	-120	204	41
1961.....	27,988	40	5	66	438	549
1962.....	31,052	-12	-3	-5	390	370
1962 weekly:						
July 4.....	31,597	10	10	34	369	424
July 11.....	31,729	8	-5	23	464	489
July 19.....	31,861	-33	-15	-75	522	399
July 26.....	31,315	75	10	32	399	517
Aug. 1.....	31,066	16	6	4	338	366
Aug. 9.....	31,559	-15	-15	(*)	411	351

<sup>1</sup> Yearly data as of Wednesday nearest June 30.<sup>2</sup> Averages of daily closing figures. 1950-62: for 2d half of June. 1953-62 for all of June.

Preliminary, June 1962 through Aug. 9.

\* Not available.

## Federal Reserve System exchanges in Treasury refundings, Aug. 8, 1962

[In millions of dollars]

Month	Amount of maturing securities held	Exchanged		Redeemed
		New or reopened issue	Amount	
1961—February.....	3,583	3½ percent note of Aug. 15, 1962.....	3,583	-----
March <sup>1</sup> .....	350	3½ percent bond of Nov. 15, 1967.....	350	-----
May.....	2,695	3 percent certificate of May 15, 1962.....	1,700	295
August.....	4,835	3½ percent note of May 15, 1963.....	700	-----
November.....	None	3½ percent note of Nov. 15, 1962.....	3,235	-----
1962—February.....	4,806	3½ percent note of Aug. 15, 1964.....	1,600	-----
May.....	2,164	3½ percent certificate of Feb. 15, 1963.....	3,306	-----
August.....	3,717	4 percent note of Aug. 15, 1966.....	1,500	-----
		3½ percent certificate of May 15, 1963.....	2,164	-----
		3½ percent certificate of Aug. 15, 1963.....	3,717	-----

<sup>1</sup> Advance refunding.

*Open market transactions of the Federal Reserve System during 1962*

[In millions of dollars]

Month	Outright transactions in U.S. Government securities, by maturity								
	Total			Treasury bills			Others within 1 year		
	Gross purchases	Gross sales	Redemptions	Gross purchases	Gross sales	Redemptions	Gross purchases	Gross sales	Exchanges, maturity shifts, or redemptions
1962—January	510	527	173	486	474	173	10	53	-----
February	585	646	61	380	522	61	132	124	- 1,307
March	1,112	350	156	691	390	156	54	-----	-----
April	542	333	36	471	333	36	11	-----	-----
May	1,136	622	-----	702	622	-----	307	-----	-----
June	747	702	174	459	625	174	152	70	-----
July	1,680	1,200	185	1,310	1,117	185	234	73	-----

Month	Outright transactions in U.S. Government securities, by maturity								
	1 to 5 years			5 to 10 years			Over 10 years		
	Gross purchases	Gross sales	Exchanges or maturity shift	Gross purchases	Gross sales	Exchanges or maturity shift	Gross purchases	Gross sales	Exchanges or maturity shift
1962—January	14	-----	-----	-----	-----	-----	-----	-----	-----
February	23	-----	+1,307	-----	-----	-----	-----	-----	-----
March	357	-----	-----	10	-----	-----	-----	-----	-----
April	50	-----	-----	10	-----	-----	-----	-----	-----
May	127	-----	-793	-----	-----	-----	-----	-----	-----
June	136	7	+81	-----	-----	-28	-----	-----	-53
July	136	10	-----	-----	-----	-----	-----	-----	-----

## INTEREST RATES AND FOREIGN DOLLAR BALANCES

(By Robert F. Gemmill, Board of Governors of the Federal Reserve System)

### INTRODUCTION AND CONCLUSIONS

Large U.S. balance-of-payments deficits since 1957 have led to substantial increases in foreign liquid-dollar holdings and to a decline of about one-fourth in the U.S. gold stock. These developments have stimulated discussion of the extent to which financial policy, and especially monetary policy, in this country might be influenced by the international reserve position of the dollar. Obviously, a country that acts as an international reserve center and in this role accumulates a large volume of outstanding short-term liabilities to foreigners must take care to insure that doubts do not arise concerning the stability of its currency. Even though a country maintains a high degree of financial stability, however, questions can be raised regarding the effect on its reserve position of countercyclical financial policies, such policies may contribute to the outflow of domestic capital and thereby worsen the country's payments position. In addition, however, concern has been expressed that antirecessionary policies involving low interest rates might put pressure on the reserve position of the United States by bringing about a conversion of foreign-held dollar balances into gold.<sup>1</sup> In this paper, we shall examine the latter problem, attempting to assess the extent to which past behavior of foreign-held balances affords a basis for such concern.

The actual U.S. balance-of-payments deficits since 1957, which have stimulated discussion of the reserve position of the United States, have reflected major developments in U.S. international transactions on both current and capital account. The proportion of these deficits that has taken the form of net foreign gold purchases has reflected the overall payments surplus of major foreign countries, the proportions of their payments surpluses, in the form of additions to official reserves, and the extent to which they hold reserves in gold.<sup>2</sup> The general conclusion of this paper is that those movements in foreign holdings between gold and dollar assets in recent years which could be attributed to interest-rate changes account for only a very small fraction of total foreign dollar holdings. The main findings upon which this conclusion is based are as follows:

1. There is no basis either on theoretical grounds or in available statistical materials for believing that foreign official institutions adjust their reserve holdings between gold and liquid-dollar assets in response to short-term or cyclical movements in interest rates. This finding is not inconsistent with evidence that such institutions do alter to some extent the composition of their holdings of liquid-dollar assets as changes occur in yields on these assets.

2. There is reason to believe that some foreign private liquid-dollar holdings are drawn down when yields on liquid-dollar assets are substantially lower than yields obtainable in other international money markets and rise when the yield advantages on short-term investments in other money markets disappears.

Foreign private dollar holdings (excluding those of Canada) rose about \$1 billion between mid-1958 and early 1960 and had declined by a somewhat smaller amount by early 1961. During these years, U.S. interest rates moved from a cyclical trough to a peak and then receded to a substantially lower level. These fluctuations in foreign private holdings are greater than the movements

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<sup>1</sup> See, for example, Robert Triffin, "Gold and the Dollar Crisis" (New Haven: Yale University Press, 1960), p. 9: "Our huge gold losses of last year [1958] were due in part to such a repatriation of foreign capital at a time when interest rates had fallen here well below the rates available in Europe. They have been slowed down this year [1959] by an extremely sharp rise of interest rates in this country, prompted by our domestic concern about creeping inflation. In this case, external and internal interest rates policy criteria happily coincided, but they may diverge tomorrow. If and when we feel reassured about our internal price and cost trends we may wish to ease credit and lower interest rates in order to spur our laggard rate of economic growth in comparison not only with Russia, but with Europe as well. We may then be caught, however, exactly as the British were in the 1920's between these legitimate and essential policy objectives and the need to retain short-term funds here in order to avoid excessive gold losses."

<sup>2</sup> See articles on gold and dollar flows in the Federal Reserve Bulletin, March 1959, 1960, and 1961.

which may be attributed to international interest-rate differentials, since other factors are known to have contributed to the changes in foreign holdings.

3. A transfer of foreign private holdings from the United States to European money markets results in some increased foreign purchases of gold from the United States. However, the gold purchases may be expected to be smaller than the volume of funds transferred, unless all funds were moved to foreign countries that take all reserve gains in gold. Such was apparently not the case in 1960 and 1961.

#### THE PROBLEM

A country's financial policies affect its reserves primarily through impact on its balance-of-payments position. Monetary and fiscal measures can influence payments on current account through their effect on overall levels of economic activity and on prices and competitive behavior. Moreover, they can influence payments on capital account through changes in the terms of payment in international transactions (so-called leads and lags), in other movements of domestic short-term capital, and in flows of domestic and foreign long-term capital.

However, financial policies can also affect the reserve position of a country acting as an international reserve center if they lead to shifts between foreign short-term claims and gold. The reserve (or liquidity) position of such a country is most conveniently measured by the ratio of its holdings of international means of payment (gold, in the case of the United States) to its short-term liabilities to foreigners.<sup>3</sup> Shifts in foreign holdings between short-term claims and gold affect that ratio, whether or not there is any change in the aggregate of foreign short-term claims and gold and hence any surplus or deficit (as customarily defined) in the balance of payments of the reserve currency country.

This paper is concerned with the effect which movements of foreign short-term capital might be expected to have on the reserve position of the United States, given a specific overall balance-of-payments surplus or deficit. If shifts of foreign short-term capital were likely to be large, the international aspects of U.S. financial policies could not be judged solely on the basis of existing and prospective balance-of-payments developments, including movements of U.S. capital and changes in unrecorded transactions. Instead, any proposed changes in these policies would have to take into account the additional consequences that such potential shifts would be likely to have on the U.S. reserve position.

If cyclical changes in interest rates are likely to produce significant fluctuations in the gold stock of a reserve currency country, over and above those fluctuations resulting from balance-of-payments developments, that country may be more restricted in the extent to which it can permit fluctuations in its balance of payments. It may thus be more restricted in the extent to which it employs flexible financial policies as countercyclical measures.

If possible shifts of foreign short-term funds were felt to be a substantial constraint on the financial policies of a reserve currency country, the country might find that the resulting disadvantages outweighed the advantages of being a reserve center. In fact, this argument has already been applied to the position of the United States. Triffin, for example, in making a case for the establishment of the International Monetary Fund as the principal international reserve center, maintains that, by this change, "we would \* \* \* have consolidated in the hands of the Fund a large portion of highly volatile foreign funds, whose sudden and unpredictable outflow might otherwise unlesn, at any time, an unbearable drain on our gold reserves. Most of all, we should have shed thereby the straitjacket which the need to prevent such an outflow would impose upon monetary management and interest rates in this country."<sup>4</sup>

Empirical evidence on the extent to which foreign short-term dollar assets may have been shifted in response to interest-rate movements can best be examined separately for foreign official and foreign private holdings.

#### FOREIGN OFFICIAL DOLLAR HOLDINGS

There is no evidence that any major foreign country has changed the relative proportion of gold in its official reserves in response to short-term or cyclical changes in interest rates. After comparing changes in the composition of reserves of foreign countries with changes in U.S. interest rates, we shall indicate

<sup>3</sup> R. Gemmill, "Notes on the Measurement of International Liquidity," *Journal of Finance*, March 1960, pp. 53-61.

<sup>4</sup> Triffin, *op. cit.*, p. 12.

why, on theoretical grounds, there is no basis for expecting changes in the holdings of foreign official institutions to correspond to interest-rate movements.

It would be most appropriate for our purpose to examine shifts in a country's reserve holdings between gold and liquid-dollar assets. However, most countries do not publish data on dollar holdings separately, and therefore data on foreign-exchange holdings will be substituted. Since holdings of foreign exchange other than dollars have been extremely small, the conclusions would not differ significantly if official dollar holdings were used.\*

The relative proportions of gold and foreign-exchange assets can, of course, vary as a result of changes in either form of reserve holdings; many countries have kept gold reserves constant over long periods of time and permitted moderate changes in payments positions to be reflected in variations in exchange reserves. We shall examine only those instances in which gold holdings were changed between the end of 1956 and the end of 1960. In this period, there were wide fluctuations in U.S. interest rates, and a country that regularly shifted even a part of its reserves between gold and dollars in response to changes in yields on dollar investments would presumably have made changes in gold holdings.

Twenty-six foreign countries changed their gold reserves by \$10 million or more between the end of 1956 and the end of 1960, excluding changes resulting from gold subscription payments to the International Monetary Fund. We consider, first, the 18 countries that increased gold reserves, dividing them into groups according to the pattern of changes in reserves. A number of foreign countries purchased substantial amounts of gold in the fourth quarter of 1960 when speculative demand for gold led to the establishment of a premium price in the London gold market. We shall regard these purchases as precautionary in nature rather than as shifts in the composition of reserves in response to the lower level of U.S. money-market rates compared with those in the first half of the year.

(a) Four countries (Belgium, the Netherlands, Switzerland, and the United Kingdom) have traditionally kept practically all reserves in gold, and the gains in gold reserves of these four countries have thus paralleled overall reserve gains, aside from some lags in periods of rapid increases in reserves.

(b) Three countries (Australia, Iraq, and Lebanon) do not maintain significant reserves in dollars. Parenthetically, both Iraq and Lebanon added to gold reserves in late 1960.

(c) Eleven countries have added both to gold and to dollar holdings at times during the period.

Five countries (Austria, Colombia, Greece, Italy, and Portugal) have increased their gold reserves both in years of high and in years of low U.S. interest rates, and all except Colombia (which experienced large fluctuations in total reserves) have steadily increased the proportion of total reserves held in gold. Increases in gold reserves of Austria and Portugal occurred primarily in 1958 and 1959; U.S. interest rates were relatively low in 1958 and high the following year. Italy increased its gold reserves throughout the period, while Greek gold purchases were concentrated principally at the end of 1960.

Three countries (Indonesia, Peru, and Spain) decreased gold holdings at total reserves declined from 1956 to 1958, and increased gold holdings again after total reserves rose. Peru added to its gold reserves in the fourth quarter of 1959 when yields on dollar assets were at a peak, and all three countries substantially increased gold reserves in the last quarter of 1960. In fact, the rise in Spanish gold reserves in the second half of the year was almost equal to the rise in total reserves.

Variations in the proportion of gold to total reserves for the three remaining countries, France, Germany, and Japan, are shown in chart 1 [not printed in the Record]. The decline in the gold proportion of French reserves that began in mid-1958 resulted from a sharp improvement in total reserves that more than offset substantial rebuilding of French gold reserves. The marked drop in holdings of convertible currencies at the end of 1959 resulted partly from large gold purchases and partly from slower additions to total reserves in consequence of special debt repayments. In 1960 French reserve gains were taken entirely in gold.

\* Official foreign-exchange holdings of the European countries for which exchange holdings were used consist mainly of dollar assets but include some sterling holdings. These latter holdings are relatively small, however. Official sterling holdings of all OEEC countries at the end of 1957 were \$360 million (see "International Financial Statistics," June 1960, p. 260), while official dollar holdings were in excess of 10 times this amount (see Federal Reserve Bulletin, March 1959, chart on p. 247).

The proportion of gold in German reserves increased steadily through 1957. In 1958 and 1959 it fluctuated primarily as a result of variation in official German dollar holdings. In 1959, when total German reserves declined, the reduction was in dollar holdings. The sharp decline in the gold proportion which began in the fourth quarter of 1959 and continued through the period of declining rates in 1960 reflected additions of almost \$2.5 billion to German reserves in the form of dollar assets. If, during this rise in reserves, Germany had continued to keep two-thirds of its reserves in gold, the additional demand for monetary gold would have been about \$1.5 billion.

The gold proportion of Japanese reserves increased from 1957 to 1959 but declined thereafter, as gold holdings remained constant while total reserves continued to rise. Press reports indicate that Japan postponed implementation of a long-range policy of increasing its gold proportion in order to avoid contributing to instability in the international financial system.<sup>7</sup>

In summary, most of these 11 countries increased gold holdings at times of high as well as of low yields on dollar assets. Germany and Japan added large amounts to their dollar reserves in 1960, but there is no indication that yields (which declined during the year) were a factor in these decisions. Changes in gold reserves of a few countries appear to have resulted from large fluctuations in total reserves.

Eight countries experienced overall declines in gold reserves. The gold proportion of Canadian reserves has declined since the end of 1937; up to mid-1959 the decline resulted from a rise in dollar holdings, and after that time it stemmed mainly from a fall in gold reserves. Six countries (Argentina, Cuba, Egypt, Mexico, and Venezuela, plus the Union of South Africa, which does not maintain substantial reserves in dollars) reduced gold reserves, as total reserves declined in consequence of balance-of-payments deficits. Argentina and Mexico have added again to gold reserves as their total reserves were rebuilt. Swedish gold reserves declined by one-fourth in 1957 and early 1958 but remained stable thereafter. This decline, which is not explained in the annual reports of the Riksbank, could represent an increased long-term preference for dollar assets but could not reflect a policy of cyclical variation in composition of reserves.

In conclusion, data on changes in reserves for these 26 countries show no evidence of shifts in the composition of reserves in response to changes in yields on dollar assets.

Furthermore, on theoretical grounds one would not expect central banks and other official institutions that hold international reserves generally to base such major policy decisions as those affecting composition of reserves on considerations of short-run profitability. Short-run fluctuations in the composition of reserve holdings, which resulted from weighing the return on investments against the potential gain through holding gold, would be recognized as constituting speculation on a change in the price of gold and, as such, would be highly disruptive of both internal and international financial transactions.<sup>7</sup> Shifts in reserve holdings between gold and dollars on the basis of short-run profitability could thus contribute directly to instability in international financial relations and make increasingly difficult the achievement of basic domestic objectives of the central banks.

Gold purchases by some foreign central banks in the fourth quarter of 1960 undoubtedly did not contribute to the stability of the international financial system. However, if we assume that these purchases were precautionary, it is highly doubtful that they would have been smaller if yields on dollar assets had been maintained at, say, 1959 levels.

Shifts of central bank funds among various types of dollar assets do not involve the dangers associated with implied speculation, and such shifts frequently occur with changes in the relative yields on these assets; however, even movements of this type are small relative to the total volume of official dollar holdings.

<sup>7</sup> See the London Times, Mar. 4, p. 11.

<sup>7</sup> In determining a long-run policy with respect to the composition of reserves, a central bank will, of course, have to consider both yields on foreign-exchange assets and the possibility of a change in the price of gold, along with a wide range of other factors. A long-run policy on amounts or relative proportions of gold and foreign exchange in reserves carries no presumption as to timing of a possible change in the price of gold (whether or not such a consideration is given appreciable weight in the formulation of the policy); and such a policy, therefore, does not imply an open element of speculation.

## FOREIGN PRIVATE DOLLAR HOLDINGS

While there is no evidence that foreign official institutions adjust their gold holdings in accordance with changes in yields, shifts of funds among international money markets by banks and other private investors could lead to changes in foreign gold holdings, over and above the changes that might be associated with a particular payments surplus in deficit on the part of a reserve currency country. For example, a shift of funds might cause a substitution of gold holding (by official institutions) for liquid-dollar holdings (by banks and other private investors). This result would occur if private investors sold dollar exchange for another currency and if neither the commercial banking system nor the central bank of that country added correspondingly to its dollar holdings;<sup>9</sup> under these conditions, initial acquisition of the dollar exchange by the central bank would be followed by a purchase of gold and (assuming that this transaction added to net foreign purchases from the United States) to a corresponding reduction in the U.S. gold stock.

Since some European central banks traditionally hold their reserves in gold and most others take part of their reserve gains in gold, any large net movement of private funds from the United States to other major financial markets (except Canada) would probably lead to a reduction in the U.S. gold stock, although the extent of the reduction would be strongly influenced by the particular markets to which funds moved. Shifts of funds to or from Canada would be reflected primarily in pressure on the Canadian exchange rate, since the Bank of Canada changes its reserves little and permits transfers of funds to affect the exchange rate.

We shall examine fluctuations in foreign private dollar holdings in order to estimate the extent to which variations in these holdings appear attributable to interest-rate movements or differentials. Analysis of changes in the holdings of different geographical areas would assist in identifying movements that might have been associated with the transfer of funds between the United States and European money markets, but data are available separately only for Canada.

The present study will be limited to examination of fluctuations in aggregate non-Canadian private holdings for two reasons. First, private dollar holdings of European countries probably account for three-fifths of total private holdings (excluding Canada), and these European funds are generally thought to be more likely to be shifted to European money markets than are Canadian funds. Second, the influence of balance-of-payments developments is likely to be much greater in the case of Canada and thus the changes attributable to interest-rate changes much less discernible than for other countries. While developments in the U.S. balance of payments may have an influence on the volume of private, as well as official, dollar holdings of foreign countries, private Canadian dollar holdings appear likely to reflect changes in the Canadian balance of payments much more directly. The Bank of Canada's policy of maintaining its reserves relatively stable has the result that a Canadian payments surplus or deficit leads immediately to a change in Canadian holdings of foreign exchange (almost exclusively U.S. dollars) or in foreign short-term claims on Canada.

To facilitate examination of the fluctuation in non-Canadian holdings, we have computed deviations of the holdings from a straight-line trend fitted to the data by the method of least squares. The results are compared in chart 2 [not printed in Record] both with yields on U.S. Treasury bills and with the yield differential between United States and United Kingdom Treasury bills, after allowing for the cost of covering the foreign-exchange risk. We have also computed a second set of deviations from a trend line adjusted to minimize variations resulting from purely statistical factors. These deviations appear as the dotted line in the chart.<sup>10</sup>

As shown in chart 2 [not printed in Record], both private holdings (measured as deviations from trend) and interest rates have exhibited cyclical fluctuations, with changes in private holdings generally lagging behind those

<sup>9</sup> Or to holdings of the currency of another country, where the banking system was willing to increase its dollar holdings.

<sup>10</sup> In the third quarter of 1956 and again in the second quarter of 1957, certain dollar holdings previously reported as privately owned were included with official holdings (see Federal Reserve Bulletin, September 1957, p. 1098). The overstatement of private holdings in published Federal Reserve figures from the end of 1955 to mid-1957 has been corrected by using estimates of the International Monetary Fund. These estimates may be derived from data on U.S. short-term liabilities to foreign official institutions published in "International Financial Statistics," June 1958, p. 242.

in interest rates. On the whole, variations in foreign private holdings appear to have corresponded more closely to changes in the absolute yield on U.S. Treasury bills than to changes in the covered differential between United States and United Kingdom bills. This fact suggests that fluctuations in foreign private holdings may have occurred in response to changes in conditions in the U.S. market relative to those in a number of foreign money markets, rather than solely in response to changes between New York and London. This conclusion is in accord with other evidence; the reports of the Bundesbank indicate that German bank funds were repatriated from abroad in mid-1960 following increased monetary restraint in that country.

However, it is also clear that factors other than interest-rate movements affected foreign private dollar holdings during the periods in the last half of 1960; for example, speculative capital movements undoubtedly contributed to the decline in foreign private dollar holdings. Thus one should not expect to find an exceptionally close relationship between movements in an aggregate of foreign private holdings and a single interest rate or rate differential. On the whole, there seems to be sufficient correspondence between movements in rates and foreign private holdings to provide support for the thesis that interest-rate movements (or factors producing these movements) have affected such holdings.<sup>10</sup>

The extent of the influence of interest-rate movements or other money-market developments cannot be estimated with accuracy, but the amplitude of the fluctuations in the deviations of foreign private holdings from trend can assist in supplying some indication. As shown in chart 2 [not printed], the amplitude of fluctuations during the period 1958-60 has been one of the magnitude of \$0.3 billion to \$0.5 billion, depending on the series used. These figures suggest that foreign private holdings might decrease by amounts ranging from \$0.6 billion to \$1 billion from a peak associated with high U.S. interest rates to a trough associated with low rates.

The actual decline in foreign holdings (as distinct from the changes in deviations from trend) which began in mid-1960 continued early in 1961 (not shown on the chart) and, through February, totaled \$0.8 billion. However, a substantial portion of the decline could have been accounted for by speculative movements of funds connected with possible changes in foreign-exchange rates, and the entire decrease clearly cannot be attributable to changes in relative money-market conditions.

Correspondingly, a part of the \$1 billion increase in foreign private dollar holdings that occurred from late 1958 to early 1960 represented increased working balances following the establishment of convertibility by major European countries. The opportunities for employing such working balances profitably have been substantially enlarged by the development of the Euro-dollar market.<sup>11</sup> A European bank accepting deposits denominated in U.S. dollars (Euro-dollars) would have a U.S. dollar asset as a counterpart to its dollar liability, and a part of the rise in foreign bank holdings of dollars in 1959 undoubtedly represented such dollar assets. European banks attracted Euro-dollar deposits by paying interest (often in excess of rates payable on time deposits in U.S. banks), and they have used the deposit claims on U.S. banks which were thus acquired for various types of financing, especially foreign trade. So long as attractive opportunities exist for employing Euro-dollar funds for dollar financing, these funds are relatively unlikely to be shifted abroad in response to changes in money-market rates.

Thus less than \$1 billion of the fluctuations between peak and trough in foreign private dollar holdings can be attributed to interest-rate movements. This figure, as an outside limit, may be compared with total foreign private dollar holdings (excluding Canada) of \$6 billion at the 1960 peak. A shift abroad of up to one-sixth of foreign private dollar holdings would lead to an increased demand for monetary gold by foreign central banks of somewhat less than the amount of funds shifted, unless the funds moved to those countries that take all reserve gains in gold, and this apparently was not the case in 1960. The gold outflow associated with such a shift might therefore be quite small, relative to

<sup>10</sup> A coefficient of correlation of about 0.8 was obtained from a correlation of U.S. Treasury bill rates (as the independent variable) with adjusted deviations from trend of foreign private holdings lagged one-quarter of a year. Calculations involving other series produced smaller coefficients.

<sup>11</sup> See Alan Holmes and Fred Klopstock, "The Market for Dollar Deposits in Europe," *Monthly Review*, Federal Reserve Bank of New York, November 1960.

total foreign private holdings. If the movements of funds were recognized as the result of cyclical changes in interest rates and were thought likely to be reversed in a short time, there might even be no conversion of newly accruing dollars into gold by foreign central banks.

#### CONCLUSION

Our examination of the practices of foreign countries has shown no evidence that official reserves are shifted from dollar assets to gold (or vice versa) in response to short-term variations in interest rates. Some foreign private funds are undoubtedly shifted from dollars to other currencies in response to international interest-rate differentials, and such movements can probably be expected to lead to increased demand for monetary gold by foreign central banks. Recent experience indicates that the volume of foreign private funds shifted abroad could be expected to be less than \$1 billion.

While this sum is not negligible, it is small in relation to recent changes in major components of the U.S. balance of payments. For example, the improvement in the current account of the U.S. balance of payments from the 1959 average to the second half of 1960 was more than \$5 billion at an annual rate. Similarly, in the last half of 1960 the net outflow on unrecorded transactions and U.S. short-term capital was at an annual rate close to \$7 billion.

In the light of these relative magnitudes, we may conclude that, so long as confidence in the U.S. dollar as a reserve currency remains undisturbed, major changes in the international reserve position of the United States are likely to result only from shifts in the balance of payments on current account or in capital movements that are reflected in changes in the U.S. payments surplus or deficit. The U.S. payments position therefore appears to represent an adequate guide to the external or international consequences of domestic financial policies. Moreover, the role of the United States as an international reserve center does not, at least at present, appear to impose significant restrictions on the range of domestic financial policies which this country is able to pursue. Effective arguments may exist for some of the recently proposed reforms to the international financial system, but the sensitivity of foreign-held dollar assets to international interest-rate movements does not appear to be among them.

OFFICIAL CENTRAL BANKING THEORY IN THE UNITED STATES,  
1939-61: FOUR EDITIONS OF *THE FEDERAL RESERVE  
SYSTEM: PURPOSES AND FUNCTIONS*<sup>1</sup>

LAWRENCE S. RITTER  
New York University

THE past decade has witnessed a resurgence of controversy over the perennial issues of monetary policy. What should be the objectives of monetary policy? What methods should it employ? What are the channels or processes through which it influences economic activity? By now, opinion has become so sharply divided—fragmented would perhaps be the better word—on so many issues as to almost defy classification, much less resolution.

What influence, if any, has this intellectual ferment had on the thinking of the monetary authorities? The purpose of this paper is to trace the evolution of official Federal Reserve views on these questions, as they have been reflected in the changes made between 1939 and 1961 in the four successive editions of the widely read Board of Governors publication, *The Federal Reserve System: Purposes and Functions*.

There seems to be a rather widely held impression that the Federal Reserve stands aloof, impervious to gratuitous advice or dissident opinion. Journal editors are all too aware of the almost tropistic reaction of academicians to policy actions and statements of the Federal Reserve. Is there any evidence of reaction in the other direction, with the System modifying its own conception of its *raison d'être* in light of commentary from

the academic community? If we are to have a viable central bank, some degree of such interchange would seem to be imperative. It is with the hope of shedding some light on this matter that the present paper has been written. But a disclaimer is quickly in order: to explore this topic fully requires a much wider inquiry than has been attempted here. My aim has been only to piece together one particular chain of evidence—namely, the changes made between 1939 and 1961 in the four editions of *Purposes and Functions*—which, while suggestive, is but one strand among many.

First a word about the book itself. *Purposes and Functions* was published originally in May, 1939. A revised second edition was published in 1947, a third edition in 1954, and the fourth and most recent in February, 1961. Bray Hammond was primarily responsible for the text of the first edition, E. A. Goldenweiser for the second, and Ralph Young for the third and fourth. However, all four editions were joint efforts, written in collaboration with other members of the Board's staff, and all bear the imprimatur of the Board of Governors. As described in the Foreword to the first edition, the volume is intended "primarily for students, bankers, businessmen and others who desire an authoritative statement of the purposes and functions of the Federal Reserve System. It is neither a primer, nor is it an exhaustive treatise. The aim has been to have it cover the

<sup>1</sup> The author is indebted to his colleagues, Clifford Clark, Robert Kavesh, and Herman Krooss, for helpful criticisms of earlier drafts of this paper.

middle ground between those extremes and to make it clear and readable without neglect of essentials."

The attainment of this goal is attested to by its widespread popularity. Not including the new fourth edition, which will probably have the largest circulation of all, over one million copies had been distributed by early 1961—160,000 copies of the first edition, 280,000 copies of the second, and 600,000 of the third. In addition, its influence is clearly evident in most of the money and banking and principles textbooks that have been published in the last two decades. It has become, rather unobtrusively, one of the most widely read and influential economics books of the day. One reason for this is the high caliber of both the analysis and the writing style throughout all four editions. Another is its uniqueness, for it has never been the custom for central banks to publicize their *modus operandi*. Almost a century ago, Bagehot complained that "there is always great uncertainty as to the conduct of the Bank of England: the Bank has never laid down any clear and sound policy on the subject."<sup>2</sup> And only two years ago the Radcliffe Committee was still prodding the Bank of England to make "a more determined effort . . . to illuminate the problems of monetary management."<sup>3</sup>

The revisions of *Purposes and Functions* have not been confined to superficial matters such as chapter organization or the updating of statistical or historical information. They have also, as will be seen, reflected significant changes in the Federal Reserve's views on the role and mechanics of central banking. Indeed, it would seem to be no accident that each

<sup>2</sup> Walter Bagehot, *Lombard Street* (London, 1873), p. 206. See also p. 160.

<sup>3</sup> Committee on the Working of the Monetary System, *Report* (London, 1959), paragraph 859.

revised edition appeared shortly after either a considerable change in economic conditions or a congressional or other inquiry that helped to induce a re-examination of previously accepted principles. Thus the second (1947) edition appeared shortly after the end of the war, the third (1954) shortly after the Patman Hearings, and the fourth (1961) shortly after the publication of the Radcliffe Report and the Joint Economic Committee's *Study of Employment, Growth, and Price Levels*. Those portions of congressional testimony or other statements that evidently were thought to be of more enduring value have been incorporated into subsequent editions of *Purposes and Functions*. It is also worthy of note that from edition to edition the volume has become more technical and more oriented toward the student and the professional as compared with the lay reader. The 1939 edition, for example, contained 128 pages and emphasized an explanation of bank reserves and their role in monetary expansion and contraction. The 1961 edition, in contrast, contains 238 pages and is a well-rounded general treatise on the many aspects of central banking.

#### I. THE OBJECTIVES OF MONETARY POLICY

*Ultimate objectives.*—As is well known, the Federal Reserve Act contains exceedingly narrow mandates, perhaps the broadest of which is to conduct monetary policy "with a view to accommodating commerce and business and with regard to . . . the general credit situation of the country."<sup>4</sup> Nevertheless, well before publication in 1939 of the first edition of *Purposes and Functions*, the System had included the mitigation of cyclical fluctu-

<sup>4</sup> Federal Reserve Act, Section 12A, as amended (United States Congress, Title 12, Sec. 263).

tuations among its responsibilities. Indeed, Marriner Eccles had attempted to include passages in the Banking Act of 1935 which would have anticipated by over a decade the intent of the Employment Act of 1946.<sup>5</sup>

Thus, the 1939 edition described the objectives of Federal Reserve policy as "to contribute, with other agencies, to economic stability" and "to maintain monetary conditions favorable for an active and sound use of the country's productive facilities, full employment and a rate of consumption reflecting widely diffuse well-being" (1939, p. 115). However, nothing was said in 1939 about economic growth or the need to maintain price stability.

In the 1947 edition the objectives of monetary policy were "to help prevent inflations and deflations, and to share in creating conditions favorable to sustained high employment, stable values and a rising level of consumption" (1947, p. 1). The main differences between 1939 and 1947 are the explicit introduction of price stability and a change from "full employment" to "sustained high employment." Those seeking a harbinger of the growth objective can perhaps fasten on the statement that the Federal Reserve endeavors "to see that the money supply is neither too large nor too small for the maintenance of stable economic progress" (1947, p. ix).

By 1954 economic growth had been explicitly introduced. The objectives of monetary policy were "to help counteract inflationary and deflationary movements, and to share in creating conditions favorable to sustained high employment, stable values, growth of the country, and a rising level of consumption" (1954, p. 1). The growth objective was frequent-

ly expressed in terms of achieving "sustainable" or "orderly" growth. However, this was about the end of the story on growth in 1954, for it received scant additional mention beyond being included among the stated policy objectives.

Although the objectives set forth in the recent 1961 edition are for the most part identical with those of 1954, two notable changes appear. In the first place, there is now considerable substantive discussion of growth throughout the volume, including a section on secular expansion of the money supply in line with the public's long-run needs for cash balances. Second, the objective of price stability is occasionally—not always, but occasionally—expressed in terms of achieving "relatively" stable prices.

None of the editions recognizes any possible incompatibility among the various objectives. Quite the contrary; it is implied in the 1954 edition that price stability is a *sine qua non* of sustained high employment and in the 1961 edition that both are prerequisites for sustainable economic growth. Similarly, the potential conflict, at least in the short run, between the growth objective and the always stated goal of rising consumption is not mentioned, despite recognition in the 1961 edition that growth is intimately related not to consumption but to investment (see 1961, p. 142). The problem of the appropriate policy mix between monetary and fiscal policy also receives only passing mention, despite the statement that "the mechanism of credit tightness and of related increases in interest rates counteracts unsound business booms to a large extent by curbing the pace of investment" (1954, p. 151).

It is of interest to note that international considerations receive relatively little attention in every one of the four editions, including the 1961 version.

<sup>5</sup> See Marriner Eccles, *Beckoning Frontiers* (New York, 1951), p. 228.

What discussion there is, is confined almost exclusively to technical factors, such as the impact of gold flows on member-bank reserve positions. While this is as would be expected in the first three editions, it is rather surprising that external objectives are not given more emphasis in the 1961 edition.

*Monetary policy or credit policy?*—I have thus far been using the term “monetary policy” in its broadest sense, as it is usually used. Within the generic context, however, controversy has long existed as to whether “monetary policy” is or should be concerned directly with money, with credit, or with both. Considerable confusion is apparent on this matter in at least the first three editions of *Purposes and Functions*.

For years quantity theorists have urged that a clear distinction be made between “money” and “credit,” and consequently between “monetary policy” and “credit policy.” To the Chicago school, the volume of money is unique, identifiable, and of crucial significance in spending decisions. It is a legitimate object of government intervention, while credit is not. It remained, however, for Gurley-Shaw and the Radcliffe Report to inculcate an awareness of this distinction in a wider audience.<sup>6</sup> Ironically, they did this by arguing exactly the opposite: that money is not unique and if central banking is to be effective it must operate directly on a wide spectrum of financial assets. In the process of rushing to the defense of orthodox central banking, many an economist discovered, somewhat painfully, that he was more of a quantity theorist than he had realized.

Technically, “money” refers to the

<sup>6</sup>I am myself indebted to John Dawson, of Grinnell College, and Paul Volcker, of the Chase Manhattan Bank, for the many hours they spent patiently giving me instruction in the new catechism.

*liability* side of commercial bank balance sheets, at least insofar as it consists of demand deposits. “Bank credit” properly refers to the *asset* side of commercial bank balance sheets, to their loans and investments. “Credit” in general refers to lending by *any* economic unit. Now money may be uniquely related to commercial banks, but credit is not; many economic units, financial and non-financial, extend credit (supply loanable funds) besides banks. Thus if the central bank believes its function is to control the money supply, it can logically confine its direct regulation to the commercial banks. However, if it believes its function is to control the extension of credit, then the rationale for confining its regulation to the commercial banks rests on rather shaky foundations.<sup>7</sup>

Throughout the 1939 edition, the System’s responsibilities were described as altering bank reserves in order to regulate both “money and credit.”<sup>8</sup> It was made clear that “money” referred to currency plus demand deposits, while “credit” referred to *bank* credit, or the asset side of the commercial bank balance sheet. It was also made clear that the concern was twofold because the creation of money stemmed from the extension of bank credit.

In the 1947 edition the concept of regulating both “money and credit” was

<sup>7</sup>“The supply of credit which can be immediately used for exercising demand is no monopoly of the banks; the power of the banks to create credit (and it is credit, not money, that is relevant here) thus provides no justification for control of the banks while other credit agencies are left uncontrolled” (R. S. Sayers, “Monetary Thought and Monetary Policy in England,” *Economic Journal*, LXX, No. 280 [December, 1960], 714; see also Sayers’ “Alternative Views of Central Banking,” *Economica*, N.S., XXVIII, No. 110 [May, 1961], 111–24).

<sup>8</sup>I have supplied the emphasis in this and all subsequent quotations that contain italicized words or phrases.

superseded by emphasis on regulation of the money supply alone. However, this turned out to be at least partly a change in terminology. It rested on the confusing view that "because deposits and currency are closely related to loans and investments of banks, the phrases 'money supply' and 'volume of bank credit' as used in this study generally mean the same thing, namely the means of payment owned by the people of the county" (1947, p. 6). Confusion was compounded by a definition of money that included savings deposits in commercial and mutual savings banks.

In the 1954 edition the emphasis on regulation of the money supply alone was jettisoned. The System instead described its intent as to regulate "*the flow of credit and money*," and throughout the volume the phrase "flow of credit and money" systematically replaced what was formerly only "money." It is not clear to what extent the System believed itself to be regulating total credit, or bank credit, or total credit by the practically convenient method of regulating its bank credit component. "Federal Reserve actions affecting the credit market are directed *for the most part* to the functioning of banks. Such actions influence the market as a whole, however, since they affect the availability of funds to other lending institutions, their attitude toward prospective borrowers, and their appraisal of investments" (1954, p. 13). "Money" was also re-defined to consist of only currency plus demand deposits. (Unfortunately, a prominently featured chart, new to this edition, listed currency and demand deposits under the head of "money" and demand and time deposits under the heading "bank credit." This has been corrected in the 1961 edition.)

If regulating "the flow of credit and

money" is indeed the way the Federal Reserve views its function, then one would be hard put to distinguish its position from the views of Gurley-Shaw and the Racliffe Report. The 1961 edition hastens to rectify this: "regulating the flow of credit and money" has been systematically replaced throughout the volume by "regulating the flow of *bank credit and money*." It is still not altogether clear, however, whether the System wishes to regulate only bank credit because it believes it to be unique, regulating as it does in the creation of money, or because it simply believes it to be the most convenient and practicable way to go about altering the total credit flow. In any case, the 1961 edition affords some measure of clarification of the System's intent and reduces terminological confusion. Whether this resolution of the matter will prove to be compatible with the stabilization objective of the System remains to be seen.

## II. THE INSTRUMENTS OF MONETARY POLICY

*The discount rate and administration of the discount window.*—The volume of member bank rediscounting had been negligible for about five years when the first edition was published in 1939. It contained traces of nostalgia for the good old days, before the Great Depression and the gold inflow, when discount rate changes "were the principal instrument by which the Federal Reserve gave effect to credit policy" (1939, pp. 49-50). Discount-rate theory was confined to a few statements to the effect that the rate is lowered to encourage credit expansion and raised to discourage it. The discussion of discount-window administration was, as might be expected in view of the circumstances, permeated by a tone of ease and accommodation. Thus "addi-

tional reserve funds are *always* available" to the member banks, and "an individual bank in making loans is not limited to its excess reserves, because it can bring them up to the required level by borrowing from its Reserve Bank" (1939, p. 73).

By 1947, however, it was made clear that "when a member bank applies for accommodation, a Federal Reserve Bank is under no obligation to grant the credit" (1947, p. 26). Access to the discount window was seen as a privilege rather than a right. Nevertheless, "a member bank with satisfactory collateral can usually obtain the desired accommodation. . . . The policy of the Federal Reserve in encouraging or discouraging borrowing by member banks expresses itself principally *not in granting or refusing loans, but in the rate charged*" (1947, p. 26). Furthermore, the influence of the discount rate "is increased by the customary reluctance of member banks to show indebtedness on their balance sheets" (1947, p. 27). The 1947 edition also introduced the role of the discount rate as a *signal*: "The discount rate . . . and particularly a change in this rate, has at times been an important indication of Federal Reserve policy; [it] not only has represented the cost of accommodation at the Federal Reserve Banks, but has reflected Federal Reserve judgment as to whether there was too much, too little, or the right amount of money for doing the country's business" (1947, p. 26).

Administrative supervision over member-bank borrowing, as contrasted with lending freely at a price, as is the practice of the Bank of England, gained further acceptance between 1947 and 1954. In the 1954 edition it is stressed even more strongly that discounting is a privilege and not a right, and that, although the Federal Reserve is a lender of last

resort in emergency situations, it should be resorted to only "on occasion . . . to meet bona fide needs . . . to meet temporary requirements or unusual banking situations . . . and for a short time only" (1954, pp. 32, 35). In line with this, Federal Reserve policy with respect to member bank borrowing is no longer described as being expressed "principally not in granting or refusing loans, but in the rate charged"; now it is expressed "*not only in granting or discouraging loans but also in the rate charged*" (1954, p. 35). And although member bank reluctance to borrow is still stressed, a word of caution is also added to the effect that "special circumstances may at times weaken this reluctance" (1954, p. 35). Finally, the concept of the discount rate as a signal is elevated to a position of much greater significance than in the previous edition: "To the business community, the discount rate in effect at the Federal Reserve Banks, and particularly a change in this rate, serves as an *objective index* of Federal Reserve policy" (1954, p. 36).

In the 1961 edition there is no evidence that discretionary supervision of the discount window has declined, but there is a clear re-emphasis on the discount *rate* as a *cost* factor. In the first place, the discount rate as signal has fallen from grace. While "*in some circumstances* a change in discount rates may express a shift in direction of Federal Reserve policy," it may also represent "merely a technical adjustment of discount rates to market rates"; thus, although "it is only natural that the business and financial community should commonly interpret a change in the level of Reserve Bank discount rates as an important indication of the trend in Federal Reserve policy," there are unfortunately "no simple rules for interpreting changes

in discount rates" (1961, pp. 46-47). Second, confidence in reliance on member-bank reluctance to borrow has deteriorated still further. Now one of the "special circumstances" that "may at times weaken this reluctance" is specified as "continuing pressures on their reserve positions" (1961, p. 45)! Third, considerably more stress is laid in the 1961 edition on the interrelations among discount rates, open-market operations, and short-term interest rates, and on least-cost methods of adjusting bank reserve positions. Member-bank reluctance to borrow evidently becomes much stronger when the discount rate is above short-term market rates (see 1961, pp. 48-50 and 58-59). In this connection, the interesting statement is made that "experience since the re-establishment of flexible monetary operations in 1951 suggests that when the indebtedness of member banks as a group has reached about 5 per cent of their total required reserves, the pace of bank credit and monetary expansion has tended to slacken" (1961, p. 59). It is not stated whether this is due to member-bank reluctance to borrow further, stricter supervision of the discount window, increases in the discount rate, or other factors.

*Open-market operations.*—The 1939 and 1947 editions contained similar expositions regarding the effects of open-market operations on bank reserves and deposits. They differed primarily in that each called special attention to the particular problem of the day. In 1939 it was the large volume of member-bank excess reserves relative to System securities holdings, so that even if the System were to sell its entire portfolio it would still absorb only about half of the then-existing volume of excess reserves.

In 1947 it was the newly expanded national debt and the need to protect

government securities from price variation, especially in a downward direction. In 1947 the magnitude and distribution of the national debt were seen as hampering monetary policy in general and open-market operations in particular; pegging the interest-rate pattern was believed to be necessary, particularly at the long end. "The vast amount of Government securities held by individuals, corporations, endowments, and savings institutions, including insurance companies, makes it desirable to continue to protect these securities from wide variations in price" (1947, p. 110). It was to be several years later before the Federal Reserve advocated unpegging the long rate.

By 1954, of course, this view of the significance of the debt as hampering monetary policy had turned a full 180 degrees. The 1954 edition viewed the magnitude and wide distribution of the debt as strengthening monetary policy, rather than obstructing it, by serving as a principal vehicle through which monetary policy was transmitted throughout the economy. "Because Government securities play a key role in the credit market, and because all financial institutions are affected by changes in the yields and prices of such securities, as well as by changes in member bank reserve positions, open market operations have direct effects upon credit availability and the climate of business expectations" (1954, p. 195). In this vein, the section on open-market operations was greatly expanded in the 1954 edition. Previously they had been discussed almost exclusively in terms of their impact on member-bank reserves and deposits; in 1954, however, non-bank financial institutions were seen as being prominently involved in transmitting the impact of open-market operations through their

reactions to changes in interest rates and securities prices. We return to this subject in Part III below.

The 1961 edition expands the section on open-market operations still further. A new chapter has been added on "The Credit Market," the chapter on interest rates has been greatly enlarged, and the chapter titled "The Influence of Reserve Banking on Economic Stability" considerably reorganized; in all of these, open-market operations and their effects are intimately involved. Again, we shall return to this in Part III.

In addition, the 1961 edition devotes much more space than did its 1954 predecessor to "bills only" and the related ground rules adopted in 1953 for the conduct of open-market operations. The 1954 edition merely noted, almost in passing, that "Although such operations may be conducted in securities of any maturity, traditional reserve banking practice has been to limit transactions to short-term Government securities. Open market operations in these securities are rapidly communicated throughout the credit market by the mechanism of the market itself, as well as through their effects on bank reserves" (1961, p. 40; see also p. 46). The point was also made in 1954—and repeated in 1961—that "Traditionally, Reserve banking operations are not directed toward establishing any particular *level or pattern* of interest rates" (1954, p. 143).

In the 1961 edition, in contrast, seven full pages (1961, pp. 35–41) are devoted to the subject of "bills only" and related operating procedures. Basically, these pages repeat the arguments previously advanced by Riefler and Young-Yager for confining operations to the short end except to correct disorderly markets,<sup>9</sup> namely, that the purpose of open-market operations should be confined to altering

bank reserve positions, that "bills only" will improve the performance of the Government securities market, that direct intervention in the intermediate or long sector is dangerous because it distorts the true demand-supply relationships and gives rise to unjustified expectations, and is unnecessary because the effects on bank reserves and the market forces of substitution and arbitrage will effectively transmit yield impulses throughout the maturity range. Fundamentally, the structure and level of interest rates should be left to the determination of private market forces: "While the course of interest rates is necessarily influenced by reserve banking action, monetary policy decisions are themselves based primarily on judgment as to the flow of bank credit and money that is appropriate for the economy, and not on judgment as to some level and pattern of interest rates that is deemed to be appropriate. To the greatest extent possible, the setting of interest rates is left to the interplay of supply and demand forces expressed in the credit and security markets" (1961, p. 122).

Unfortunately, the 1961 edition of *Purposes and Functions* made its appearance in February of that year, the very month in which "bills only" was abandoned. In the second printing—dated April, 1961—an attempt has been made to take this change in System policy into account, while at the same time retaining intact the bulk of the still-new fourth edition. On pages 35 and 41 statements have been inserted in the second printing to the effect that "In early 1961, in view of conditions that had developed in the

<sup>9</sup> Winfield W. Riefler, "Open Market Operations in Long-Term Securities," *Federal Reserve Bulletin*, XLIV, No. 11 (November, 1958), 1260–74; and Ralph A. Young and Charles A. Yager, "The Economics of 'Bills Preferably,'" *Quarterly Journal of Economics*, LXXIV, No. 3 (August, 1960), 341–73.

domestic economy and in the United States balance of payments with other countries, the Open Market Committee authorized transactions in longer term securities" (1961, p. 35). Perhaps of more significance than these insertions, however, is the deletion in the second printing of one of the key paragraphs justifying the "bills only" policy, a paragraph that had just appeared for the first time in the first printing of that edition.<sup>10</sup> Nevertheless, the greater part of the argument for "bills only" and the doctrine of minimum intervention has been left unchanged in the second printing, including the above-quoted statement to the effect that the structure and level of interest rates should be left as far as possible to the determination of private market forces.

*Changes in reserve requirements.*—The treatment of reserve requirements is very similar through all four editions. About the only new material appears in the 1961 edition where, for the first time, the subject of equity is raised in connection with reserve requirements. In discussing the feasibility of frequent changes in reserve requirements, the Board notes that

<sup>10</sup> The deleted paragraph is the following: "If Federal Reserve operations were regularly conducted in all maturity sectors of the Government securities market, the portfolio managers of financial institutions, other investors, and professional traders might well become unduly sensitized to possible changes in monetary policy. A particular hazard, for instance, would be that the trading in the longer term area of the market, which normally experiences the widest price swings, might become overly influenced by guesses about the maturities that might be involved in System operations. In these circumstances, discontinuities in market performance and unsettled market tendencies might occur with increased frequency. Also, market prices and yields would not adequately reflect the interplay of primary supply and demand forces stemming from current economic tendencies. This would handicap market observers, including reserve banking officials in their efforts to follow and interpret current economic developments" (pp. 40-41, first printing, fourth edition).

even small changes in required ratios would have a relatively large impact on member-bank reserve positions: "If, to avoid a large reserve effect, a change is limited to a particular class of bank, a perplexing problem of equity as between classes of banks is presented" (1961, p. 54). It is also noted that the counter-recession decreases in member-bank reserve requirements during the 1950's, which were not reversed in subsequent booms, "were facilitated by the fact that existing levels of reserve requirements were high in relation to past periods and also in relation to the standards for non-members banks adhered to by many States" (1961, p. 55). No similar equity considerations are mentioned with respect to reserve requirements on commercial banks vis-à-vis non-bank financial institutions.

*Selective credit controls.*—The topic of selective credit controls has had a rags-to-riches-and-back-to-rags odyssey through the four editions of *Purposes and Functions*. In 1939, of course, only margin requirements were mentioned. The point was made that the excessive use of stock market credit might have wide ramifications and that via margin requirements the System "is able to impose restrictions on the use of bank funds for stock market speculation without restricting the volume of credit available for commercial and industrial needs or raising its cost" (1939, p. 112).

More than three times as much space was devoted to selective credit controls in 1947, with a discussion of consumer credit controls added to the section on margin requirements. Again: "These methods are supplementary to methods of general regulation, and *their merit* is that they make it possible to restrain the flow of money into certain fields at times when conditions in the economy as a

whole are such as to make general restraints . . . undesirable" (1947, p. 38). Regarding consumer credit control in particular, the authority for which had just expired, the Board noted that:

One reason why consumer buying on instalments was subjected to special regulation is that variation in the volume of such buying has a disturbing influence on business stability. Purchases on an instalment basis are likely to be large at a time of general prosperity [and] are likely to increase still further a demand for goods that is already larger than can be easily supplied. On the other hand, at a time of depression and unemployment . . . the necessity for many purchasers on instalment to meet their payments tends to reduce still further the amount of money available to consumers for current purchases. It is believed by many that regulation of instalment purchases, prescribing stiffer terms in a boom period and permitting easier terms in a depression, would tend to reduce somewhat the swings from prosperity to depression and would therefore support the main purposes of Federal Reserve policy [1947, p. 46].

In addition, it was also noted that consumer-credit controls "tended to cause competitive business forces to take the direction of lowering prices instead of keeping them up by means of offering easier and easier credit terms" (1947, p. 46). The Board concluded that selective controls over stock market and consumer credit had been developed far enough to be "a useful complement to the older and more general instruments. . . . They are flexible in themselves and can help to make credit policy in general more flexible" (1947, p. 47).

By the 1954 edition a considerable degree of disenchantment was evident. This was still two years before the start of the inconclusive Federal Reserve-National Bureau Study of Consumer Credit, three years before its completion. Margin requirements still found favor, although

it was no longer a "merit" but merely a flat statement of fact that "selective methods make it possible to reach specific credit areas without imposing stronger credit measures than might otherwise be appropriate" (1954, p. 57). The section on consumer-credit controls still mentioned the "price competition instead of progressive easing of credit terms" point, but the long paragraph reproduced above regarding the cyclically aggravating impact of consumer credit is no longer in evidence. Instead, the reader is warned that before imposing selective credit controls one should be sure that their contribution will be great enough "to outweigh the burdens of regulation, on both those subject to it and those administering it" (1954, p. 67).

By the 1961 edition we have come full circle. Margin requirements are still approved on the grounds, as in 1939, that excessive use of stock market credit may have wide ramifications, and that by way of margin requirements the System can exercise an influence in this area without employing its general controls. "Such use of the general instruments, to be effective, would necessarily run the risk of undesirable, broader effects" (1961, p. 61). Although it would appear that the same argument could be applied in the consumer-credit area, in the 1961 edition, as in 1939, there is no mention whatsoever of selective controls over consumer credit.<sup>11</sup>

<sup>11</sup> In a letter to Senator Douglas in late 1959 Chairman Martin noted that the imposition of consumer-credit controls "would be preferable to either calculated or uncontrolled inflation, but we should recognize that they involve a degree of regimentation never before accepted in this country except in time of war" (*Employment, Growth, and Price Levels*, Hearings before the Joint Economic Committee, Eighty-sixth Congress, 1st sess., [Washington: Government Printing Office, 1959], p. 3455; see also pp. 1490-91).

### III. THE THEORY OF MONETARY CONTROL

Tastes differ with respect to the extent to which economists desire or believe it necessary to spell out the detailed process through which they visualize monetary policy as influencing aggregate spending and the level of income. By and large, quantity theorists seem to confine themselves to explanations in terms of a stable demand for cash balances that is primarily a function of income, often expressed as a stable velocity. Beyond that, the particular categories of spending affected by monetary policy are rarely specified. Keynesians (if one may use that term to cover a wide variety of views when it comes to the subject of monetary policy) analyze the process more in terms of the interest elasticity of the demand for idle balances and the interest elasticity of particular sectors of investment and consumer spending. The quantity theory implies a low interest elasticity of demand for idle balances, that is, an insensitivity of hoarding to monetary expansion (no liquidity trap) and an insensitivity of dishoarding to monetary contraction (no substantial release of idle balances to augment active balances in periods of tight money). It also implies a substantial interest elasticity of investment or consumer spending.

The explanations in the various editions of *Purposes and Functions* of the mechanism through which monetary policy is seen as influencing aggregate spending cannot be placed squarely into either camp. In terms of the method of approach—not the conclusions—perhaps the first two editions are more inclined toward a quantity-theory orientation and the last two toward a Keynesian approach. But this is an inadequate charac-

terization, for the first two editions continuously stress that while the Federal Reserve "can create credit when it is in demand, can encourage the demand for it by making funds abundant and cheap, and can create deposits by open market purchases of securities, they can not create a demand for credit or cause the created deposits to be actively used" (1939, p. 86). And while the broad outlines of a Keynesian framework are discernible in the last two editions, the analysis contains unique contributions of its own. In Tobin's words, in commenting on Federal Reserve testimony during the Patman Hearings, which is essentially reproduced in the 1954 edition, this "third school sets forth a new theory of monetary control which claims that both of the old schools are asking the wrong questions. According to this theory, monetary controls work much more through restricting the availability of credit than through increasing its cost, much more through restraints on lenders than through reactions of borrowers."<sup>12</sup>

The various editions of *Purposes and Functions* differ greatly in the attention they devote to the theory of monetary control. In 1939, discussion was limited to the assertion that the effects of monetary policy "extend to all forms of economic activity and are felt indirectly by everyone" (1939, p. 11). However, the only causal process mentioned was that through its control over bank reserves the central bank influenced both the availability and the cost of bank credit

<sup>12</sup> James Tobin, "Monetary Policy and Management of the Public Debt," *Review of Economics and Statistics*, XXXV, No. 2 (May, 1953), 118-27. Tobin concludes: "Only the future will tell whether this kind of monetary policy will do the job to the satisfaction of the monetary authorities themselves, or whether in the end they will conclude that monetary control can only be successful through the more pronounced changes in interest rates on which central banks traditionally relied in the past."

and thereby the money supply. It was implied that this in turn influenced aggregate spending, but there was no analysis of how this occurred or which particular types of expenditure might be affected.<sup>13</sup>

In the 1947 edition, the principal purpose of the Federal Reserve was seen as the regulation of "the supply, availability, and cost of money" in order to avoid both inflation and depression. But the only description of exactly how monetary policy contributed to this end was confined to a general statement to the effect that if the supply of money is "too scarce, too dear, or too hard to get" it will lead to depression, while if it is "too plentiful, too cheap, or too easily obtainable" it will lead to inflation. Relying on its control over member-bank reserves, the Federal Reserve evidently steered a middle course between Scylla and Charybdis.

The 1954 edition thus represented the first real attempt to explain the process, as the Federal Reserve saw it, through which monetary policy works. Both it and the 1961 edition utilize roughly the same framework for this analysis. Within that framework, however, a number of changes appear between 1954 and 1961, clearly reflecting both the experience gained and professional discussion in the intervening years. It will facilitate comparison to trace through the entire process step by step, comparing the 1954 with the 1960 analysis at each stage. At the risk of caricaturing a complex and subtle explanation in the interest of brevity, the following is the essence of the process of restraint as seen by the Board.<sup>14</sup>

<sup>13</sup> All editions of course mention that the structural reforms instituted by the Federal Reserve Act, such as establishing a lender of last resort, correcting the pyramiding of reserves, and making the currency more elastic, make financial panics less likely than before 1914.

1. The Federal Reserve puts pressure on member-bank reserve positions, initially probably through open-market operations, thereby hampering the banks' ability to make loans and create money. There is no difference between the 1954 and 1961 editions regarding this first step.

2. 1954: To some extent, the banks then turn to the discount window for additional reserves. However, such funds are only temporary at best. In addition, member-bank reluctance, administrative supervision of the discount window, and raising the discount rate in line with short-term market rates, all operate to limit recourse to this source of funds. The banks are thus forced to sell short-term government securities to obtain the reserves necessary to satisfy loan demands. While an individual bank can indeed augment its reserves in this fashion, this will draw reserves from other banks and no net addition to reserves will take place. "Consequently, banks as a group cannot expand their total supply of lendable funds in this way except when such paper is being bought by the Federal Reserve System" (1954, p. 126).

1961: The 1961 edition is the same as the above except for the substitution of the phrase "total loans and investments" for the expression "total supply of lendable funds" in the concluding quotation.

3. 1954: The sales of short-term securities by the banks, and perhaps by the System as well, if it wants to intensify the pressure, drive short rates up. With yields now more attractive, "nonbank investors may be induced to buy more of them, using temporarily idle deposit balances. Sales of short-term paper by banks

<sup>14</sup> Anti-depression policy is by and large explained as merely the opposite of anti-inflation policy. One possible exception is the view that if a boom gets out of hand it will make it more difficult for monetary policy to cure a subsequent recession.

to other investors and the use by banks of the proceeds to make loans will shift the ownership of deposits and may increase the activity of existing deposits, but such sales will not increase total bank reserves so as to permit an increase in total bank credit and deposits" (1954, p. 126).

1961: The tone of the 1961 edition is much less sanguine than the above quotation. In its place is substituted the following: With yields on short-term securities now more attractive, "nonbank investors may use temporarily idle balances" to buy them, "or they may even be induced to economize on cash balances held for current payments. When banks sell short-term paper to other investors and use the proceeds to make loans, ownership of deposits may shift from holders of idle balances to borrowers who are spenders and will shortly disburse the proceeds. To the extent that this occurs, the velocity of existing deposits will increase. Total bank reserves and total bank credit and deposits do not increase in this process, but the volume of money transactions increases as the existing supply of money is used more actively" (1961, p. 127).

4. 1954: The sale of short-term securities soon depletes bank liquidity, so that the banks become increasingly reluctant to reduce their short-term holdings further. They are also by now reluctant to sell longer-term issues as well. The rise in short rates has exerted an upward pressure throughout the yield curve, bringing about lower capital values on longer issues.<sup>24</sup> "Many banks . . . are reluctant to sell securities at a loss. As the potential loss becomes greater, this reluctance

<sup>24</sup> Neither edition makes any serious attempt to argue that only small changes in interest rates will suffice to lock lenders into their existing portfolios (cf. Tobin, *op. cit.*), although there is some suggestion of this in the 1954 edition, pp. 44 and 145-46.

deepens" (1954, pp. 126-27). In addition, monetary restraint has injected a note of caution and uncertainty into the business outlook. Because of these factors, banks start to conserve their liquidity and stop selling securities in order to make loans.

1961: The 1961 edition reproduces the concept of the erosion of bank liquidity, with consequent reluctance of the banks to continue their sales of short-term issues. However, the "uncertainty effect"—the dampening influence of a restraining monetary policy on expectations regarding future business conditions—is not mentioned at all and the so-called "lock-in effect" is sharply downgraded: "Banks are influenced *to some extent* by potential capital losses on the securities in their portfolios and they hesitate to sell securities at a loss. Income tax considerations and strict earnings calculations, however, may moderate *or even negate* the deterrent effect of such losses on continued sales of such securities" (1961, pp. 127-28).

5. Both the 1954 and 1961 editions stress that this process of monetary restraint leads to credit rationing by banks as well as to higher interest charges. The credit rationing takes the form of more careful screening of loan applicants and greater over-all selectivity in lending practices and standards. One of the reasons for this mentioned in the 1954 edition, however, is not in evidence in 1961, namely, the effect of a tight money policy in inducing a reassessment of prospective business developments.

6. 1954: Non-bank financial institutions have not escaped unscathed. In the first place, the prospect of continued monetary tightness also tempers their optimism about future business trends. In addition, rising interest rates and concomitant lower capital values of the

securities they hold produce a less ebullient market atmosphere and a general decline in their liquidity. The size and wide distribution of the public debt are important in this process. Thus financial institutions "become less willing to sell prime securities to acquire higher yielding but more risky assets, partly because they can sell the prime securities only at a loss, which they hesitate to accept. They also become more interested in retaining in or adding to their portfolios the more liquid types of assets, because of concern about the decline in the market value of their entire investment portfolio and the general uncertainty about future developments" (1954, p. 129). As a result, they "become less willing to make any but the best grade loans and investments, and they generally exercise greater caution in accepting credit applications from marginal risks" (1954, p. 128).

1961: It is clear that in the 1954 edition the reaction of non-bank financial institutions to monetary policy was seen as a significant aspect of the mechanism of restraint. Indeed, it was largely on this base that the availability doctrine was initially constructed. In the 1961 edition, however, the lending behavior of non-banks is not viewed as nearly so susceptible to System control as in 1954. As elsewhere, the uncertainty effect has been discarded and the lock-in effect qualified. In addition, the large and widely distributed federal debt, and the highly developed financial structure it serves to interconnect, are no longer viewed as unmixed blessings: "Because market sectors are related . . . the effect of reserve banking policy . . . is transmitted throughout the national credit market and has an influence generally . . . on the willingness and ability of non-bank financial institutions to lend. At the

same time, the broadening of the credit market and the growth of financial intermediaries *enlarge the sources of credit available to borrowers, intensify competition on the side of supply, and increase the potentiality for accelerated credit expansion*" (1961, p. 104). Similarly, it is now noted that rising interest rates may *attract* funds to some financial institutions: The size of the cash balances that businesses and individuals find it desirable to hold depends in part on the level of interest rates. The form in which contingency or speculative balances are held—whether as demand deposits that bear no interest or as interest-earning assets—is highly sensitive to the interest return. Insofar as rising interest rates . . . lead to a greater preference for interest-earning assets, some additional flow of credit may become available out of what would otherwise be idle balances. Such an addition to the flow of available credit tends to offset somewhat the credit-restraining effects of anti-inflationary monetary policy" (1961, pp. 130, 133).<sup>16</sup> Elsewhere, however, it is alleged that the attraction of funds to non-bank financial institutions under the stimulus of rising interest rates "helps to correct forces making for inflationary tendencies" because it enables a larger proportion of borrowing to

<sup>16</sup> Considerably more attention is devoted to the topic of monetary velocity in the 1961 edition than in any previous edition. See especially pp. 127-33. The 1961 edition concludes: "In assessing the effect on economic activity of changes in the money supply, it is important to recognize that there is no simple automatic measure of the appropriate relationship between the amount of money outstanding and the level of economic activity. A given volume of money, for example, can be associated with either higher or lower levels of total spending depending on how often it is used. With the changing use of cash balances a potential countervailing force to restrictive or expansive monetary policy, it is necessarily incumbent on the monetary authorities to pay close attention to monetary velocity and to weigh its strength carefully in determining possible actions" (1961, pp. 129, 133).

be met through the facilities of these institutions and thereby "reduces pressures leading to bank credit and monetary expansion" (1961, p. 140).

7. 1954: All that remains is to identify the particular categories of final expenditure affected. Restraint is exerted on borrowing and thereby on spending by *three* main channels: (a) the higher interest cost, (b) the greater difficulty of obtaining a loan from almost any lender, even if one is willing to pay the going rate, and (c) the clouding of business prospects in general, due to the monetary uncertainties that stem from rising interest rates, lower capital values, and the declared intent of the central bank to maintain price stability. It is emphasized that it is marginal borrowing and spending decisions that will be affected. The particular spending categories likely to be most influenced are long-term investment in plant and equipment, inventory accumulation, residential construction, and consumer spending. These direct effects are likely to set in motion a sequence of secondary multiplier and accelerator repercussions that will magnify the initial impact.

1961: Restraint is exerted on borrowing and thereby on spending through *two* main channels: (a) the higher interest cost, and (b) the greater difficulty of obtaining a loan, especially from commercial banks, even if one is willing to pay the going rate. It is still emphasized that it is marginal borrowing and spending decisions that will be affected; "The result usually is a smaller increase in spending than transactors desired rather than an actual contraction in spending. For this reason, the curtailment in spending is difficult to observe" (1961, p. 135). The particular spending categories likely to be most influenced are much the same as above. However, in the absence of the

uncertainty effect and with the downgrading of both the lock-in effect and the responsiveness of non-bank financial institutions, it is implied, although not explicitly stated, that somewhat more reliance must now be placed on the reactions of borrowers to interest costs relative to former emphasis on the behavior of lenders in restricting the availability of credit. As before, the direct effects are seen as likely to set in motion a sequence of secondary multiplier and accelerator repercussions that will magnify the initial impact.

In summary, the major changes between 1954 and 1961 in the process of monetary restraint, as seen by the Board, are the following: (1) The large and widely distributed Federal debt, and a highly developed financial system, are no longer viewed as unmixed blessings since they facilitate the mobilization of idle balances and the creation of credit despite the actions of the central bank. (2) The lending behavior of non-bank financial institutions is no longer viewed as highly susceptible to System control. (3) It is now recognized that stability in bank reserves and the money supply, and in total bank loans and investments, may still permit an expansion in total credit and in total spending, due to higher monetary velocity resulting from dishoarding and economizing on cash balances induced by higher interest rates. (4) The lock-in effect with respect to sales of securities, particularly by banks, has been sharply downgraded. (5) The uncertainty effect, the thesis that central-bank policies introduce an element of caution and restraint into the short-term business outlook, and thereby curtail the desire to borrow and the willingness to lend, has been discarded. (6) In addition to the renewed attention men-

tioned above regarding the importance of interest rates relative to liquidity preference, a somewhat increased emphasis is also evident on the importance of interest rates as a cost factor to borrowers. Credit rationing by lenders, however, is still considered to be of great significance.

What can we conclude from this excursion through more than twenty years of *Purposes and Functions*, through many aspects of central banking theory about which, it should again be stressed, there is little or no consensus within the profession? Many conclusions are possible regarding the evolution and present state of particular doctrines. However, I would

like to emphasize a conclusion of a somewhat different nature. Without regard to the merits of specific positions, past or present, it is obvious, at least from this particular chain of evidence, that the thinking of the monetary authorities has not been parochial or dogmatic. It has instead been eclectic, pragmatic, and responsive to both experience and discussion within the profession. It has shown itself capable of change and adaptation in light of trends in both economic conditions and economic analysis. A word of commendation is in order, after which we can, with better conscience, return to the fray.

