

# **JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT**

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## **HEARINGS**

**BEFORE THE**

### **JOINT ECONOMIC COMMITTEE**

### **CONGRESS OF THE UNITED STATES**

**EIGHTY-EIGHTH CONGRESS**

**FIRST SESSION**

**PURSUANT TO**

### **Sec. 5(a) of Public Law 304**

### **(79th CONGRESS)**

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**Printed for the use of the Joint Economic Committee**

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**PART 2**

**Statements of Economic Interest Groups**



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PART 2  
Statements of Economic Interest Groups



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(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

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## JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

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The following letter was sent to 19 organizations inviting them to submit written comments on the materials and recommendations contained in the 1963 Economic Report of the President. The comments were given consideration by the Joint Economic Committee in the preparation of its annual report on the President's Economic Report.

JANUARY 23, 1963.

DEAR — —: The Joint Economic Committee is again calling upon a number of leaders of banking, business, labor and agriculture, and consumer organizations in order to secure economic facts and counsel for consideration in the preparation of our annual report on the Economic Report of the President.

Because of the pressure of time, and a statutory deadline of March 1 for filing our report, our hearings this year must necessarily be brief, and, further, in order that the members of the committee may have time to consider written statements, these statements should be received no later than February 15.

We would appreciate having your comments on the materials and recommendations contained in the 1963 Economic Report of the President, including, of course, the appended report of the Council of Economic Advisers. I am enclosing a copy of the report for your convenience, in the event you are able to prepare comments.

In addition, I am enclosing a list of the other organizations that have been invited to submit written comments, as well as a list of the individuals who have been invited to testify the first week of the hearings.

It would be of assistance to the committee if we could have 20 copies of your comments. Such comments as you care to give us will be made available to the public through a printed compendium of the invited statements.

Sincerely yours,

PAUL H. DOUGLAS, *Chairman.*

Listed below are the organizations which were invited to submit written comments:

American Bankers Association.  
American Farm Bureau Federation.  
American Federation of Labor and Congress of Industrial Organizations.  
Chamber of Commerce of the U.S.A.  
Committee for Economic Development.  
Conference on Economic Progress.  
Consumers Union, Inc.  
Federal Statistics Users' Conference.  
Life Insurance Association of America.  
Machinery & Allied Products Institute.  
National Association of Manufacturers.  
National Association of Mutual Savings Banks.  
National Farmers Union.  
National Grange.  
National Independent Union Council.  
National League of Insured Savings Associations.  
Railway Labor Executives Association.  
United Mine Workers of America.  
United States Savings and Loan League.

(The statements and letters of the organizations which submitted statements to the committee follow :)

## THE AMERICAN BANKERS ASSOCIATION

NEW YORK, N.Y., *February 14, 1963.*

HON. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR DOUGLAS: In response to your request for comments on the materials and recommendations contained in the 1963 Economic Report of the President (including the appended report of the Council of Economic Advisers), we are pleased to submit the attached statement.

We hope that this statement of views will be of some assistance to the committee in the preparation of your annual report.

Sincerely yours,

CHARLES E. WALKER,  
*Executive Vice President.*

### COMMENTS ON THE PRESIDENT'S ECONOMIC REPORT AND THE ACCOMPANYING ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS

#### INTRODUCTION

The President's Economic Report and the annual report of the Council of Economic Advisers are comprehensive and thoughtful documents, ranging widely over a large number of today's economic problems and policies. Faced with the wealth of detail and analysis contained in them, we have chosen to limit our comments to those broader aspects of policies and problems which, in our judgment, will deserve the greatest attention in the months ahead. Naturally, our discussions tend to be concentrated in areas where our emphasis or views differ, to a greater or lesser extent, from those expressed in the reports on which we have been invited to comment.

We share with the President and the Council the concern expressed over the need for measures designed to improve the long-range growth performance of the Nation's economy. We share, also, their conclusion that major tax reduction offers the most promising approach to strengthening and reinvigorating the domestic economy. Obviously, the use of major tax reduction as a long-range stimulus to the economy carries potential risks as well as potential rewards—the net results being heavily dependent on the manner in which a program of tax reduction is integrated into the overall financial policies of the Government, including spending policies, monetary policy, and debt management. The rewards which can be secured by tax reduction adequately are detailed in the President's Economic Report. In our judgment, the potential risks which are incurred, and the implications of these risks for Federal spending, monetary policy, and debt management, do not receive sufficient attention. Nor, in some cases, do specific recommendations in the report reflect recognition that these risks are present.



The President and his Council find that a program of major tax reduction, coupled with further increases in Federal spending which lead to the largest peacetime deficit ever planned, is compatible with the need for domestic price stability, consistent with the requirement for securing further balance-of-payments improvement, and responsive to the need for a faster growing economy. Moreover, the administration does not anticipate that the incurring of a budget deficit now estimated at almost \$12 billion, and at a time of serious imbalance in our international accounts, will present serious conflicts among the objectives to be served by debt-management and monetary policies.

We accept, as desirable goals of public policy, the objectives which are outlined by the President and the Council: expanding output and employment opportunities; price stability; and balance-of-payments equilibrium. We do not believe, however, that the President's program is best designed to contribute to the achievement of these objectives. We find particularly puzzling the light treatment given to possible conflicts, at least in the short run, between the policies which may be required to achieve each of the goals. The balance between domestic growth and full employment, on the one hand, and price stability, on the other hand, has always been extremely difficult to strike. Economic expansion, even within the framework of price stability, is not necessarily compatible with balance-of-payments equilibrium in the long run, and in the short run is likely to aggravate our payments problem. Moreover, the decline in the Nation's international liquidity position makes it extremely doubtful whether monetary policy can serve the short-term interests of both balance-of-payments improvement and domestic economic expansion. These are only a few illustrations of the areas in which we may experience short-term conflicts in the pursuit of multiple economic goals. The administration's economic program, featuring heavy emphasis on economic growth, reflects all too often the judgment that these economic objectives are mutually complementary in the short run as well as in the long run.

The following sections contain a report of our views, in turn, on the fiscal, monetary, and debt management policies proposed by the administration, and on the policies discussed with respect to our persistent balance-of-payments deficit. A final section reviews the Council's wage-price guidelines for collective bargaining.

#### FISCAL POLICY

At its 88th annual convention last September, the American Bankers Association cited tax reduction as the major tool available for stimulating longrun economic growth, but it cautioned that reductions in tax rates would not in fact encourage sustained growth unless a number of safeguards were observed. One of the most important of these safeguards was cited as follows:

"Tax reductions must be implemented within the bounds of fiscal prudence \* \* \* (This) means that \* \* \* Federal spending over a protracted period must be strictly limited and effectively controlled \* \* \*."

In our judgment, the requirement for implementing a tax cut "within the bounds of fiscal prudence" would not preclude a temporary swelling of the Federal deficit if this increase resulted from a tax reduction of the magnitude proposed by the President. For practical as well as economic reasons, our endorsement of tax reduction has not been coupled with the demand that the reduction be accomplished without exerting a temporarily adverse impact on the Federal budget. We regard tax reduction as an investment in future economic vigor, and we look upon the accompanying temporary enlargement of the deficit as the price, though not the purpose, of the tax cut. Even a temporary enlargement of the Federal deficit resulting exclusively from tax reduction is not without risk at this time—the risk of generating renewed inflationary pressures and compounding our balance-of-payments difficulties. Yet our confidence in the constructive forces that tax reductions can unleash leads us to believe that the price, in terms of a temporary and manageable swelling of the deficit, can and should be paid.

Despite our confidence in the stimulative powers of tax reduction, we remain concerned about the size of the projected deficit for the coming fiscal year. We note particularly that the increase in the deficit is much more a product of further increases in Government spending than of revenue losses attributable to tax reduction. In our opinion, fiscal planning which results in the projection of a \$12 billion deficit for the coming fiscal year borders closely on economic brinkmanship, and our concern over this development is further deepened by the knowledge that in 5 of the past 6 fiscal years the budget deficit originally has been underestimated, on the average, by \$8 billion.

Thus, the incorporation into the 1964 budget of a \$4.5 billion spending increase represents one of the most disappointing aspects of the administration's fiscal program. If spending for the year ahead had been budgeted at fiscal 1963 levels, the projected deficit would have been held to the approximate level of the manageable deficits incurred in each of the last 2 fiscal years. The exercise of stricter discipline is essential if we are able to afford tax reduction without running the risk of allowing an unmanageable deficit to develop, and it will remain essential in the future if we are to allow the process of economic expansion to produce a progressive strengthening in the Government's fiscal position. By combining tax reduction with a significant increase in Federal spending for fiscal 1964, the administration has not only magnified the risks which attend major tax reduction, but it also has raised the question of whether or not, in the future, we can expect the determined efforts to curtail Federal spending which are imperative if the process of tax adjustment is not to result in a deterioration of the Government's fiscal position. Unless these risks can be reduced, and unless the capacity of the administration to curtail spending more effectively can be demonstrated, the desirability of embarking on a tax reduction program must be expected to be appraised with considerable skepticism.

Our concern over the size of the deficit being planned for fiscal 1964 (and recognizing that the estimate of \$12 billion could be significantly short of the mark) reflects our appraisal of the possibilities for financing a deficit of unusually large magnitude without generating

renascent inflationary pressures and/or imposing a critical strain on international confidence in the dollar. A failure on either of these counts would constitute a severe setback to our domestic economy and, of greater significance, impair the economic security of the entire free world. Given our limited capacity to finance deficits without running risks the consequences of which could be extremely grave, it is particularly regrettable that the deficit being forecast is so heavily weighted by increasing Federal spending. In our present circumstances, these spending increases are, dollar for dollar, both less effective and less efficient in serving the long-range growth needs of the Nation.

The administration's judgment that unused capacity in the economy safeguards against the renewal of inflationary pressures is questionable. As Paul Samuelson points out in his basic text, *Economics*, "the real difficulty with full employment lies not in its rough definition but in the fact that wages and prices may begin to soar while there is still considerable unemployment and excess capacity." This is particularly true when a significant amount of the unemployment is structural, and not cyclical, in nature.

Aside from the fiscal implications of the administration's proposal to reduce taxes, there also are questions related to the structure and timing of the proposed tax cut. At our annual convention last year, we recommended the following structural and procedural approaches:

"\* \* \* both the magnitude and the character of rate reductions must be tailored to provide additional incentives for sustained economic expansion, rather than simply to give a temporary one-shot boost to the economy. This requirement dictates that reductions in tax rates should be both substantial and permanent. Moreover, it means that rate reductions must be designed specifically to provide additional incentives for capital investment \* \* \* upon which the achievement of rising productivity is so heavily dependent.

"\* \* \* even with strict limitation upon Federal spending a gradual transition to lower tax rates is almost certain to produce temporary and moderately unfavorable effects on the Government's fiscal position. These effects can be minimized by providing for a gradual reduction of tax rates according to a predetermined schedule, rather than by a single major reduction \* \* \*."

It is clear that the President's tax program meets two of the basic requirements expressed above: that the reduction be substantial and permanent, and not of the one-shot variety; and that there be a gradual transition to the lower rates. With regard to the structure of the tax reduction, however, our position has emphasized the provision of "additional incentives for capital investment \* \* \* upon which the achievement of rising productivity is so heavily dependent." This emphasis suggests the need for concerned action to improve the sluggish performance of business investment by sharpening the profit incentive. The most direct approach to strengthening this incentive is by substantial and immediate relief from the heavy tax burden for those most immediately concerned—corporations and individuals in the middle and upper income brackets. In fact, in his 1962 Economic Report, President Kennedy emphasized such incentives in speaking of his plans for tax reform:

"Later this year, I shall present to Congress a major program of tax reform. This broad program will reexamine tax rates and the defini-

tion of the income base. It will be aimed at the simplification of our tax structure, the equal treatment of equally situated persons, and the strengthening of incentives for individual effort and for productive investment."

The statements in the 1963 Economic Report, on the other hand, place greater stress on inadequate demand, and the proposed structure of tax reduction is weighted heavily by the desire to spur consumption expenditures. As stated by President Kennedy, "the most important single thing we can do to stimulate investment in today's economy is to raise consumption by major reduction of individual income tax rates." Increasing consumption is regarded as the starting point for acceleration of economic growth. Thus, the actual tax reduction and reform program, as described in the President's January message, is skewed in favor of the lower income groups; less emphasis is given to relief for middle and upper income individuals and for corporations more closely identified with the investment process.

While it is recognized that the causes and effects in the consumption-investment process scarcely can be separated but in theory, and that the increases of both are mutually interdependent, it nevertheless seems evident that the structure of the proposed tax reduction fails to strike a proper balance between those features which can be expected to stimulate consumption directly and those which will operate primarily to stimulate growth-producing investment. The crucial investment mechanism in the economic process will fail to function properly, regardless of consumption stimulants, unless profit horizons are extended directly by reducing the taxes applicable to the fruits of investment.

The Council's report recognizes that the shortfall in expansion last year was in "the failure of expenditures other than consumption to rise as far as had been expected." While consumption, wages, and Government expenditures have all moved briskly ahead during the past decade corporate profits and business investment have behaved sluggishly. Surely this record lends support to the view that tax reduction should concentrate more directly on incentive, the profit motive, and investment.

#### MONETARY POLICY AND DEBT MANAGEMENT

Under the caption "Monetary Policy and the Balance of Payments" the Council's annual report points out that:

"While a balance must be continuously struck between credit and interest rate policies in support of domestic economic expansion and policies to protect or improve the balance of payments, any conflict is more a shortrun than a longrun one. In the long run, the U.S. balance of payments probably has much to gain from a fully operating, rapidly gaining domestic economy."

Unfortunately, Federal Reserve authorities have found themselves in this "shortrun" position for several years, and there seems to be little likelihood that our balance-of-payments difficulties will soon evaporate.

Still, the Council seems to stress the domestic side of the problem:

"What matters most at this time is that financial policy should be designed to facilitate rather than retard the expansionary process

which the tax program is designed to launch \* \* \*. When unused productive resources are available, it is not inflationary to permit a parallel expansion in the supplies of money and liquid assets and in the availability of bank credit."

The Council goes on to mention the concern sometimes expressed that too much monetary stimulus "may be an embarrassment" at a future time when the public's excess liquidity could be used to "add fuel to inflationary flames." In the Council's judgment, however, such a danger is lessened, since "the same mechanisms which supply the economy with liquidity can be reversed—and very quickly—to restrict liquidity and credit."

It is to be noted, however, that our experience suggests that prompt withdrawals of liquidity from the economy have been difficult to accomplish successfully. As a practical matter, we are most likely to avoid overt inflationary pressures in periods of economic prosperity if the liquidity added to the economy during the preceding period of slackness is not excessive.

Despite the constraints that balance-of-payments discipline has placed on the monetary authorities, particularly with respect to the level of short-term interest rates, there has been no lack of credit availability in this country. In 1962, the growth in the public's liquid assets, and of bank assets, was unusually large. And measured against gross national product, total liquid assets have been sustained at a relatively high level.

In view of our international payments problems, any additional monetary ease would carry grave risks. Nor is there any indication that additional monetary ease would prove helpful to the domestic economy. Recent remarks of the Chairman of the Board of Governors of the Federal Reserve are to the point: "My present feeling is that the domestic liquidity of our banks and our economy in general is now so high that still further monetary stimulus would do little if any good—and might do actual harm." This observation was reinforced in January by the president of the Federal Reserve Bank of New York, who expressed his view that "if money had been easier it would not have had any appreciable effect on business activity and might have encouraged undesirable speculative excesses in some directions."

We do not subscribe to the view that our balance-of-payments difficulties stem primarily from excessively easy monetary policies, and we do not look upon monetary restraint as containing the permanent solution to our payments difficulties. Nevertheless, as our international liquidity declines and as the prospects for fundamental improvement in our international accounts remain uncertain, we are forced to the conclusion that greater emphasis may have to be placed on monetary policy as a defensive weapon in the protection of the dollar. The necessity for this approach can be reduced or eliminated only by the vigorous implementation of fundamental corrective actions on other fronts.

With respect to debt management, the association's resolution which sets forth our views concerning the relationship between tax reduction and the management of the public debt contains the following relevant passage:

“\* \* \* the implementation of a program of tax reduction must be accompanied by a willingness to employ maximum flexibility in the use of debt management and monetary policy, including a willingness to rely on market forces for the determination of long-term rates of interest \* \* \*”

Under the circumstances of what might well be a peacetime high in the Federal budget deficit, and given the risks discussed earlier of inflation and/or further deterioration in our international financial position, maximum flexibility in debt management is more urgent than ever before.

The Council report notes that “the ‘proper’ way of financing a deficit is that which contributes to the goals of increased output, growth, price stability, and payments balance.” While one cannot take exception with the Council’s conclusion, it is pertinent to note that it offers little evidence of the recognition that in debt management, as well as in monetary policy, serious difficulties can arise in attempting to serve all of our economic objectives simultaneously. Within the context of our present economic problems, it would be reassuring to have the administration’s unequivocal pledge that, if necessary, maximum efforts will be made to finance the deficit by sales of obligations to genuine savers, and that it is prepared to pay whatever rates of interest are required to secure such a noninflationary placement of the debt. Similar commitments to flexibility of this kind have been voiced by Treasury officials. In addition, monetary authorities have cited the dangers of efforts to maintain interest rates at artificially low levels. The failure of the President’s report—and of the Council’s report—to echo this sentiment is a source of concern. Since the underlying emphasis in each report is on the importance of securing a faster rate of growth, with secondary stress on the need for balance-of-payments improvement and virtually no admission of the possibilities for a renaissance of inflationary pressures, there is ample reason for suspecting that the administration might resolve the conflicting objectives of debt management policies in a manner which could be injurious to our economic health.

Moreover, the failure of the administration to recommend the removal of the 4¼-percent interest-rate ceiling on Government bonds underscores the overall impression that the administration may lack the dedication to flexibility in debt management and monetary policy which the noninflationary financing of an unusually large deficit requires.

Although the Attorney General has ruled that 4¼-percent bonds can be marketed at a discount, thereby permitting a de facto breach of the 4¼-percent ceiling, there is no assurance that his view would be sustained by the courts and, in any event, discount selling is a cumbersome and inefficient way of marketing long-term securities. In the judgment of most market observers, the Attorney General’s opinion does not provide the final answer to the problem of the interest-rate ceiling, and ultimately the problem must be confronted.

The possibility of higher interest rates should not be dismissed at the outset in thinking ahead about the complex tasks facing debt management and monetary policy. As has been amply demonstrated in fast-growing European nations, rising rates of interest are not an enemy of domestic growth. This is not to say, by any means, that we

should tighten monetary policy prematurely. But the emphasis must be on a flexibility free of rigid views or commitments as we feel our way along.

#### THE BALANCE-OF-PAYMENTS DEFICIT

The most urgent economic problem now confronting the United States is, in our judgment, the persistent deficit in our international accounts. Upon the resolution of this problem rests not only the economic security of the United States, but also the strength of our free world allies and our role as political and financial leader of the free world alliance. In view of the gravity of our international financial problems, and of our recent failure to show significant balance-of-payments improvement, the absence of additional positive measures for strengthening our payments position is a source of the utmost concern.

Despite general observations that the payments deficit must be eliminated, the reports of the President and the Council of Economic Advisers contain few specific proposals which could be expected to result in permanent or fundamental relief to our payments position. Quite to the contrary, the overall economic policies prescribed for the coming fiscal year reasonably can be expected to produce an adverse impact, at least in the short run, on our balance of payments. In view of the reduced volume of our international liquidity, these shortrun complications are far too serious to be glossed over with the observation that, in the long run, economic growth and balance-of-payments equilibrium are compatible goals of public policy. In fact, whether or not they are compatible depends not upon the rate of growth, but rather upon the characteristics and structure of growth and upon the trend of domestic cost and prices.

In the absence of measures which would reduce the dollar drain associated with oversea spending by the Federal Government, it can be argued that our balance-of-payments weakness creates the necessity for relatively austere domestic economic policies. In striking contrast, the President's recommendations call for the introduction of strong economic stimulants. These recommendations ignore the increasing short-term aspects of our balance-of-payments problem, and they are based on the assumption that the United States has considerable time and maneuverability with which to redress the imbalance in its international accounts. We do not share these judgments.

We are particularly concerned over the administration's emphasis that balance-of-payments equilibrium must be achieved by increasing the surplus on private accounts, rather than by reducing the deficit on Government accounts. The notion that the private sector of the economy should be held responsible for generating whatever payments surplus is required to support a predetermined level of oversea Government spending is indeed a novel one. To our knowledge it is without precedent. Assertions to the effect that a cutback in oversea spending would necessitate the sacrificing of national objectives should not be allowed to obscure the fact that a failure to cut back such spending can, by undermining our international financial position and the world payments system, lead to incomparably more serious sacrifices of our objectives.

We do not believe that the United States has either the time or the maneuverability which would allow it to seek answers to its balance-of-payments problems in essentially long-range approaches. However attractive such long-range remedies may appear to be, we can afford short-range stimulus only if it is accompanied by measures which produce immediate relief from the large dollar drain resulting from heavy Government spending abroad. A program of domestic economic expansion would be a realistic prospect if accompanied by such direct and forthright action. The failure of the President to propose such action must stand, in our judgment, as a strong inducement for reducing the risks in the expansionist economic policies which the administration has outlined.

#### WAGE AND PRICE GUIDEPOSTS

The Council's Annual Report restates the guideposts for "non-inflationary wage and price behavior" presented for the first time in the 1962 report. The Council apparently feels that these guides, stated in terms of an industry's rate of productivity increase, continue to be useful as reference points in collective bargaining.

Opinions vary as to the influence the guidelines had in negotiations last year. Some observers contend that their impact was limited to large-scale negotiations in the concentrated industries, while they had little or no impact in the smaller or more fragmented industries. Others contend that they were a source of difficulty for Federal conciliators, who found that unions usually seize upon the general guide—the 3-percent trend rate of overall productivity increase—as a minimum. Most everyone agrees that the guideposts were of little significance last year because of the generally stable economic environment.

In earlier sections of this commentary, we have expressed our fears that inflation may once again appear on the scene, particularly unless the program to spur economic growth is implemented in a cautious and well balanced manner. Even if prudent policies are followed, the possibility of rising prices becomes greater as we approach a full employment situation. For these reasons, it is all the more important to analyze and discuss the wage-price guides now, rather than later when they may be a crucial reference point in wage negotiations.

While the economic theory on which these guideposts are based may be sound, the practical implications of their use as instruments of public policy is another matter. The difficulty arises from the fact that productivity gains both in the economy as a whole and in particular industries are exceedingly difficult to measure with precision. Such measurement is so difficult that opposing bargaining groups—labor and industry—could easily come up with equally convincing statistics to back their own special interests. This being the case, a referee would have to come into the picture to settle the argument. This referee probably would be the President, or his representative, backstopped by statistics compiled by Government agencies, and, in all probability, interpreted by the Council of Economic Advisers itself.

With the effective mobilization of public opinion, as illustrated by the famous steel price incident, industry and labor could be forced, in



effect, to act as suggested by the Council's interpretation of the "guideposts." In our judgment, this method of determining wages and prices would be even more objectionable than wage and price controls openly administered by a Government board—an arrangement acceptable only in wartime. Somewhere along the line, the results could well be de facto determination of wages and prices by the administration without a mandate from the Congress or the people. Such a transfer of decisionmaking from the market to the Government simply could not be tolerated in a free enterprise society.

The answer to the problems of achieving noninflationary pricing and wage decisions does not lie in allowing for public participation in these decisions, either directly through legislation or indirectly through moral suasion, but rather in assuring a market balance between labor and industry. If the economic environment is stable, such a balance should result—on the average, but not invariably—in noninflationary wage and price decisions in response to market forces.

There is no question that our Government is alert to the dangers to a free market economy which are inherent in monopolistic price fixing by business. Vigorous enforcement of antitrust laws should continue to combat undue business concentration. At the same time, undue labor power must be curbed. There are indications that this vital "half" of the problem is beginning to be faced, but its solution must be pursued with a great deal more vigor and candor if the principle of equality of bargaining power between labor and industry is to be achieved.

There are various approaches to such equality, including the possibility of applying the antitrust laws to labor as well as to business. However, the important and indeed crucial need is for a recognition and endorsement of this basic principle by the administration; once that occurs, solutions to the problem can no doubt be found.

#### SUMMARY AND CONCLUSIONS

The foregoing comments on the economic reports of the President and the Council can be summarized by the following six points:

(1) There is no room for further increases in Government spending at this time. The combination of a large tax cut and additional Government spending would violate standards of fiscal prudence by bloating the Federal deficit to inflationary proportions. The planned spending increase should be eliminated.

(2) If Federal spending is held constant, the magnitude and timing of the President's proposed tax reduction would appear to be appropriate; but it should be aimed more directly at stimulating investment. Accordingly, corporations and middle- and upper-income groups should be relieved of their heavy tax burdens to a greater extent than is now planned.

(3) In view of the aggressive fiscal policy planned, the Treasury must be prepared to finance increases in the public debt in a noninflationary way, out of savings, to the extent necessary. To assure that this is possible, the archaic 4¼ percent interest-rate ceiling on Government bonds should be removed.

(4) Any further monetary ease would be largely ineffective in its stimulus, could lead to a deterioration in the quality of credit, and is unwarranted in view of the contemplated fiscal policy measures. Possibilities for the necessity of higher interest rates as a temporary measure for dealing with our balance-of-payments problem should not be dismissed.

(5) Faster economic growth per se may or may not help to solve our balance-of-payments problem. At any rate, the primary burden of a permanent solution should not be shifted from the Government sector, which accounts for the larger part of the deficit, to the private sector. The most obvious approach is to reduce the disproportionate burden now borne by the United States in the common defense of the free world.

(6) The Council's wage and price guideposts are elusive in practice and reliance on them could lead to de facto determination of wages and prices by the administration. Achievement of noninflationary wage and price decisions lies in the principle of equal bargaining power between business and labor, which must include methods to curb concentrations of labor power as well as of business power.



**AMERICAN FEDERATION OF LABOR AND CONGRESS OF  
INDUSTRIAL ORGANIZATIONS**

WASHINGTON, D.C., *February 15, 1963.*

HON. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
New Senate Office Building,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: Enclosed is a copy of Mr. Walter P. Reuther's testimony, on behalf of the AFL-CIO, on the Economic Report of the President.

Sincerely,

NAT GOLDFINGER,  
*Director, Department of Research.*

STATEMENT ON THE PRESIDENT'S ECONOMIC REPORT, PRESENTED ON BEHALF OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS BY WALTER P. REUTHER, VICE PRESIDENT, AFL-CIO; CHAIRMAN OF THE AFL-CIO ECONOMIC POLICY COMMITTEE, AND PRESIDENT, UAW, FEBRUARY 15, 1963

America cannot afford and must not tolerate continuance of the tragic waste and human hardship resulting from high unemployment and gross underutilization of our capacity to produce.

Persistent economic slack deprives us of tens of billions of dollars of wealth each year. The wealth we lose is the wealth we need to solve our most serious domestic problems and to begin to grapple effectively with the problem of peace in the world.

Poverty continues to pervade our society despite the myth of affluence. Our public services and facilities—in education, health, urban renewal, mass transportation, resource conservation and development, and many other fields as well—are shamefully short of our needs. Slums disgrace our cities and breed crime and juvenile delinquency. The morale of the unemployed deteriorates, their skills rust, and their family life is subjected to severe stresses and strains. The development of our young people in dignity, self-reliance and a sense of purpose and participation is stunted by denying them entrance into the world of productive work. The problems of our minority groups continue to burden the conscience of the Nation as lack of employment opportunities tends to perpetuate and aggravate their second-class status.

These and the many other problems that flow from economic stagnation damage the image of democracy in the eyes of the emerging peoples of the world. Economic stagnation itself deprives us of the means to aid their rapid development in freedom which is the essential condition to the preservation of democracy and peace in the world.

These problems brook no compromise or delay. We cannot be content with halfway measures trimmed to appease ideologically blinded mentalities incapable of grasping the economic realities of the second half of the 20th century. We must not procrastinate and permit our problems to multiply even as our ability to solve them increases.

We have the means to solve these problems now. We need only to muster the will, the vision, and the daring to apply the bold programs that can lift us quickly out of the mire of economic stagnation and onto the high road toward full employment and vigorous economic growth. In the interim before those programs can take hold, other quick-acting measures must be applied to create jobs for as many of the unemployed as possible and to assure adequate sustenance for the families of those for whom jobs cannot be provided immediately.

#### GROWTH MUST TAKE PRIORITY

Above all, we must not be deterred from applying known solutions to our major problem—the problem of economic growth—for fear that by so doing we will create or aggravate some other problem. We must view our problems in perspective. We must recognize that full employment and growth have highest priority, and that adequate economic growth itself will in large measure facilitate the solution of the problems advanced as reasons for not vigorously pursuing growth policies.

Full employment and growth will help to avoid the danger of inflation by reducing unit production costs and by stimulating investment in cost-reducing equipment and in expanded capacity to meet future periods of peak demand. Growth will help to meet the balance-of-payments problem by reducing the costs of producing American exports and by keeping U.S. capital at home and attracting capital from abroad as our expanding domestic markets provide profitable investment opportunities. Growth will help to avoid budget deficits as an expanding economy expands the tax base and generates revenues that grow even more rapidly. Moreover, growth achieved through increases in public and private spending will create both the investment funds and the investment incentives that some now seek to create artificially through policies that would retard rather than foster growth.

#### FULL EMPLOYMENT POLICIES

Unemployment, idle capacity and retarded growth are clearly due to lack of adequate demand. The demand gap can be filled by a sound combination of tax, public spending, and private wage and price policies. For this purpose we propose:

1. An immediate tax cut, concentrated in the lowest income brackets, of the magnitude of \$10 billion per year.
2. A major increase in public spending to meet our social deficits in such fields as education, health, housing, urban renewal, mass transportation, and resource conservation and development, together with a substantial increase in international economic aid.
3. A dynamic and positive wage policy designed to increase private consumer demand by increasing wages and salaries. The Government must embark on a policy of active encouragement to

collective bargaining for higher wages to make up for the lag of real wages behind productivity and to correct the growing imbalance between consumer demand and capacity to produce consumer goods.

4. Machinery to invoke the force of public opinion as a restraining influence on administered price abuses. This is essential to give maximum effect to demand-increasing measures, to avoid their being perverted to inflationary ends, and to prevent increased public and private spending from leading to bigger accumulations of idle funds in corporate treasuries where they do the economy no good.

Tax cuts are proposed primarily as the swiftest means to give the economy the stimulus it so urgently needs. Increases in public spending take longer to put into effect and the process of raising wages to the extent needed will be even slower. As the combination of all three demand-increasing measures lifts us toward full employment, there will be time to get our priorities in order and to develop tax, public spending, and wage and price policies aimed at achieving the most effective use of the fruits of sustained and healthy economic growth to improve the quality of life at home and to aid the development of the emerging nations.

Restoration of full employment must be the first priority. As we move toward that goal we can consider the longer range problems of reform of the tax structure; the extent to which we plough growth-created increases in Government revenues into tax reduction and increased public spending, respectively; and the wage policies consistent with the priorities we establish as between increases in private and public consumption within the framework of a stable price structure.

#### POLICIES TO HELP THE UNEMPLOYED

Meanwhile, we must take steps immediately to relieve the plight of the unemployed.

We have no moral right as a nation to ask millions of families to continue to bear the hardships of unemployment while we take our time in applying programs to provide them with work. The unemployed need our help now. They cannot wait until we set our national economic house in order. They must not be required to wait. We must move immediately to open up as many additional jobs as possible, as quickly as possible and to provide more adequate incomes for those for whom we cannot quickly provide jobs. For these purposes we propose:

1. Increasing statutory overtime premium pay from time and one-half to double time to deter unnecessary overtime work and to encourage employment of additional workers to perform the work now done on an overtime basis.

2. Legislation providing rational reduction of working hours, such as flexible adjustment of the statutory workweek to create jobs for the unemployed by reducing the workweek without loss in weekly pay whenever demand is inadequate to provide full employment on a 40-hour-week basis.

3. Federal minimum standards for benefit amounts, duration, and eligibility under the State unemployment compensation laws

with immediate temporary supplementation of benefits and duration up to those standards until the States have time to conform to them.

These measure, and the reasons for them, will be discussed more fully in the following pages.

#### GREATER DEMAND IS BASIC NEED

There is general agreement that a substantial increase in demand is now the primary need of the economy. The Council's report is full of references to that need. For example:

"The slowdown of 1962 was rooted in the prolonged sag of demand below capacity that has continued since 1957. The forces that have kept us below full employment in the past several years persist. Our challenge now is to overcome them."

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"In the past 5 years, the economy has been consistently out of balance—with too little demand to match our supply capabilities."

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"\* \* \* inadequate demand remains the clear and present danger to an improved economic performance."

#### THE ENORMOUS TASK BEFORE US

We need to give increased demand the first priority in the program to restore the economy to health, and the increase must be massive. The enormous magnitude of the task before us has been partially indicated by the Council of Economic Advisers. Its report shows, for example, that the extent of unemployment is far greater than the official figures ordinarily published would suggest. When the loss of man-hours due to part-time unemployment is added, it shows a total work loss for 1962 equal to 6.7 percent of the labor force, the equivalent of full-time unemployment for 4.8 million people. In addition, there are 800,000 men and women outside the labor force, and so not counted with the unemployed, who would enter the labor force if there were job opportunities. By any meaningful criterion, they also are unemployed. This gives a true unemployment figure of 5.6 million, or 7.7 percent of the labor force.

The report points out that, to employ the normal annual increase in the labor force, to employ the added workers who would be drawn into the labor market by strong employment opportunities, and to reduce unemployment to the still unsatisfactory level of 4 percent by the end of 1963, would require the creation of 3.1 million additional jobs—exceeding the rate of increase for any postwar year except the boom year of 1955.

But this is not the whole task. The report points out that many workers will be displaced from their present jobs by mechanization, technological advance or other sources of productivity advance, and new jobs must be found for them. The Council does not estimate the number of such jobs, but even with the slowing down of the pace of recovery in 1962, output per man-hour last year increased by 3.5 percent over 1961. A 3.5 percent rate of productivity advance in 1963

would require the creation of 2.5 million new jobs just to hold our own. A 4 percent rate of advance would require 2.9 million. Therefore it is safe to estimate that we would have to create 5½ to 6 million new jobs altogether in order to reduce unemployment to a still excessive 4 percent by the end of this year.

In terms of production, the report states:

“For the unemployment rate to be reduced from 5.6 percent to 4 percent within 1 year would require an 8 to 9 percent increase in GNP at constant prices.”

This estimate is almost certainly too low, because the Council understates the rate of productivity advance which can be expected in a growing economy. But even this conservative estimate means that GNP would have to increase by \$44 to \$50 billion at 1962 prices in 1963, rather than the \$19 to \$29 billion forecast by the Council. This is a greater increase than the economy has achieved in any postwar year, although the rate of increase was slightly over 8 percent in 1950 and again in 1951 under the combined impact of the Korean war and recovery from the 1949 recession.

In short, to achieve even the inadequate goal of reducing unemployment to 4 percent this year, a major stimulus would have to be applied to the economy very quickly.

#### CONSUMER DEMAND IS THE KEY

The element of demand which can be most quickly and effectively increased is that of consumer demand. This is also the most important element in total demand, and the area of demand which has been most seriously deficient. James W. Knowles, executive director of the staff of this committee, has emphasized the latter fact. In a remarkably comprehensive and penetrating analysis of the state of the economy which he gave to the American Statistical Association last September, Mr. Knowles said:

“On the other hand, final demand for construction and goods combined is low by about 7 to 8 percent of potential output. *Of this shortfall in demand, about 5 to 6 percentage points, or 70 to 75 percent of the shortfall, can be attributed directly to the low demand of consumers for goods and residential nonfarm construction.* Interestingly enough, during the postwar period changes in the ratio of consumption plus nonfarm housing construction to potential GNP have tended to lead changes in the ratio of plant and equipment spending to potential GNP.” [Emphasis added.]

The last sentence has a particular bearing on the question of provision of incentives to investment, with its clear implication that the most effective incentive is an increase in consumption, which in turn requires an increase in consumer buying power.

The deficiency of demand is partly a reflection of the continued existence of widespread poverty in our allegedly affluent society.

In 1960, according to the Commerce Department's most recent detailed study of income distribution, 10.5 million multiperson families—23 percent of all families—had incomes under \$4,000 before taxes, the before-tax incomes of almost 3.3 million of these families were less than \$2,000. An additional 4 million unattached persons who lived alone—37 percent of the total—had incomes of \$2,000 or



less. The vast majority of these families and unattached individuals—approximately 20 percent of America's men, women and children—were living in poverty by the current standards of our society.

In addition, the income share of the 60 percent of all families at the bottom of the income ladder—whose needs are the greatest—actually declined between 1955 and 1960. Their share of all family income has probably continued to decline in the past 2 years.

The income share of the wealthiest 20 percent of American families rose between 1955 and 1960—particularly after account is taken of capital gains and expense-account living.

At the same time, the share of accumulated wealth of the richest families has been climbing. The share of all personally held wealth of the Nation's richest 1 percent of families rose steadily from 24 percent in 1953 to 26 percent in 1956 to 28 percent in 1961, according to Robert J. Lampman's study of wealth holding in the United States.

The number of millionaires rose from 27,000 in 1953 to 100,000 in 1961, according to Lampman. And the very rich—with holdings of \$5 million or more—increased 500 percent, from 2,000 to about 10,000.

Clearly we need programs that will add to the buying power of those who have the least and need the most—not those who already have the most, and who in recent years have been increasing their share at the expense of those at the bottom of the income ladder.

#### ADMINISTRATION'S PROGRAMS ARE INSUFFICIENT

The programs proposed by the administration to strengthen our economy are insufficient to provide the quick and effective attack on unemployment which is needed, and they are not intended to do so. Walter Heller, the Chairman of the Council of Economic Advisers, has implicitly admitted that, even if the administration's program is adopted, unemployment will still increase in the first part of this year. He has explicitly forecast that, even with some subsequent improvement, it would be no lower at the end of 1963 than at the end of 1962.

In a press conference called on January 21 last, Dr. Heller estimated that the unemployment rate toward the end of 1963 would be between 5.5 and 5.8 percent, and that this would represent some improvement over the earlier part of the year. Since the rate for December 1962 (the latest month reported at that time) was 5.6 percent, this clearly implies that, pending passage of the tax program, he expects unemployment to rise; and, even after it goes into effect, the impact of the first stage will be no more than sufficient to bring unemployment down to the level of last December, and perhaps not even that far. This is obviously not good enough.

Mr. Knowles has also warned of a possible increase in unemployment this year. In the analysis previously referred to, he said: "It would not be surprising at all if rising GNP was accompanied by rising unemployment in coming months."

That is to say, the rise in GNP may not be enough to absorb the new entrants into the labor market and offset increases in productivity.

As to the goal of a 4-percent unemployment rate, which Dr. Heller described as an "interim target," he admitted in his press conference that the administration's program will not achieve it before 1965.

He said: "I should think that given action on the schedule that the President has laid before the Congress and will detail in his tax message, that full employment could be reached sometime in 1965."

This country cannot afford to accept 4 percent unemployment as "full employment," and it certainly cannot afford to wait until 1965 to reach even that inadequate objective. The cost in human hardship, in economic waste, in lost national economic strength, and in international prestige is much too great.

The economic cost alone is staggering. Even by the Council's conservative estimate we have lost \$170 billion of potential production since 1958. They estimate the loss at \$30 to \$40 billion in 1962, and as much or more this year even if the administration's program is adopted. We believe all these figures are substantially understated. In any case, we must end this intolerable condition of continued slack and waste of human and material resources.

#### I. A PROGRAM TO RESTORE FULL EMPLOYMENT

We need a quick and effective attack on unemployment today. We need to restore momentum to the economy—not by 1964 or 1965, but in 1963. We need more buyers in the stores, more new orders coming into the plants. Then, the silent machines can be put again in motion, and unemployed men and women called back to work. Then, businessmen will be given the one sure and lasting incentive for expanding investment—a buoyant market for all that they can produce. And while we are moving, however rapidly, toward that goal, we need to show more compassionate concern for those who are still the victims of involuntary unemployment.

#### TAX REDUCTION

The speediest route to full employment is via tax reduction. Within weeks after tax reduction legislation is enacted it can be made effective in reduced withholding from wages and salaries. The resulting increases in take-home pay will immediately be reflected in increased purchases in stores and service establishments across the Nation. The effects of these purchases will radiate back through wholesalers and distributors to factories, mines, and farms in the form of increased orders, increased employment and resulting further increases in purchasing power.

Thus, tax reduction in adequate magnitude, properly distributed to assure that the bulk of tax savings will be quickly spent, could reduce unemployment sharply below present levels this year—in 1963.

The administration's program admittedly will not do that. Its immediate effect is too small. And a large part of the tax savings provided by that program will go to increase liquid reserves of corporations and high-income families rather than to increase spending.

#### *The administration's tax program*

The AFL-CIO will spell out its detailed position on the administration's tax program to the appropriate committees of the Congress at a later date. We are concerned here with its immediate impact on the economy.

That impact, in the year 1963, is far short of the magnitude of the Nation's need. As proposed by the administration, the first stage tax reduction would not take effect until the second half of this year. On an annual rate basis, it would yield tax savings of \$6 billion, which means \$3 billion in calendar year 1963. Meanwhile, however, automatic increases in social security taxes effective at the beginning of this year will be draining \$2 billion more out of the economy than last year. Thus the net gain from the administration's program in 1963 is only \$1 billion.

Taking account of the social security tax increases, the net gain on an annual rate basis during the second half of this year is still only \$4 billion, as Mr. Heller conceded at the press conference previously mentioned. This is hardly enough, even with multiplier effects taken into account, to make any substantial inroads on the full employment gap which, by the overly conservative measurement of the Council of Economic Advisers, amounts to \$30 to \$40 billion.

The combined effects of social security tax increases and proposed income tax reductions in 1963 on typical low-income families illustrate clearly the gross inadequacies of the administration's tax program as compared to the economy's needs.

A family of four with income of \$3,000 now pays \$60 in income taxes if it takes the standard deduction. Under the administration's tax program, its income tax would be reduced to \$55.50 in 1963, a saving of \$4.50 for the entire year. But assuming the income comes from wages, this family's social security tax will be increased by \$15 for the year. Thus it would have, not an increase in purchasing power, but an actual decrease of \$10.50.

A similar family with \$5,000 income would fare only slightly better. Its net savings, after offsetting \$24 in social security tax increases against proposed income tax decreases of \$31, would amount to \$7 for the entire year. This is equivalent to 13½ cents per week.

Net 1963 tax savings will be considerably more substantial at higher income levels, both because social security tax increases affect only the first \$4,800 of income and because the proposed income tax rate reductions are much greater, and applied to much larger income bases, in the upper as compared to the lower income brackets. But upper-bracket income tax reductions are largely wasted insofar as their economic impact is concerned. Families in the top brackets are unlikely to increase their consumer spending at all as a result of tax reduction, and will not be able to find profitable investment outlets for their extra take-home incomes so long as so much slack remains in the economy.

To the extent that the proposed 1963 reduction in the basic corporate tax rate yields savings to smaller corporations in need of funds to expand, it may bring some small economic benefit. But much of these tax savings, also, will go into liquid reserves held by the corporations or their stockholders for lack of investment opportunities.

Even the inadequate and badly distributed tax reductions proposed for 1963 are in jeopardy because they are combined with complicated proposals for tax reform. The likely result is that the entire program will be bogged down in the legislative mill with neither reductions nor reforms enacted in time to have any effect this year.

*Massive tax reduction needed now*

If we are to get America back to work quickly, we need a much more massive tax reduction, concentrated to the maximum extent in the lowest income brackets, where high-velocity purchasing power will result. To facilitate speedy enactment, such a tax cut should be kept wholly separated from controversial tax reform proposals.

The AFL-CIO, from time to time, has advanced a number of proposals along those lines. I would like to express my personal preference for a proposal that seems to me to best meet the specifications shaped by our current needs.

This proposal would avoid entirely the thorny controversies surrounding tax reform by leaving the present tax structure intact. The taxpayer would continue to compute his tax liability exactly as he does today. But that liability would be reduced by a credit of \$1.50 per week per person. This credit could be made immediately effective for withholding purposes so that a taxpayer with a family of four persons, for example, would gain an immediate increase of \$6 per week in his take-home pay if he now pays that much or more in income tax.

Thus, every family of four persons now paying \$312 or less per year in income taxes would have the full amount of its present tax liability added to its purchasing power. Every such family paying more than \$312 per year would increase its purchasing power—its ability to meet current needs or to assume larger installment payment liabilities—by \$6 per week, \$26 per month, \$312 per year. A family of four with \$5,000 income would have its 1963 taxes reduced from the present \$420 to \$108 as contrasted with \$389 under the administration proposal.

Total tax savings on this basis would amount to \$10 billion per year. Practically all of it would be translated immediately into high-velocity purchasing power dollars because most of it would go to low- and middle-income families. The family with a \$5,000 income would gain just as much in tax savings as a family of the same size with \$500,000 in income.

Allowing for the multiplier effect as these tax savings are spent, circulated, and respent throughout the economy, the gain in total demand and in GNP would be on the order of \$25 billion annually. A substantial beginning would be made toward closing the full-employment gap between capacity and demand.

A bill providing for such a tax credit could be very simply written and, if there is the will in Congress to carry out the mandate of the Employment Act, very quickly enacted.

As such tax credit legislation helped to carry us up toward full employment, Congress could afford to act with greater deliberation in considering sound, long-range reform of the tax structure. Enactment of the tax credit would not in any way prejudice that issue. If it were adopted as a temporary measure with an expiration date fixed in advance, the approach of that date would create pressure to avoid procrastination on passage of permanent tax reduction and reform. But immediate enactment of the tax credit would relieve the Nation of the price that would have to be paid in human suffering and economic loss if tax reduction were to wait while Congress debated tax reform.

## PUBLIC SPENDING

The insufficiencies of the administration's tax program would not have been so serious if they had been offset by an expanded program of spending to meet our public needs. But, unfortunately, the conservatives, to whom a balanced budget is the be-all and the end-all of Government activity, have exerted a negative and restrictive influence on the proposed budget. Apart from national defense and space programs, and the interest on the national debt, we are told in the budget message that "total expenditures for all other programs in the administrative budget, taken together, have been held to this year's level, and even reduced somewhat."

The combined effect of Government tax and spending programs on the economy is shown in the national income accounts budget, which is designed to measure the impact of these programs on the Nation's income and output. The small extent of that impact is indicated by the fact that spending for fiscal 1964 is planned to rise only \$5.8 billion over fiscal 1963, and that is partly offset by an expected increase in receipts, in spite of the tax cuts, of \$2.6 billion. Thus, the net impact of the proposed budget on the economy is a total stimulus in fiscal 1964 only \$3.3 billion greater than in the current fiscal year (totals do not match exactly due to rounding).

This means that we are not only denying the economy a stimulus that would promote employment and growth, but we are turning a blind eye to our mounting backlog of long-neglected public needs.

*Needs to be met*

In such essential areas as education, health, housing, urban renewal, and the conservation and development of natural resources, a short-sighted policy of continuing neglect will exact a heavy and tragic price in the future.

*Education.*—Our schools are overcrowded, many of them obsolete, and many teachers are underpaid. Yet we are still failing to build as many new classrooms as we need, and we see a constant draining away of teachers from the profession to better paying jobs.

*Housing.*—In housing, the Census Bureau reports that over 16 million homes are either dilapidated, substandard, or overcrowded. To reduce this backlog and provide homes for a growing population, we need to build an average of 2.4 million new homes a year. Last year, in spite of some improvement, we started only 1.5 million. Fewer than 30,000 of these were in public housing—fewer than in any year since 1956.

*Urban renewal.*—Providing good homes in decent neighborhoods involves more than building houses. It requires a comprehensive program of urban redevelopment and renewal. The Rockefeller Brothers Fund Report, "The Challenge to America: Its Economic and Social Aspects," states:

"The blight of slums is spreading through our metropolitan areas, and particularly in the centers of our cities, at a rate far in excess of our programs to remedy it. The problem is intensified by the fact that many racial minorities are confined to blighted areas. \* \* \*

"The investment required to make our cities attractive and healthy places in which to live has been estimated as running into the hundreds

of billions of dollars. Ten million substandard urban units would cost an average of perhaps \$10,000 each to replace or rehabilitate. But one must add to this other necessary investments. Urban transportation is approaching the chaotic. Basic community facilities such as schools and parks are inadequate. The decline or leveling off of the tax base, which accompanies urban blight, creates acute financial problems for city officials; at the same time costs for health services, welfare, and fire and police protection are rising. \* \* \*

"The Federal Government has assumed important leadership; but far more needs to be done."

An effective, overall program of urban redevelopment must include plans to expand and improve educational and health facilities, water and sewage systems, roads and streets, recreational facilities, neighborhood renewal efforts, air pollution programs, and mass transportation systems, as well as slum clearance and housing.

While much of the cost of such a program would come from private investment and part from State and local authorities, to be effective it requires bold Federal leadership and financial assistance.

*Health.*—To meet our health needs, the U.S. Public Health Service estimates that we must make up a shortage of well over a million hospital and nursing home beds. In addition, the Service estimates, we need:

Nearly 2,000 public health centers to provide such services as immunization, maternal and child health clinics, nursing services, and communicable disease controls.

Almost 2,500 diagnostic or treatment centers for nonhospitalized patients to provide such services as orthopedic, cancer, mental hygiene, tubercular, and dental care.

Over 200 comprehensive rehabilitation centers to assist handicapped people.

We need also a program of Federal financial assistance to professional schools and students if we are to graduate the increasing number of doctors, dentists, and nurses we will need to care for a growing population.

We need President Kennedy's program for an all-out attack on mental illness, which, directly and indirectly, is now costing us billions of dollars a year.

*Highways.*—In the field of transportation, we are already making good progress in the construction of major interstate highways, but there is a need for either Federal grants or long-term, low-interest loans for the construction and repair of local roads.

*Airports.*—The 1961 national airport plan of the Federal Aviation Agency shows 1,361 projects planned for the improvement of airport facilities through June 1965, but the program cannot be completed in that time without Federal assistance to the extent of over \$500 million.

*Resource conservation and development.*—Programs to conserve our natural resources are an investment in America that will pay solid dividends in cheaper power, better water supplies, protection of valuable farm and forest lands, and provision of needed recreational facilities. Yet we have been shamefully neglecting them. We should proceed with multipurpose power projects that will also prevent the tragic waste of floods and provide irrigation for farmlands. Close to half the 16,000 community water supply systems lack sewage disposal

or purification facilities to prevent water pollution. Our forests are also neglected. In the past 9 years we have reforested only a little larger area than was reseeded in 1 year during the 1930's. In one State alone, Montana, the U.S. Forest Service has estimated that full forest development would create over 100,000 additional jobs, 31,000 in the forests, and another 72,000 jobs in service industries.

These are but some of the many public needs which can be met only by a national effort, with Federal Government leadership and financial assistance. To meet them will cost money—more than we have been spending in the past. But that money is an investment in the future of our country, an investment that will pay off in greater earning power and higher living standards for us and our children, just as surely as any private investment in plants or machinery. Spent now and in the years immediately ahead, it will also provide part of the increase in demand needed to get our economy rolling forward at the pace it should.

#### *Increased public spending long overdue*

Increased spending to meet our public needs is long overdue, for in fact we have been starving this sector of our economy. Excluding the costs of Government attributable to past wars, space activities, and the need for national defense, real Federal expenditures per capita have been declining sharply since World War II. Among the exclusions is space, and interest on the public debt, nearly all of which was incurred in paying the costs of two world wars.

The remaining Federal expenditures, expressed in constant dollars of 1962 buying power, have decreased from \$227 per capita in fiscal 1947 to only \$150 per capita in fiscal 1963.

In this same period, the real value of our national production has been rising faster than our population. In consequence, while such Federal expenditures absorbed 8.9 percent of gross national product in 1947, they will take only 4.9 percent of GNP (as estimated by the Council) in 1963. In short, the share of our total national wealth devoted to meeting our peacetime public needs has been almost cut in half. We can well afford to do more. We must do more.

The same situation emerges from an examination of our Federal public debt, through which Government deficits are financed. The debt grew tremendously between 1941 and 1946 to pay the costs of World War II. In conditions of rapid economic growth, it declined from 1946 to 1949. Then, under the impact of, first the Korean war, and, later, the budget deficits resulting from a slack economy, the debt in dollar terms again increased—but not nearly as fast as even the slow growth of a lagging economy. At mid-1949, the Federal debt held by the public represented 84.4 percent of 1 year's total output of the economy. By 1962, it represented only 44.9 percent of 1 year's output. In other words, it would have taken the full value of all the goods and services produced in the country for a period of 308 days in 1949 to have paid off the national debt. Today, it would require only 164 days' production.

Thus, in comparison with the total size of our economy, the share of our wealth devoted to public spending has been sharply reduced and our national debt has become steadily less burdensome. Yet we continue to deny ourselves essential services that can only be provided

through public spending, and to deny the economy the needed increase in demand that would flow from that spending.

#### A POSITIVE WAGE POLICY

It is time for economic policymakers in the United States to rethink wage policy in relation to the requirements of sustained full employment and healthy economic growth. It is time to make the shift from the negative wage policy that is in large part responsible for the persistent economic slack from which we suffer to a dynamic and positive wage policy designed to achieve and maintain balance between consumer demand and expanding capacity to produce consumer goods and services.

There is now general recognition that inadequate demand, particularly consumer demand, is the source of our economic difficulties. A major part of the deficiency is in consumer demand. But increases in by far the largest single source of consumer demand, wages and salaries, are either not considered or are too often rejected out of hand as means to take up the slack. Paradoxically, in a country ideologically committed to a preference for private over public action, encouragement of sound private action to increase demand through a positive wage policy is rejected in favor of Government action in the fiscal and monetary spheres.

Even when Government fails to meet its responsibilities for full employment through tax reduction and public spending, unemployment and resultant lost wealth are accepted as preferable to a positive wage policy that could make a major contribution to filling the gap between demand and capacity.

The reasons for this attitude are not difficult to understand. Economists and policymakers are paralyzed by fear that a positive wage policy would lead to inflation and worsening of the balance-of-payments problem. But this fear rests implicitly upon a completely false assumption—the assumption that the Nation is powerless in the face of inflationary administered price abuses.

A positive wage policy admittedly must be coupled with effective machinery to minimize such abuses. We shall outline below a proposal for such machinery.

We must either abandon the goal of full employment and reconcile ourselves to stagnation and high unemployment with all their intolerable domestic and international consequences or we must move to increase demand through a positive wage policy coupled with the creation of machinery to curb inflation.

We do not urge that wage policy be substituted for fiscal and monetary policy; that it be required to carry the entire burden of supporting full employment. Tax reduction can act more quickly to increase demand when quick action is necessary. And, as we have indicated, increased public spending is urgently needed to improve the quality of American life as well as to move us forward to full employment.

We do urge that a positive wage policy be included, along with fiscal and monetary policy, as part of the Nation's arsenal of weapons in the struggle against economic stagnation and for full employment. Otherwise we carry on that struggle with one arm tied behind our backs.



*Wages and productivity*

A dynamic and positive wage policy is thoroughly consistent with the now famous wage and price "guideposts" set forth in the 1962 Report of the Council of Economic Advisers.

The labor movement has long recognized the basic principle of the "guideposts:" that, in the long run, improvements in real wages depend upon increases in productivity. That is one reason the labor movement has been consistently alined with those forces that have been urging policies that would promote stable full employment and vigorous economic growth; the atmosphere in which productivity advances most rapidly. The labor movement has come increasingly to recognize also that its wage and fringe benefit gains must come out of the fruits of our advancing technology and not out of the pockets of consumers through increases in the price level.

But popularized press treatment of the "guideposts" has tended to emphasize longrun truisms at the expense of shortrun imperatives. While real wages cannot significantly outstrip productivity in the long run, full employment will not be achieved, growth will be retarded, and the rate of productivity advance itself will be depressed if consumer demand (of which wages and salaries form by far the largest part) together with public demand are inadequate to absorb the potential output of our productive resources. The immediate and urgent necessity is for a wage policy designed to correct deficiencies in total demand. For at least the short-run future, real wages and salaries must increase faster than productivity until a workable full employment balance has been achieved between demand and capacity.

The Council's "guideposts" explicitly recognize that wages should not be confined to marching in lockstep with productivity at all times and in all circumstances. It noted that: "\* \* \* there is nothing immutable in fact or in justice about the distribution of the total product between labor and nonlabor incomes."

The Council recognized further that: "It is desirable that labor and management should bargain explicitly about the distribution of the income of particular firms or industries. It is, however, undesirable that they should bargain implicitly about the general price level."

Lending further emphasis to this point, the Council's report said: "Finally, it must be reiterated that collective bargaining within an industry over the division of the proceeds between labor and nonlabor income is not necessarily disruptive of overall price stability. The relative shares can change within the bounds of noninflationary price behavior. But when a disagreement between management and labor is resolved by passing the bill to the rest of the economy, the bill is paid in depreciated currency to the ultimate advantage of no one."

The proposal to couple a positive wage policy with measures to curb administered price inflation is designed specifically to avoid "passing the bill to the rest of the economy"—to assure that wage increases will increase demand rather than be used as an excuse for inflationary price increases.

*Unleash collective bargaining now*

If ever there was a time when wage increases were needed to increase demand, and when no inflationary consequences need ensue, that time is now. Demand in general—and consumer demand in particu-

lar—is inadequate to support full employment. The proposed tax program will not supply the necessary increase. Slack in the economy assures that wage increases would create no inflationary pressure from the demand side. Indefensibly low breakeven points that permitted major corporations to earn substantial and, in some cases, record profits in 1962 while operating far below capacity provide substantial latitude to raise wages without creating any cost necessity to increase prices. And, far from outstripping productivity, real wages have been lagging behind productivity since 1956.

#### *Wages lagging behind productivity*

In manufacturing, real straight time average hourly earnings of production workers increased by only 10 percent between 1956 and 1962—an average of 1.6 percent a year. Despite the depressing effects of stagnation aggravated by two recessions, output per man-hour in the private economy increased by 17.8 percent during the same period—an average of 2.8 percent per year.

During the past 2 years, 1961 and 1962, the lag of real manufacturing wages behind productivity was even greater. Average real straight-time hourly earnings increased by only 2.7 percent while productivity advanced by 6 percent—more than twice as fast.

While the earnings figures do not include fringe benefit increases, it is inconceivable that such increases could be sufficient to close the gap between real earnings and productivity. For recent years, we have it on the authority of Dr. Heller (at his January 21 press conference), that the proportions of fringe benefits to wages have not changed greatly “in the last 2 or 3 years.” This means that the relationship between productivity advances and wage and fringe gains combined cannot be much different from the relationship between productivity and wages alone.

Data on real hourly compensation of employees for the private economy as a whole, which include fringe benefits, also show a lag behind productivity since 1956, although not as great as for manufacturing production workers. From 1960 to 1962, while productivity increased 6 percent, real hourly compensation increased only 4.8 percent.

It is significant that the lag was greater in the stronghold of collective bargaining—among manufacturing production workers—than in the private economy as a whole.

This is in part a result of the negative wage policy—the creation of a climate of public opinion adverse to wage increases and to unionism as such—under the Eisenhower administration. It is a result also of oversimplified misinterpretation of the Council’s “guideposts” by the public generally and frequently by third parties—mediators or arbitrators—taking an active part in the framing of collective bargaining settlements.

The lag of real wages behind productivity in recent years in itself is sufficient to call for the unleashing of collective bargaining—for a shift from a policy of discouragement of wage increases to one of active encouragement. The need for active encouragement is emphasized by the fact that consumer demand, which depends so heavily upon wages and salaries, is far short of full employment requirements.

The experience of the 1920’s supplies a stern warning of the conse-

quences that would flow from continuance of the present negative national wage policy. Fortune magazine, in an article in its February 1955 issue, entitled "What Caused the Great Depression," laid major stress in its diagnosis upon the lag of real wages behind productivity. It pointed out that this led to a distortion of the income distribution structure in favor of upper income groups. Fortune was sharply critical of the trade union movement for permitting that to happen by not vigorously carrying out its responsibility to raise wages. Interesting enough, Fortune also put part of the blame on administered price abuses.

Describing developments during the 1920's, Fortune noted:

"\* \* \* A rising share of national income in the late 1920's went to upper income groups. Interest, profits, rent, (i.e., property income) rose 14 percent between 1926 and 1929, while wages and salaries rose only 7 percent, and proprietors' income—that of farmers, professionals, and unincorporated business—rose only 1 percent."

The economic history of recent years ominously parallels the course of events described by Fortune. From 1953 to 1962, property income (dividends, interest, corporate cash flow excluding dividends, and rental income of persons) increased by 81.1 percent, while wages and salaries increased by only 49.3 percent, and proprietors' income rose only 22.4 percent. In these figures we have evidence of a growing imbalance in the economy that underlines the urgency of moving quickly from a negative to a positive national wage policy.

#### *Congress can help*

Congress can make a significant contribution to creation of a climate of public opinion favorable to a positive wage policy by liberalizing present labor legislation. Although the language of the Wagner Act calling for encouragement to collective bargaining is still retained in present legislation, that legislation in practice represents a shift from encouragement to, at best, grudging tolerance. The organization of workers, particularly in some of America's lowest wage industries, is severely hampered by present law.

A positive wage policy also requires legislation to broaden the coverage and raise the minimum wages provided under the Fair Labor Standards Act as well as legislation and adequate appropriations to keep Walsh-Healey Act minimum wage determinations abreast of current movements of prevailing minimum wages (including fringe benefits) in industries producing under Government contract.

#### *Other action to increase consumer demand*

Wage policy should be accompanied by other measures to make up for present deficiencies in consumer demand. These should include, for example, medical care for the aged under social security; increased social security benefits; the broadening of the public assistance program and increased public assistance payments; higher payments to workers being retrained under the Area Redevelopment, Manpower Training, and Trade Expansion Acts; legislation to end the exploitation of migrant farmworkers; and special measures to raise the incomes of low-income farm families.

## CURB ADMINISTERED PRICE INFLATION

As noted, fear of inflation is the main reason for rejection of a positive wage policy. For the last 10 years, at least, that fear has been directed primarily to the wrong source. What inflation there has been was not produced by excessive wages, much less by excess consumer demand. It was the result of misuse of administered price power by the large corporations which hold that power. As Dr. Gardiner Means told the Senate Antitrust and Monopoly Subcommittee concerning the inflation of the 1953-58 period:

"The administered price groups \* \* \* account for 85 percent of the gross increase in the wholesale price index. If these groups had not gone up in price, the wholesale price index would have risen less than 1 percent and, so far as the wholesale price index is concerned, there would have been no inflation. Anyone who thinks the recent inflation is not an administrative inflation had better study the record."

In order effectively to apply a positive wage policy, we must see to it that corporations with power to administer prices are restrained from misusing that power to force up prices once again, as would happen if they were to translate every wage increase into an automatic price increase, regardless of the size of their profits or the level of their break-even points.

The AFL-CIO has long recognized the danger of abuse of price-administering power. At its most recent convention, in 1961, it urged that the spotlight of public attention be directed toward the pricing policies of dominant corporations in key industries.

As a means to this end, my own union, the UAW, has urged that we invoke the force of an informed public opinion against unjustifiable price increases as a substitute for the forces of price competition which is, for all practical purposes, absent from the industries in question. This can be done if the public has full access to all the pertinent facts relating to a proposed price increase. To get those facts and make them public, we propose the appointment of an administered price board. Whenever any corporation controlling, say, 25 percent or more of the sales of an important product wished to raise its price, it would first have to notify the board, and appear at a public hearing if the board thought necessary.

The board would hold public hearings, would have power to dig out all the pertinent facts, and would issue a report. The corporation would then be at liberty to raise prices, up to the limit of its proposal, if it saw fit. But if the facts were such as to persuade any reasonable man that a price increase was not justifiable, and if the public had access to those facts, we do not think any increase would take place. In most such cases, the mere existence of a hearings procedure would probably mean that the price increase would never be proposed.

There are probably no more than 100 corporations that would be subject to this procedure, but their leverage on the economy is extremely great. As Dr. Means has shown, their price decisions represent the only real threat of inflation in periods of slack demand. They are the price leaders in their industries; the prices they establish are accepted by the price followers. And it has been shown that the prices set in oligopolistic industries such as those they dominate are

fixed at the same level as they would be under conditions of outright monopoly.

Unions would also be subject to the hearing procedure, an important factor in relationship to the proposed positive wage policy. Whenever a corporation subject to the hearing procedure claimed that acceptance of any union demand would require it to raise prices, both the corporation and the union would be summoned to a hearing and required to produce the facts relevant to their claims. As the Council pointed out in its report last year, there are situations where a wage increase is justified even though it may require a price increase; the Council referred explicitly to situations where wage rates are exceptionally low, for example, and implicitly to industries in which the rate of productivity advance is less than the overall rate for the economy. Where that was the fact, a price hearing would reveal it. On the other hand, if a union's demand would require an unjustifiable price increase, the facts would show it. Or if the company's position were such that it could well afford to meet the union's demand without a price increase, the facts would show that. The parties would resume negotiations with the knowledge that an informed public was prepared to pass judgment on the outcome.

*Break-even points are now too low*

There is another price problem that requires attention—the fact that some prices have already been raised to levels where they will inhibit recovery.

The Council has pointed out that in periods of economic slack “the weakness of markets leads to attempts to raise prices to cover high average overhead costs.” These attempts have been so successful that major companies in the auto and steel industries, for example, have break-even points well below 50 percent—they are able to make profits while operating at substantially less than half of capacity, and while larger numbers of their workers are unemployed.

As the economy grows under the impetus of a recovery program, profits will grow even faster due to more efficient use of manpower and equipment, and the spreading of overhead costs over a larger volume of production. If corporations are unable to find enough attractive investment outlets for those higher profits, they will be draining off essential buying power from the economy.

Mr. Knowles has warned that this danger exists at present price levels. In the economic analysis previously referred to, he said there has been “\* \* \* a strong move on the part of management to lower break-even points to protect rates of return on capital and to provide insurance against cyclical swings in demand. The result, of course, is that in some industries, at least, if the economy should rise to relatively high levels of employment; that is, to potential output levels, the total cash flow to capital, including both profits after taxes and depreciation funds, would reach higher levels than would be needed to finance the level of investment that business could maintain year after year without developing excess capacity.”

In short, even though an increase in demand would provide incentives for new investment, it would also, at present price levels, cause profits to rise so fast that business would still be unable to find profitable investment opportunities for all its funds. Failure to invest savings

fully would mean withdrawal of uninvested savings from the spending stream, with a resulting return to conditions of inadequate buying power and a slowing down of the economy once again.

A positive wage policy would help to counter this tendency. It would restore excessive profits to the mainstream of purchasing power and so provide a continuing impetus to the recovery process and support for full employment.

## II. MEETING THE IMMEDIATE NEEDS OF THE UNEMPLOYED

Some time lag is inevitable before any full-employment program can make its effects fully felt. Even if the program outlined above were to be speedily set in motion, there would be need to apply interim measures to relieve the plight of the unemployed. That need is even more urgent if unemployment is to remain at present levels toward the end of this year, and as high as 4 percent as late as 1965. The less adequate the program to bring about rapid restoration of full employment, the stronger is the moral obligation to apply other measures to aid those condemned to prolongation of their joblessness by the inadequacies of the program.

### DOUBLE TIME FOR OVERTIME

Even if no steps were taken to increase demand, unemployment could be sharply reduced by simply increasing the penalty costs of overtime work.

Mandatory overtime premium pay was originally provided by law at a time of high unemployment for the specific purpose of deterring overtime work and thereby providing additional employment opportunities for the jobless. When first adopted, the statutory time-and-one-half premium for overtime adequately served that purpose. But it is no longer adequate today.

Through both legislation and collective bargaining, various fringe benefit costs have been added to the wage package which vary with the numbers of people employed rather than with the numbers of man-hours worked, and to which the overtime premium does not apply. Training, paperwork, and other costs related to the hiring and employment of additional workers act as a further offset to overtime premium pay. As a result, the cost of overtime premium pay is often less than the cost of adding more workers to the payroll.

There has been a strong tendency, therefore, for industry to work its present workers overtime rather than to increase the number of workers employed. This had tended to aggravate the unemployment problem. The existence of intolerably high levels of unemployment side by side with extensive overtime urgently requires corrective action.

The overtime deterrent must be drastically increased if it is to serve its intended purpose. We propose that it be increased from 50 percent of the regular wage rate to 100 percent—from time-and-a-half pay for overtime to double time.

The urgency and magnitude of the problem is apparent from BLS data on overtime hours worked by manufacturing production workers—the only group for whom statistics on average overtime hours worked are available.

During 1962, the average manufacturing production worker worked 2.8 overtime hours per week. This was equivalent to 6.9 percent of the total hours worked by all such workers. It was equivalent to the hours that would have been worked by 870,000 workers, each employed 40 hours per week.

But this is only a small part of the story. The above figures do not include overtime hours worked by white-collar and technical employees in manufacturing. Nor do they include large amounts of overtime worked in nonmanufacturing. Other BLS data show that, during the first 11 months of 1962, the average proportion of workers employed 41 hours per week or more amounted to 26.4 in construction, 27.7 in transportation and in public utilities, 39 in trade, 24.2 in finance, and 27.8 in the service industries.

There are no data available which would permit precise calculation of the number of additional jobs that would be created by substituting double-time premium pay for the present time and one-half. Aside from the absence of data on overtime worked in nonmanufacturing, it must be recognized that some overtime work is unavoidable and would continue to be worked even with higher overtime penalty pay. This is true, for example, of overtime work arising out of machine breakdowns or relatively short periods of overtime to fill rush orders.

It is most unlikely, however, that such unavoidable overtime accounts for more than a very small proportion of all overtime hours worked. Twenty-five percent of the total would seem to be a most liberal allowance for the proportion of all overtime that is, in fact, unavoidable and that would continue to be worked in the face of a double-time premium.

Assuming that as much as 25 percent of the overtime hours worked by manufacturing production workers during 1962 would have been worked even at double time, the hiring or recall of additional workers to perform the remaining 75 percent of the work involved would nevertheless have created the equivalent of 650,000 40-hour-per-week jobs.

That much additional employment would have been sufficient to reduce the 1962 average unemployment rate by 0.9 percentage points—from 5.6 percent to 4.7 percent.

Elimination of avoidable overtime for nonproduction workers in manufacturing and for the large numbers of workers doing overtime work in industries other than manufacturing would have brought the 1962 unemployment rate down even further.

Some of the many workers not now looking for work because they are hopeless about finding jobs would probably be attracted back into the labor market by the greater number of employment opportunities that reduction of overtime would create. In addition, reduction of overtime would not necessarily yield an employment increase fully commensurate with the overtime hours eliminated, but, even taking those factors into account, a double-time penalty would nevertheless have significant impact in reducing the unemployment rate.

Surely with such great possibilities of sharply reducing unemployment available from the simple expedient of increasing overtime premium pay, we cannot in good conscience neglect this device to provide jobs for many hundreds of thousands of unemployed workers while we wait for full employment policies to take effect.

## FLEXIBLE ADJUSTMENT OF THE WORKWEEK

The intolerable burden of unemployment has led the labor movement to demand some form of reduction in weekly hours worked with no reduction in weekly pay. This would not only create more jobs as employers hired additional workers to make up for the cut in hours, but it would add to purchasing power by increasing the total sum of weekly wages.

At its most recent convention, the AFL-CIO approved two possible methods of reducing the statutory standard workweek. One would be an amendment to the Fair Labor Standards Act simply reducing the standard workweek to 35 hours. The other would be an amendment to the act providing for automatic adjustment of the workweek based upon the level of unemployment—the flexible workweek. We believe that the length of the workweek is not a matter which should be determined arbitrarily by labor, management, or government. It should be consistent with the needs of the Nation and the national objective of a full employment economy. The proposal for flexible adjustment of the workweek is designed to be consistent with both.

It would bridge the gap between those who rightly insist that every possible tool be used to attack the hardships and suffering caused by high unemployment, and those who equally rightly maintain that when we have restored full employment we will require 40 hours of work a week to help reduce our backlog of unmet needs. With a flexible workweek, when demand is high and unemployment correspondingly low, the standard workweek would be 40 hours. But when demand is low and unemployment high, as now, the length of the workweek would be cut accordingly to make more jobs.

When unemployment is less than a specified percentage of the labor force, the statutory standard workweek would remain at 40 hours. If unemployment should rise above that percentage for a specified period of time, the workweek would be automatically reduced on a graduated basis related to the level of unemployment. As increased demand provides the basis for increasing production, the workweek would be automatically lengthened toward 40 hours again.

Maintenance of weekly pay when hours are reduced is essential. Otherwise we would merely be spreading the hardships of unemployment a little thinner, and adding nothing to total purchasing power.

However, to avoid hardships on the individual employer, the proposal envisions that compensation for the hours cut out of the regular weekly schedule be financed through a national workweek adjustment fund to be accumulated out of revenues of a small payroll tax on all employers.

This method of financing would help to stabilize the economy. In good times, when demand is high, money would be drawn into the fund. In bad times, when demand needs to be increased, withdrawals from the fund would add to buying power.

Any employer who reduced hours of work in accordance with a temporary reduction in the statutory standard workweek would be reimbursed from the fund for the added cost of continuing to pay his workers for 40 hours a week. An employer who did not reduce hours worked would not be reimbursed, and would be required to pay the full normal rate plus the overtime premium for all hours worked in



excess of the reduced standard. This would provide a strong stimulus to reduce scheduled hours and to hire additional workers.

If the proposal for a flexible workweek were made immediately effective, as it should be to give immediate relief to current intolerable levels of unemployment, it would have to be financed in the beginning through an advance to the national workweek adjustment fund from the Treasury, to be repaid later out of the revenues from the proposed payroll tax.

The cost of this proposal, spread as it would be over the entire business cycle, would be small. Even that small cost would probably be at least substantially offset by savings in unemployment compensation and supplemental unemployment benefit costs to employers, and savings in welfare costs to the public.

Such a measure would help to stabilize the economy. It would help to reduce the hardships of unemployment. By creating more jobs it would protect workers from the loss of human dignity and self-respect and the destruction of family morale, which often represent the most disastrous even though immeasurable costs of unemployment.

#### UNEMPLOYMENT COMPENSATION

When we enacted unemployment legislation, we rejected the callous doctrine that the unemployed were to blame for unemployment. We accepted the philosophy that unemployment reflects a failure of public policy and that meeting the needs of the unemployed and their families is therefore a public responsibility.

The persistent high unemployment of recent years, and forecasts that present and proposed policies will leave unemployment at intolerably high levels through 1965 and beyond, make it imperative that we take steps to meet that public responsibility by improving our unemployment compensation system.

Besides some residue of frictional and structural unemployment will always be with us, no matter how effective our full employment policies. Moreover, although we know the means available to moderate and quickly end cyclical fluctuations, we are not likely to avoid cyclical unemployment entirely in the near future. For the long run as well as for today, therefore, we must have a sound unemployment compensation system that adequately meets the needs of the unemployed and functions effectively as a first line of defense against recession.

Our present unemployment compensation system falls far short of our needs because employer pressure for experience rating savings has resulted in reduction of the average level of benefits as a proportion of the average wage loss suffered by the unemployed, has restrained the extension of duration and has made eligibility requirements increasingly restrictive and disqualification penalties increasingly severe. State legislatures have responded to such pressures out of fear of competition from other States offering employers lower unemployment compensation costs at the expense of the welfare of the unemployed.

In a nationally integrated economy with a national labor market, we should have a uniform national system of unemployment compensation. Until that goal can be achieved, we must strengthen the

present Federal-State system by the introduction of minimum Federal standards for benefits, duration and eligibility; by broadening coverage; by improving financing; and by establishing a system of cost equalization or reinsurance to help States whose economies are subject to wide fluctuations resulting in abnormally high benefit costs.

President Kennedy last year proposed legislation embodying significant steps toward most of these ends. He has indicated that similar legislation will be proposed this year.

We urged last year that the President's proposals be strengthened. We hope that the bill to be offered this year will go further than last year's.

In this connection, we would direct the attention of the administration and of Congress to the fact that, through collective bargaining, employers in such major industries as autos and steel now provide unemployment compensation benefits (State and private supplemental benefits combined) equal to roughly 65 percent of the unemployed worker's regular gross weekly pay for a duration of up to 52 weeks. We see no reason why Federal standards legislation should provide less.

#### *Temporary Federal supplementation*

Whatever the Federal standards adopted, the States will require time to amend their laws to conform to them. It also may be necessary, as proposed in the administration's bill last year, to provide for a phased approach to higher benefit standards to allow the States time to strengthen their funds in order to be able to meet increased benefit costs.

Unemployed workers and their families, however, need the protection of more adequate benefits and duration now. Similarly, the economy has equally urgent need—now—for the added consumer purchasing power that more adequate unemployment compensation would provide.

We therefore urge that Federal standards legislation includes, provision for immediate Federal supplementation of benefit amounts and duration provides under the State laws to the levels to be provided after the final stage of effectuation of the Federal standards. Offsets against such a tax increase could be provided to employers in States which put into effect, in advance of the schedule set forth in the Federal standards bill, the benefit and duration improvements provided for in that bill. Such offsets would provide an incentive for those States that are financially able to do so to meet minimum standards without unnecessary delay.

While provision of more adequate unemployment compensation will not relieve us of our obligation as a nation to provide jobs for the unemployed, it will at least help to tide them over until we meet that obligation.

### III. OTHER PROGRAMS NEEDED

Implementation of the programs outlined above will go far to restore and maintain full employment, while helping to meet more adequately the private and public needs of all our people. But the list is by no means complete. In almost every sphere of governmental activity and public responsibility we need to be doing more than we are.

We need to make more adequate provision to maintain the health of the people, especially in providing health care for the aged through social security.

We need to step up and expand existing programs to deal with pockets of poverty and areas of special trouble in the economy, to revitalize distressed areas and to provide training or retraining for those who require it.

We need special programs to provide work opportunities to unemployed young people, where they can learn skills that will help them find permanent employment.

We need programs to restore prosperity to farm families, and to see that our wealth of food and fiber is more adequately and effectively distributed to meet human need, both here and in less fortunate countries.

We need to make much faster progress in the battle against racial discrimination—in voting rights, in employment, in education, in housing, in public facilities, and elsewhere. Through legislation and education we must strive to put an end to second-class citizenship in this country once and for all.

We must take all measures necessary to insure a strong and adequate national defense, neither crippled by lack of needed funds nor impaired by waste or needless duplication of effort.

We must encourage the development of both basic scientific research and technological application of scientific discoveries for civilian as well as for defense purposes. We must also insure, through creation of a technological clearing house, that those responsible for public policy have a fuller knowledge of the progress of technological advance in industry and the probable impact of such advances on employment and economic activity.

We must continue efforts to expand our trade with other countries and to lower the trade barriers among all free countries. At the same time, we must make sure that provisions to minimize possible hardship and to facilitate readjustment for individuals, businesses and communities adversely affected by increased imports are adequate. We must also work for the establishment of international fair labor standards to insure that workers in this or other countries are not made the victims of trade competition based on wages and working conditions which are inferior in relation to productivity.

We must stop starving the programs of economic and technical assistance to underdeveloped countries, and we must strive for increased participation on the part of other countries which can afford to share in the task. We must use our best efforts to encourage the social and economic reforms which are necessary in some parts of the world before our aid can be effectively used. We must persuade the uncommitted peoples, both by our example and through our assistance in developing their own economies, that peace and prosperity and freedom can be had together, that in fact they are indivisible.

All of the programs which are suggested here have their role to play in solving the problem of unemployment and restoring the rate of growth in the economy. Some of them have a special importance because they can most quickly and powerfully give the economy the stimulus it needs to achieve our most immediate goal, that of attacking unemployment. Others will add to the long-term strength of the

economy. Still others, such as programs in health, education, housing, and other fields of public spending, are important not only to increase levels of demand but to help meet human needs which have been too long neglected.

#### DEMOCRATIC NATIONAL ECONOMIC PLANNING

As the various programs are put into effect and recovery advances, it will be necessary from time to time to reexamine the programs, change priorities, and shift the emphasis from one to another. All of this should be done, not on any hit-and-miss basis, but as part of a democratic national plan for economic growth and full employment.

It is time we conquered our fear of the word "planning" in national affairs. It is one of the myths of the past which hobble our response to economic challenges and warnings. Surely the experience of the past decade has taught us that an economy as massive, as complex, and yet as easily thrown off balance as ours cannot be left to drift. Nor is there any great virtue in efforts to steer it by a series of last-minute maneuvers, adopted only when it seems about to crash upon the rocks.

Until the last 2 years, those responsible for the economic decisions of government have not only been adverse to planning, they have been unable to plan because they have not been equipped with a sufficiently clear and comprehensive analysis of what was happening in the economy. We congratulate the Council of Economic Advisers on having made a good start toward remedying that deficiency. We differ with many of the specifics of the Council's analysis. We believe it has been far too conservative in its appreciation of the urgency of the situation we face, and of the potentialities for growth in the economy if the forces of growth are freed from the restraints which have so long inhibited them. In consequence, the goals it has set have been far too low, and the programs it has proposed have been too limited even to achieve those inadequate goals.

But we believe that in basing its analysis of our situation upon such concepts as potential output, and the gap between the potential and the actual, the Council has taken the first step essential to the development of plans for the achievement of our full potential.

In a free, democratic society, economic planning of course cannot and must not be done by government agencies alone. It must be a far broader process, in which industry, labor, farm groups, government, the universities, and representatives of all sectors of the economy function together to work out, year by year, the goals which we will agree to set for ourselves and the blueprints for action to achieve those goals.

Democratic planning does not mean more centralized control. On the contrary, it can and must mean the enlargement of areas of individual decision and voluntary cooperation. Just as the motorist on the highway is free to choose and reach his destination only if he can be reasonably sure that those he meets will obey the traffic rules, so the individual person or the individual enterprise in a free society can feel able to plan his own future more securely if he knows that the economic decisions of his neighbors are being made in accordance with an orderly purpose—the achievement of optimum growth for the economy as a whole.

Democratic national economic planning is already in effect in some of the countries of Western Europe whose record of full production, full employment, and rapid economic growth puts to shame our record of the past 9 years. They include countries as divergent in cultural background and political orientation as France and Sweden. Belgium, with a Conservative government, established a planning program 3 years ago. The Conservative government of Britain has created the National Economic Development Council to plan its economy. Italy recently has established planning machinery. Moreover, the new action program for the Common Market envisions an overall plan for the combined economies of the six member nations.

There is a serious question whether a planless and stagnating U.S. economy will be able to hold its own in competition with the economies of Europe aided by democratic planning to achieve full and efficient utilization of resources and rapid growth.

It is perhaps for this reason that the more farsighted members of the American business community are beginning to look objectively at the merits of planning. For example, in April 1962, a *Business Week* editorial, discussing the European planning experience, made these comments:

"Preponderant opinion among European businessmen, economists, and government officials is that economic planning has in fact had much to do with the long and remarkably stable European boom."

\* \* \* \* \*

"In Britain and on the Continent the majority of business leaders appear to have overcome their traditional horror of the word 'planning.' As one British manufacturer put it: 'Since all of us plan in our own businesses, I see no reason why we should be afraid of the word.' In the United States, however, 'planning' is still a dirty word for most businessmen (except in their own businesses)."

Business Week concluded:

"The deep involvement of U.S. business in both trade and investment—and competition—with Western Europe makes it essential for U.S. businessmen and Government officials to take a serious and unbiased look at new European ways of coping with the economic problems of free societies."

With our vast potential here in the United States, we should be able to reach heights of economic achievement beyond our capacity to visualize today if we plan and order our affairs for maximum growth and utilization of our productive potential.

But before we can achieve the pace of advance which is within our capability, we must deal with the immediate problems which burden and harass us. We must undertake a massive frontal assault on the mountain of unemployment. We dare not harden our hearts to the need of the unemployed, who have been denied man's basic right to stand upon his own two feet and work to support himself and his family. We dare not close our minds to the staggering economic waste of idle men and idle machines, a waste which is stunting our growth, sapping our strength, and depriving us annually of tens of billions of dollars worth of goods and services that we badly need.

These problems can be solved. We must have the courage, the foresight, and the determination to solve them. I am confident that our system of freedom is equal to the challenge we face if we will but commit ourselves and our resources to the task ahead.

## CHAMBER OF COMMERCE OF THE UNITED STATES

WASHINGTON, D.C., *February 14, 1963.*

Senator PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
Congress of the United States,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: In accordance with your letter of January 23, I am enclosing a copy of my statement on the economic reports.

As you requested we have forwarded 20 copies of this statement to the committee.

Needless to say, we look forward to the committee's report on March 1.

Yours sincerely,

EMERSON P. SCHMIDT,  
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STATEMENT OF EMERSON P. SCHMIDT, DIRECTOR OF ECONOMIC RESEARCH OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA ON THE ECONOMIC REPORT OF THE PRESIDENT AND THE ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS FOR THE JOINT ECONOMIC COMMITTEE, FEBRUARY 15, 1963

The opportunity to evaluate the President's Economic Report and that of the Council of Economic Advisers is welcomed even though the Chairman of the Joint Economic Committee requested only a written statement rather than a personal appearance.

As in previous years, the economic reports (the separate authorship of which was not indicated from 1954 to 1961) contain much useful data, information, and analysis. The aura of confidence of last year's report is not reflected this year. Considering the all-pervasive emphasis on the 1963 tax cut, one may assume that the authors of the reports believe that if it is not adopted, the economy is likely to fall into a recession, although they do not quite say this. Even with the proposed tax cut it is assumed that the relative economic growth this year will be less than that of 1962. And on February 10, 1963, the Chairman of the Council stated that in the absence of a tax cut the probability of a recession would be substantially increased.

### ECONOMIC OUTLOOK

The President and his economic advisers foresee a more moderate economic gain for this year than a year ago. Failure to attain the GNP and other targets set in January 1962 is acknowledged.

The goals of 5 percent annual economic growth rates promoted in 1960 by administration spokesmen are now regarded as illusory. Last year's quarterly rise in GNP was only about half that of 1961. (\$6 billion versus \$12.5 billion). In setting the goal for 1963, last year's

growth goal was again lowered, relatively. Since, over time, this means a lowering of the base, year after year, on which the percentage growth rates are quoted, it seems that the deceleration of the expected growth rate is being accelerated. As the sights on growth are being lowered, the sights on deficits are rising. Estimated corporate pretax profits for this year (1963) are \$3.5 billion below the January 1962 estimate of the Council for last year (1962)—a substantial short fall and downward revision. The question has been raised whether the administration is returning to some of the prevalent ideas of the 1930's—a neostagnation syndrome. (See, for example, the Morgan Guaranty Survey, May and August 1961, New York.)

The President based his growth forecast for 1963 on four factors (p. XII):

“The outlook for continued moderate expansion in 1963 is now favorable:

“1. Business investment, responding in part to the stimulus of last year's depreciation reform and investment tax credit and to the prospect of early tax reduction and reform, is expected to rise at least modestly for 1963 as a whole.

“2. Home construction should continue at about its 1962 level.

“3. Government purchases—Federal, State, and local combined—are expected to rise at a rate of \$2 billion a quarter.

“4. Consumer purchases should rise in line with gains in business and Government activity.

“These prospects, taking into account the proposed tax reduction, lead to the projection of a gross national product for 1963 of \$578 billion, understood as the midpoint of a \$10 billion range.”

Thus the 1963 expansion rests on rather tender reeds. A tax cut this year will come late if at all, although some benefits should accrue from the 1962 improved depreciation guidelines and the investment credit for enterprises which are able to use one or the other or both. But, even if home construction should continue at its 1962 level, this would not be an expansionary factor. We can, however, be reasonably certain that the President is on safe ground when he states that Government spending will rise. But the assumption made here and throughout the Economic Report that consumer expenditures will rise because of the foregoing three factors rests more on hope than on solid analysis. A rise in the legal minimum wage this year will have adverse impact on employment. Social security taxes are rising by \$2 billion this year and postal costs, mostly business costs, are expected to rise by about one-half of a billion dollars. Should a tax cut fail this year, the economy may well be retarded. If the tax program goes through in its proposed form, corporation tax collections will be greatly accelerated and, to some extent, this will impair the working capital and interest earnings of corporate enterprises. The suggested cuts and collection acceleration will mean that, in the above sense, the corporate tax rate will not fall below 52 percent until 1966 and will not reach the proposed figure of 47 percent until 1969. The President's proposed tax reforms and reductions will accentuate divisive forces in our society and the proposed cuts may achieve less than optimum results for reasons which are discussed below.

In an hour-long television appearance in December, the President acknowledged that he is finding it much more difficult to evolve solu-

tions to domestic and international problems than he had assumed before he took office. In spite of the bold promises of 2 or 3 years ago, we still have a series of unsolved social, economic, fiscal, and international problems: agriculture, transportation, war veterans, welfare, Government debt management, persistent stubborn unemployment, continued international payments imbalances and defensive maneuvers to preserve the dollar, the unsatisfactory progress under the Alliance for Progress, the Cuba debacle, a fractured NATO, France and De Gaulle, the frustrations in the implementation of the 1962 Trade Expansion Act because of the failure of Britain to enter EEC, deterioration in relations with Canada, a failure to improve our image abroad. The administration seems unable or unwilling to come to grips with the problems raised by labor leaders and strikes. Nor does this inventory of problems exhaust the issues facing the country and our Government. But the more courageous recognition of the gravity of some of these problems is commendable.

Fortunately, a highly decentralized economic system has a strength of its own so that even when the Government is either weak or for other reasons is unable or fails to cope with significant and crucial problems, freedom can be preserved and the damage is not completely exhausting. If for no other reason, this is a good reason why every effort should be made to strengthen the private sector of our society instead of assuming that every minor defect or deficiency calls for new laws and piling Government bureau on Government bureau.

#### IS THE PROPOSED TAX CUT WELL BALANCED?

The report's emphasis on tax cuts is most commendable in the light of the slow growth and abortive recoveries from recessions. To the extent, however, that individuals anticipate benefits from a tax reduction and in the face of the widespread consensus for some fairly prompt tax reduction, the effects of such a reduction may be somewhat discounted by those who think that a reduction is certain or reasonably certain.

The Economic Report is concerned more predominantly with slow growth, and tax reductions as the remedy, than with any other issue. Section after section, regardless of the major topic treated or the chapter under consideration, reveals a treatment of the slow growth-tax cut issue. The phrase or idea of a "deficiency in demand" permeates the discussion. The tax cut proposal is heavily weighted in favor of short-run consumption, indicating that demand deficiency is viewed primarily as being in final consumer expenditures. This conclusion seems to be taken for granted more than it is proven or thoroughly reasoned out in the report.

This may be a wrong diagnosis and prescription. Economists have noted, for example, that throughout our history when consumer purchasing power had reached new peaks, this was, nevertheless, followed by recession or depression; likewise, after extended periods of unemployment and reduced consumer income and consumer spending, recovery, nevertheless, took place. And this sequence took place long before we had any consciously contrived built-in economic snubbers or any closely reasoned contracyclical policy, say, prior to World War II. All this raises a doubt about the nature of the assumed deficiency of



demand as found in the report. The analogy between government and private deficits may be overdrawn (pp. 74-77). In fact, the report seems to vacillate; it notes that, "The national wealth grows rapidly in prosperous years when investment is high and slowly in years of recession and slack" (p. 81). Needless to say, perhaps, investment and production without markets are futile. (On this controversy see U.S. News & World Report, Washington, Feb. 18, 1963, p. 40 ff.)

All this is relevant in the appraisal of the particular tax cut now proposed, although the depreciation reform and tax credit of 1962 did improve the situation, but did not go to the heart of the problem. For this reason it may be worth while to state the case for greater attention to the corporation income tax as a roadblock to more growth, particularly since the proposed cut is so small and greatly delayed.

The corporation income tax has virtually no defenders except those who view it through the eyes of the revenue collectors and those who see it as something of a recession snubber. Its incidence is capricious and uncertain. It raises the general price level. It is largely a disguised sales tax. It has put the corporate form of doing business at a disadvantage in contrast to some other forms of enterprise such as cooperatives. It retards new investment. It reduces investment per worker. It raises the average age of plant and equipment of our capital stock. It distorts investment decisions because of its severe bite. It consumes an enormous amount of time of high-priced talent in problems of compliance and efforts to avoid its burden. Virtually all major business decisions are tax oriented.

In the face of these points, it is hard to understand the tardiness with which any cut was proposed, the smallness of the cut proposed in January 1963, and the spread of the cut over 3 years.

The foregoing is a substantial indictment. Objective scholars generally have nothing good to say for the corporation income tax. Its survival can be explained chiefly in terms of its fiscal prowess as a revenue raiser, the misconceptions about its incidence and about its economic impact. Part of our indictment is based upon the assumption that the tax on corporation income is largely passed on to the consumer, and is not substantially absorbed by the shareholders. What follows is not a plea for shareholders—they do not bear its burden or at least its major burden; our analysis is designed to encourage more rapid economic growth. First we must note the differences between those who think that the corporate tax is absorbed by the shareholders and those who think it is largely passed on to the consumer.

For those who think the tax is absorbed (a declining number), the present tax would imply a reduction of corporate or shareholder income by 52 percent. The optimistic analysis in the Economic Report is based primarily on this type of assumption (see, for example, pp. 45 and 47). Clearly this tax take of 52 percent would involve a striking reduction in the volume of retained earnings available for financing new investment; it would, likewise, greatly reduce the potential savings of shareholders. Since under the assumption of absorption the prospective return from new corporate investment would be greatly reduced, this impairs not only the supply of investment funds, but also the incentive to use them. It would slow economic growth.

Now what of those who believe that this tax does not greatly reduce corporate or shareholder income? Unlike those who believe that the corporation income tax is absorbed by the shareholder, those who believe it is predominantly shifted generally tend to view (but wrongly) this tax as relatively harmless—just a hidden sales tax and a meritorious gatherer of revenue for Uncle Sam, with no adverse effect on corporate saving, investment, risk taking, or innovation. Those who believe the tax is shifted tend to be largely complacent about the size of its bite, just so long as their competitors are equally taxed. But this is a dubious conclusion and a wrong inference.

By what process is the tax shifted to the consumer? Certainly not by merely adding the tax to the price. When business costs rise, this does not mean that higher costs can automatically be passed on to the consumer. Steel and aluminum companies, for example, have shown this in the past 6 months of declining earnings, red ink, and dividend cuts. In the case of a regulated public utility, insulated from competition, new costs may be added on. If all competitors could and would simultaneously raise prices by the amount of the corporate tax, this might stick. But such is not the means by which the corporate tax is shifted to the consumer in a competitive economy.

Rather, the shift occurs slowly and gradually by the curtailment of the supply of goods and services offered. Basically, the tax reduces supply by imposing a new barrier to added investment, which barrier would not exist if there were no such tax.

Initially when adopted or raised, the corporate tax may tend to fall on equity investment, on shareholders. For this reason the dividend credit is justified. But since the investor has alternative opportunities and weighs the risks and earnings prospects, a new investment to be justified must promise to yield a pretax return which will leave a satisfactory return after the payment of the tax. In short, new investment must promise not only a satisfactory net return, but also the tax itself. A cut to 50 percent in 1964 and 47 percent in 1965 will help, but will still prove to be an undue handicap, particularly in the face of the proposed accelerated tax collections.

Here is the essence of the situation: Assuming 10 percent to be the needed incentive, new investment and new ventures tend to be deferred until they hold out the prospect of earning 10 percent net after tax (although some investment may be undertaken not to earn a return, but to protect the return from previous investments). The tax, nevertheless, defers new capacity and innovations. Older equipment tends to be used longer; this induces a rise in the average age and obsolescence of our plant and equipment. It reduces the investment in tools per worker.

This protection of existing investment against new competitive investment reduces the output and permits the sale of the output at prices which are higher than could otherwise be obtained. This is the process by which the corporation income tax tends to be shifted to the market—to the consumer.

To induce new investment, moreover, the pretax anticipated yield must be progressively higher (not just proportionately higher) as the tax rate rises.<sup>1</sup> Under a 50-percent corporate income tax, for example,

<sup>1</sup> See: George Terborgh, "Effect of Corporate Income Tax on Investment," Machinery and Allied Products Institute, Washington, D.C.

if the investor is to keep \$1, the company must earn \$2—1 for the U.S. Treasury and 1 for the investor; if the corporate income tax were 75 percent and the investor wanted to keep \$1, the corporation would have to earn \$4 pretax—\$3 would go to the U.S. Treasury and the \$1 would go to the investor (the latter to be taxed also, of course, as individual income). The tax rate above 52 percent would not only exact heavy penalties, but substantial reductions in tax from this level would offer large advantages; a reduction of 12 percentage points from 52 percent, for example, would yield more than 40 percent of the benefit to be obtained by abolishing the corporate tax entirely. The above contrast of a 50-percent and a 75-percent tax rate shows why this is so.

In short, the indictment against the corporation income tax is severe. Thus it should be clear why economists, generally, can find nothing good to say for it in terms of the optimum operation of our economy.

More investment in plant and particularly equipment is important also in the short run to counter recession or slow growth, because we have a large quantity of production facilities, including labor, committed exclusively to the production of producers goods. Any slack in this sector means substantial unemployment of men and machines and therefore lower and foregone earnings. We seldom have maximum employment unless we have a high rate of capital formation. For this additional reason a tax reduction, in terms of short-run objectives, needs heavy emphasis on sparking and stimulating saving and investment by business as well as by individuals.

Many argue that we have excess capacity and therefore little need for new investment. "Excess capacity," however, may be illusory. Some industries and many enterprises have none now. Investment in many service enterprises is inadequate. Recovery to full employment would quickly expose shortage of capacity in company after company and even industry after industry, just as labor shortages would show up quickly. In fact, much of our unused capacity is high cost and in the wrong place, just as many of the unemployed are not in the right place nor qualified for existing job openings. While the steel industry was operating at 50 percent of capacity in 1962, the United States Steel Corp., for example, announced plans for a new specialized and completely modern mill at Gary, Ind., facilities to cost an estimated \$55 million. The same is true of Bethlehem Steel Co. Many similar cases could be cited. Shortage of "capacity" is by no means the sole determinant of the need for new investment.

Badly needed economic growth, furthermore, does not necessarily mean exclusively more output of the existing types of goods and services. Progress embodies new frontiers, new goods, and new services as well as new ideas, technological innovations, and the cultivation of unmet latent wants—physical, educational, cultural, etc. Human wants are insatiable. Talk of an "affluent society" has little meaning to 80 to 90 percent of our households. To them such talk is a bad joke. Unused existing capacity has small relevance to the opportunities which may lie ahead if we reduced the tax impediments on savings, investing and particularly risk taking.

In short, the Joint Economic Committee might well make a thorough analysis of whether or not the administration's tax cut program is really capable of "getting us moving again." The reduction by only 5 percentage points in the corporate tax should be critically reviewed.

Furthermore, all of what has been said under this topic is based on the general assumption that the corporation income tax is not absorbed by shareholders in the long run. While some of them might benefit under this proposal, the benefits accruing to others (the economy as a whole) would be much more substantial. The tax is a penalty on enterprise, on innovation, on the worker, and on the household. Substantial reductions in the upper personal income brackets will release funds for investment and stimulate investment incentives.

#### GOVERNMENT SPENDING, DEFICITS AND GROWTH

The President states that if we tried to bring a balance in the budget by cutting Government expenditures "we would not only endanger the security of the country but we would so depress demand, production, and employment that tax revenues would fall and leave the Government budget still in deficit."

This conclusion is by no means self-evident. A considerable body of evidence throws it in doubt. Whether this is a valid conclusion depends on time and circumstance. A tax cut as a contracyclical weapon is preferable to a spending increase and the Economic Report is to be commended for its relatively minor reliance on further spending. (This is not to say, however, that many new programs are not proposed and existing ones are augmented as shown most clearly in the Budget of the United States for 1964.)

Spending has been or is proposed to rise \$5 to \$6 or more billion per year as shown by figures beginning with 1960 (consolidated cash statement) :

[In millions]

	Total	Rise from previous year		Total	Rise from previous year
1960.....	\$94,301		1963.....	\$116,774	\$9,065
1961.....	99,523	\$5,227	1964.....	122,477	5,703
1962.....	107,709	8,181			

In spite of these large increases, plus \$4 billion or more at the State and local level, the economy has been sluggish since 1957. Cash payments by the U.S. Treasury to the public have jumped from \$70.5 billion in 1955 to \$122.5 billion (estimate) in fiscal 1964, a rise of over \$50 billion. In the postwar period, prior to 1957 when we had relatively full employment with short recessions from which full recovery occurred, the rise in Government expenditures was smaller absolutely and relatively in most years; this was particularly true of the administrative budget. There is little evidence that deficits or greater Government spending will restore prosperity. Wartime spending and deficits with massive monetary injections and Government purchases of goods and services regardless of costs, are not a relevant guide for more normal periods.

The view so widely held that an increase in Government expenditures relative to tax receipts is necessarily expansionary and a decrease is contractionary, is not substantiated either by economic logic nor by empirical evidence. (For a brief discussion of this matter see, Milton Friedman, "Capitalism and Freedom," University of Chicago Press, 1962, pp. 79-84.)

The Subcommittee on Fiscal Policy of the Joint Economic Committee reported: "The subcommittee has found no necessary relationship between the amount of Federal expenditures and the rate of economic growth over the long run" (Jan. 23, 1958, p. 6).

Even the short-run relationships between deficits or Government spending and growth in GNP are inconclusive. A comparison of GNP changes with the quarterly Federal cash surplus or deficit shows that the relationship has been highly variable. For example, the GNP was rising in 47 of the 60 quarters of the period 1947-61; in 22 of these rising quarters there was a Federal cash budget surplus and in 25 quarters there was a deficit. Relative to the 13 quarters in which GNP declined, 8 showed a surplus and 5 showed a deficit. If the GNP figures are lagged one-quarter to allow more time for surpluses and deficits to operate, the picture is not far different; 20 of the 47 rising quarters showed a Federal cash surplus in the preceding quarter and 27 showed a deficit, while the 13 declining quarters showed 7 surpluses and 6 deficits.<sup>2</sup> Use of the national income accounts for the Federal sector for purposes of analysis reveals similar inconclusive results.

The deficits of the 1930's did not restore prosperity; to equal those deficits in relative size, the \$11.9 billion deficit now projected for 1964 would have to be raised by nearly 50 percent. Even then there is no reason to believe that it would bring us prosperity.

That there is much fat and waste in the Federal budget cannot be denied. Even the defense and space programs should be critically reviewed with the object of substantial paring of less essential expenditures. Defense expenditures from 1953 to 1964 will run over \$600 billion—larger than our GNP in any year. How much defense have we bought? Need? Do we have adequate machinery to make an objective appraisal of demands for defense spending?

The budget is loaded with fast-growth expenditures and programs, going far beyond the normal legitimate rate of growth which should be expected in those Government areas that reflect our population and economic expansion. This year's budget urges many new programs, most of which begin on a modest basis in the first year but which will, if adopted, grow and grow.

The Economic Report, and particularly the budget supplemented by a flood of special messages from the President, enumerated many existing but growing needs as well as new needs. Argument is often advanced that the public makes these demands. This is almost entirely false. The average citizen is too sensible, modest, or self-reliant to make demands on the public treasury. The biggest single pressure for spending comes from within the Government itself. Perhaps the most massive recent evidence is to be found in the book by Ezra Taft Benson, "Cross Fire: The Eight Years With Eisenhower," 1962. Even so-called farm pressure groups called repeatedly for more moderate subsidies and price supports than the Congress insisted upon.

In a bitter address before the American Council on Education on Federal subsidy to education, Secretary of Health, Education, and Welfare, Abraham Ribicoff, let the cat out of the bag: "Mail urging

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<sup>2</sup> See testimony of George Terborgh, Hearings, House Ways and Means Committee, Aug. 3, 1962.

the Congress to do something for education was infinitesimal. There was a great void, a great silence."—The Washington Post, October 6, 1961.

There it came straight from a source who should know. The Congress in 1961 lowered the retirement age for males to 62 under old-age and disability insurance, at a time when many were lamenting our slow economic growth. Inquiries to key members of both the House and Senate to find out if the public demanded age lowering for eligibility did not produce even one scintilla of evidence to support the popular view that "the public demanded" this relaxation for eligibility.

Indeed, it is literally true that the general public never initiates any demands on Government, with the single exception of the situation where its position is abruptly reversed and worsened, like the midwest farmers in the early 1930's. True, once aid or a giveaway program has been launched and a public clientele has developed, the public through spokesmen, often self-selected, will press to keep the pabulum flowing.

When a problem is no longer large and massive, that seems to be the very time when Government takes action. Alexis de Tocqueville more than 100 years ago noted that when the least fuel is behind a problem, then it becomes subject to broadened discussion and public action. Medicare may be a good example; there is more private insurance available than ever. Elderly people are better off than ever. The majority have OASDI. They have preferred income tax treatment. The Kerr-Mills Act provides help. Nevertheless, Government programs for the aged multiply. In spite of an all-out campaign in 1962, including Madison Square Garden type of sessions, the administration could not muster enough votes to pass this measure in 1962. Another trial is to be made in 1963.

In short, there are hundreds of millions of dollars of expenditures which have a low priority and could be eliminated entirely. Many activities could be left to lower levels of government or private individual or group effort. The idea that the Government must subsidize housing construction rests on false assumptions. As reported a year ago in our testimony, housing starts were relatively higher in the mid-1920's than in the mid-1950's as shown by the accompanying table. In several years in the mid-1920's, say 1925 and 1926, new nonfarm residential private construction outlays were 6.98 percent and 6.75 percent, respectively, of total personal consumption expenditures; in 1955 and 1956 the figures were 7.28 percent and 6.54 percent, respectively—no major change. (Both pairs of years followed a war and were periods of prosperity.)

*Housing starts—Federal aid*

Year	Nonfarm housing starts (thousands)	Housing starts per million dollars GNP (1964 prices)	Housing starts per thousand population
1925.....	937	5.79	8.09
1926.....	849	4.97	7.23
1955.....	1,328	3.38	8.04
1956.....	1,118	2.78	6.65

In the years 1955 and 1956 housing starts were only about 3 per \$1 million of GNP as against over 5 in 1925-26 (1954 prices); this shows a 60 percent better performance in the earlier Government unassisted period, relative to the mid-1950's, as shown by the table. In terms of population, housing starts were actually higher in 1925-26 than in 1955-56 (right column).

Possibly these few figures do not prove anything conclusively; but they do suggest that the enormous amount of costly Government effort and allied private effort (congressional hearings, survey, reports, legislation and appropriations and the establishment of housing agencies and programs—dozens of programs—and the large number of private meetings, trips to Washington by builders, contractors, mortgage fund suppliers, etc.) may have been largely wasted; at least, this question may be worth looking into.

Since then two objective scholars published their findings as shown by the accompanying table.

*Share of residential construction expenditures in gross national product*

	<i>5-year moving averages in percent</i>		<i>5-year moving averages in percent</i>
1910-----	3.9	1940-----	2.6
1915-----	2.8	1945-----	1.6
1920-----	2.3	1950-----	4.0
1925-----	5.6	1955-----	4.2
1930-----	3.0	1958-----	4.2
1935-----	1.6		

It will be noted that the share of residential construction expenditures in GNP have not reached the 5-year moving average centered on the year 1925.<sup>3</sup>

In short, it is time that both the Congress and the administration recognize the capacity and willingness of the people to solve their own problems without a prop from Uncle Sam, a prop which is overpriced and undereffective. Spending loopholes are numerous. Their identification and effective exposure would reveal many potential savings. The idea that "the public demands" would be greatly deflated.

The budget is not expected to be in balance before 1966 or 1967 and perhaps not then. Meantime the dangers of inflation are consciously downgraded because we have slack in the economy. But conditions can change. A great rise in public debt will add to liquidity in the economy. Debt financed for the time being by mopping up money savings, may, nevertheless, later be transferred into bank credit and thereby be inflationary. Here's a further reason for effective spending control.

ANTIGROWTH FACTORS IGNORED

Even though the Economic Reports are gravely concerned with slowed economic growth, surprisingly little attention is paid to the job-making climate, to the wastes inherent in the Government's agriculture program, the survival of obsolete subsidies, the wastes of subsidies, uneconomic import quotas, uneconomic artificial substandard interest rates. In case of a strike or threat, reform of featherbedding

<sup>3</sup> Land Economics, February 1962, University of Wisconsin, Madison, Wis.—"Housing in a Growth Economy," by Donald A. Fergusson and Raymond F. Valenti.

and uneconomic work rules are deferred repeatedly and delayed, merely to help end or prevent a strike.

Space does not permit any detailed analysis of these policies as anti-growth factors. We have optimum allocation of resources if the national income cannot be lifted by any reassignment or different uses of resources. Conversely, when GNP or national income can be increased by restructuring the use of our resources, this means that we have not attained their optimum use and, therefore, our optimum growth.

Individuals who serve on Government payrolls as economists should be expected to be in constant search of misuse of resources and should be relentless in pressing for policy and budget changes, including congressional policies, which will steadily work toward the optimum use of our manpower and other resources within a context of limited Government and human freedom. These omissions are major defects in the Council's Economic Report. These antigrowth policies and practices are not only wasteful but also tend to raise our costs at home and abroad.

#### THE UNION AND WAGE PROBLEM

The Economic Reports pay little attention to the labor field other than unemployment. There is no real concern with the numerous strikes which have paralyzed the economy in recent years—a paralysis, the cost of which is difficult to measure because the adverse impact reaches far beyond the immediate companies or industry affected. Much of the cost involves loss of freedom and other human values on which no price tag can be put. The dock workers strike of 1962–63 caused worker layoffs in major countries throughout the world and seriously threatened the foreign exchange earnings of distant countries, many of them poor countries relying heavily on one or two major exports, whose products (often perishable) could not be unloaded at our ports. Similarly our own exports were thwarted. Even though some of these losses are not irretrievable, the damage to human beings is substantial both here and abroad. Yet the Economic Report fails to engage this matter.

The President's intervention in the steel price increase of April 1962 is commended by the report, but wage settlements which breach the wage guidelines of the 1962 and of the 1963 report are not even identified or mentioned.

The so-called wage and price guidelines are again repeated in this year's Economic Report (pp. 83–88). A widely read weekly magazine commented, "The White House offers two kinds of wage guidelines for 1963; the word and the deed" (*Business Week*, Jan. 26, 1963).

The acceptance of the longshore strike settlement, even though it exceeded the "general" productivity guidelines for wage settlements by 100 percent, is in notable contrast with the reaction to a steel price increase announcement last April, although there had been no price increases since 1958. This will not go unnoticed as other union officials make their "demands."

The "general" guidelines announced in the Economic Report last year (and again confirmed this year) suggested wage increases, including fringes, be limited in each industry to the increase in productivity in the economy as a whole (about 3 percent annually in the last decade; from 1957 to 1962, annual rise was 2.7 percent on labor



force basis); this, it was argued, would prevent inflation. But this is not the whole of the announced guidelines; in those industries in which there was unemployment or in which the current wage rates were high compared with those earned elsewhere by similar labor, this "general" guideline was declared by the Economic Report to be too high.

By these tests the longshoremen should not have had even a 3 per cent increase. The industry had offered 22 cents per hour over 2 years. The union demanded 50 cents. Senator Morse's panel appointed by the President "ordered" (on a take it or leave it basis—with a threat of compulsory legislation) 37½ cents per hour plus an extra paid holiday. The basic wage had been about \$3 per hour, high considering the skills involved. There was unemployment in the industry. This settlement, therefore, represents twice the normal productivity gain in our economy and represents a serious breach of the so-called guidelines announced by the administration. But no Government official raised his voice in opposition; instead the settlement has been commended.

The Economic Reports, both this year as in previous years, virtually ignore the devastation of prolonged strikes and the inventory traps created by industrywide and pattern bargaining which keep upsetting forecasts, budgets and expectations.

The reports propose all sorts of solutions for innumerable problems, but seem to be utterly devoid of a solution for the strike paralysis problem and strike threats, suggestions for which were advanced in our report, *Inflation, Unions, and Wage Policy*. Since the National Government itself is heavily responsible for the buildup of the power of union officials, this oversight is inexcusable.

The Economic Report lauds Presidential intervention in the steel price situation of April 1962 and states that the wage-fringe settlement in steel in 1962 was "generally regarded as noninflationary" (p. 87); it is interesting to note that the Council attributes this conclusion not to itself but to unnamed others.

Furthermore, it is quite improper from an analytical point of view to regard any particular wage change as inflationary or deflationary. Inflation is primarily a monetary phenomenon and particular wage changes may have cost-raising or unemployment effects, but should not be viewed as inflationary or otherwise; this is too narrow a view. This settlement has raised steel costs higher than they otherwise would have been. This the Council could have said. It has helped to price our steel a little more out of the market both here and abroad, by mitigating tendencies toward price reduction. It has reduced the market for domestic steel. It has played a part in the shift of income from investors (including retained corporate earnings) to employees, as shown by the widespread decline of steel company earnings in 1962 and the cuts in dividends, cuts which affected more people than are employed in the steel business.

Nowhere does the report point out that the fundamental demand theorem of economic states that the demand for any goods or service is a negative function of its price. On the contrary, more workers are to be priced out of the labor market by extending minimum wage coverage and the minimum wage is to rise to \$1.25 per hour this year—not a welcome prospect for the young and unskilled disemployed.

## THE BALANCE-OF-PAYMENTS PROBLEM

The President and the Council now seem to despair of the prompt elimination of the imbalance in our international payments. In spite of substantial new efforts, our exports have increased very little in the last year or two—up from \$19.5 billion in 1960 to only \$20.8 billion in 1962. The goal of closing the payments gap is now deferred from some time in 1963 to some unspecified future time.

There is a major discrepancy between the posture taken by the President in the Economic Report and that taken by the Council of Economic Advisers on a matter that may be more than passing interest. At issue is the relationship between economic growth and balance-of-payments equilibrium.

On page xx of the report the President says, “\* \* \* indeed, in the long run, a healthy balance-of-payments position depends on a healthy economy.”

In contrast the Council's report is essentially uncertain. Where it is not uncertain, it is unconvincing on the impact of economic development on the balance of payments, although on page 59 it endorses the President's view.

The report of the Council (p. 103) states that “no one can be certain whether the positive or negative effects of domestic economic expansion on the balance of payments will predominate in the long run.” The Council's uncertainty is understandable because the effect of growth on the balance of payments is complicated. Some difficult problems must be wrestled with in the future; serious thought must go into devising real defenses for the dollar to replace the ad hoc measures taken to date.

The Council makes an attempt to support the President's position as follows: “\* \* \* recent experience here and abroad suggests strongly that, ultimately, the key to a sustained balance in international payments is a dynamic, growing, full operating economy. That kind of economy has produced payments surpluses in Europe, while 5 years of economic slack have not eliminated the U.S. payments deficit.”

Unfortunately the evidence offered leaves the question of causation unanswered. Has Europe's economic vitality caused her balance of payments surpluses by the mechanisms which the Report discusses or has her surplus stimulated economic growth and has our deficit been caused by slow growth or has the U.S. balance of payments deficit, through its deflationary impact on the economy, caused the domestic slack? The Council does not answer these difficult questions.

## MONEY SUPPLY AND GROWTH

Slow growth may also stem from inadequate domestic liquidity. The sluggish recoveries from recession and the slowed rates of economic growth coincide roughly with the accentuation of our balance of payments difficulties which became marked first in 1958. The disequilibrium in our international payments position may be playing a more adverse role than is commonly realized.

The growth in our money supply (currency and demand deposits) has been very small since 1957; from 1958 to December 1962 the growth has been only \$7 billion. In part this is explained by our international payments bind. Most economists who regard a sufficiency in mone-

tary growth as the key to sustained economic expansion and freedom from all but mild dips, generally believe that our money supply should grow by 3 percent per year, about four times the rate since 1958. Growth in time deposits may supplement the money supply, but is generally not adequate substitute for currency and demand deposits.

The money supply was stagnant until late 1962. Total reserves of member banks (less reserves behind Treasury deposits) have not risen much.<sup>4</sup> The studies by Clark Warburton and, more recently, by Milton Friedman and his associates, as well as others, strongly support the view that a steady growth in the money supply is the indispensable prerequisite for a sustained upward economic trend.<sup>5</sup>

#### CONCLUDING COMMENT

In spite of the foregoing criticisms, the Economic Reports of 1963 contain much useful information and analysis. The more restrained diagnosis and prescription (with some exceptions) is commendable.

The Nation faces some serious problems, economic and other. It may be at a critical point in history with regard to international questions, and the behavior of the economy in terms of stability and growth. The economy is rather evenly poised—some factors pointing down and others up. There is no evidence of a strong upswing at this time. The wrong policy or policy mix could mean not only a downturn but also slowed growth for some time to come. A Treasury deficit seems inescapable. Deliberately enlarging that deficit should be accompanied by a firm policy of no-nonsense expenditure control and the elimination of low priority expenditures and government activities. Tax reductions for individuals and business should be geared to incentives to deepen capital and open up new productive job-making in the private sector.

When governments make mistakes they may be large and catastrophic. Individuals and individual business, too, make mistakes; but under a private competitive enterprise system with a multitude of separate enterprises, and preferably an increasing number of such enterprises, the mistakes may be relatively small and to some extent they may be offsetting one another.

For these reasons as well as the benefits of human freedom we should test every Government program and proposal by its impact on the strength, vigor and growth of private effort and private enterprises.

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<sup>4</sup> For significant outlines and data see "Bank Reserves and Money," Federal Reserve Bank of St. Louis, Oct. 9, 1962.

<sup>5</sup> "Capitalism and Freedom," University of Chicago Press. See also, "Can We Depression-Proof Our Economy?" Chamber of Commerce of the United States, Washington, D.C.

## COMMITTEE FOR ECONOMIC DEVELOPMENT

WASHINGTON, D.C., *February 14, 1963.*

HON. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
Congress of the United States,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: In response to your letter of January 23, asking for comments on the 1963 Economic Report of the President, I submit herewith a statement by Mr. T. O. Yntema, Chairman of the Research and Policy Committee of the Committee for Economic Development. Mr. Yntema's statement is accompanied by a copy of a policy statement, "Reducing Tax Rates for Production and Growth," issued by CED's Research and Policy Committee in December 1962.<sup>1</sup>

I am sending 25 sets of these materials to Mr. Knowles for the use of the members and staff of the Joint Economic Committee.

Sincerely yours,

HERBERT STEIN,  
*Director of Research.*

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### STATEMENT OF T. O. YNTEMA, CHAIRMAN, RESEARCH AND POLICY COMMITTEE, COMMITTEE FOR ECONOMIC DEVELOPMENT<sup>2</sup>

I am pleased to respond, on behalf of the Research and Policy Committee of CED, to your invitation to comment on the 1963 Economic Report of the President.

The President's report concentrates on tax revision, and I shall follow this lead in my comments. My remarks are largely based on a policy statement "Reducing Tax Rates for Production and Growth," issued by our committee in December 1962. Copies of this statement are supplied herewith for members of the Joint Economic Committee.

We believe that prompt, substantial, permanent reduction of Federal tax rates on individual and corporate incomes would increase production, employment, investment, and growth in the American economy. At the same time we recognize a danger that tax rate revision may become elevated in public thinking to the status of a sovereign remedy for all ills. In our statement we said:

"Neither the lag of production nor the lag of private investment is due to taxes alone. The behavior of the economy in any specific respect is always due to a combination of factors, no one of which can be singled out as the cause. We concentrate on tax policy in this statement not because it is the only cause of our present difficulties but because it is an important cause and one of the most readily remediable."

<sup>1</sup> Copies of policy statement were distributed to members of Joint Economic Committee; they can be obtained from the CED.

<sup>2</sup> The Committee for Economic Development is composed of 200 businessmen and educators. Its purpose is to conduct objective economic research, to support and promote economic education, and to formulate and publish recommendations on major economic problems that will contribute to growth and stability in the American economy, higher living standards, and increasing opportunities for all Americans, and to strengthening the institutions and concepts essential to progress in a free society.

In brief, our tax recommendations are as follows:

1. A cut of tax rates should be enacted early in 1963, to take effect on January 1, 1963. The rate cuts we recommend would reduce revenue by about \$6 billion a year, before offset for the additional revenue that would be collected on the resulting increase of national income. About \$4 billion of this cut would be in taxes on individual income and about \$2 billion in taxes on corporate income.

2. Federal expenditures in fiscal 1964 should be held to the level of fiscal 1963. As it turns out, this would require expenditures in fiscal 1964 to be held \$5.8 billion below the budget estimate for that year. If that is done, and as soon as it is clear that it will be done, there should be an additional tax cut of about \$5 billion, divided between individual and corporate rates.

3. Tax rate reduction now, in 1963, should not be obstructed or delayed by consideration of complicated and controversial problems of the tax structure.

Although the tax program we recommend is substantially different in composition from that proposed by the President, the size of the cut we recommend if fiscal 1964 expenditures are not held down to the 1963 level is about the same as the first step of the President's program; namely, \$6 billion. If our proposal were followed, however, the tax reduction would go into effect earlier, and the reduction for the calendar year 1963 would therefore be larger. We think this question of timing is important. The loss of production, investment, and employment that the tax reduction is intended to correct is going on now. The time to make the correction is now, or at least as soon as possible. The months that are lost by delaying can never be recaptured.

We do not propose any deferred tax cuts to be enacted now and take effect in 1964 or 1965. We see no reason to defer tax cuts from the present, when we need them, to 1965 when we may or may not need them. It is imprudent to commit ourselves now to make certain tax reductions in 1965. We should make now the cuts that are desirable now, and wait before committing ourselves to making cuts in 1965.

Because we believe that prompt rate reduction is important, we think it is unwise to hinge reduction of the rates upon enactment of a long list of complex and hotly disputed structural revisions of the tax system. We say this without reference to the merits of the particular package of tax revisions proposed by the administration. (Personally, I have serious doubts that the package will contribute to prosperity and economic growth.) Our point is that if tax rate reduction is going to wait upon final resolution of the issues raised by the President's package then tax rate reduction is going to wait too long. No one, even if enthusiastic for the proposed revisions, can reasonably maintain that their adoption in 1963 or 1964 is so important as to justify delay in rate reduction. Surely there is no economic or budgetary reason for making all of a \$13.5 billion tax rate reduction dependent on a \$3.5 billion of revenue raising tax revisions. It may be argued that the tax revisions cannot be enacted if they are not tied to so large a rate cut. But if the American people find the \$3.5 billion revision pill so bitter that they will not swallow it without \$13.5 billion of rate reduction sugar coating, perhaps they shouldn't swallow it at all.

We recommend a balanced program of rate reduction, applying both to the individual income tax and to the corporate income tax. The administration's proposal does provide for allowing a reduction in the corporate tax rate from 52 to 47 percent, a reduction originally scheduled to occur at the end of the Korean war and repeatedly postponed. This five-point reduction would take place in two steps, two points on January 1, 1964, and three points on January 1, 1965. In view of the objectives stated by the administration, this reduction is too small relative to the total cut proposed and, because deferred, too uncertain. Our national objective is not only to get up to high employment and high production but also, when we get there, to grow rapidly. Growing rapidly requires a high rate of investment. Therefore, we want to assure that when employment and production are high the rate of investment will also be high. The rate of investment will depend in part upon the rate of corporate profits taxation. The Economic Report recognizes this, and the interest in growth is the chief reason offered for reducing the corporate profits tax. However, only one-fifth of the proposed revenue reduction from rate cuts would be used to reduce corporate profit taxes. This is an inadequate reflection of the importance of the corporate profits tax as an obstacle to economic growth.

Two critical questions raised by a proposal to cut taxes at the present time are what would be the effect on the deficit and what would be the significance of this effect. It is sometimes suggested that a reduction of tax rates will not reduce the revenue but will increase it and will in fact eliminate the deficit. While this is a theoretically possible course of events its actual occurrence would depend upon a particular combination of conditions that may or may not exist. We can be fairly confident that a reduction of tax rates will cause some increase of the national income. This rise of the national income will yield some increase of revenue. But whether the increased revenue from this source will completely offset the revenue lost by the cut of tax rates is uncertain, and whether it will more than offset the revenue loss and eliminate the existing deficit is even more uncertain.

Therefore, I think it is unwise to discuss the tax cut on the assumption that the stimulation of the economy engendered by the tax cut alone will reduce or eliminate the deficit. However, I believe that we can make this different, and more significant, statement. If the economy gets up to its potential rate of production and employment the budget can be balanced with lower tax rates than we now have. We can make some cut of tax rates and still balance the budget if the combination of tax cuts, other policies, and the spontaneous forces of the economy get us up to high employment and production. This does not mean that we can balance the budget by cutting taxes enough so that the tax cut alone would get us up to high employment. The tax cuts that would be necessary to do this might leave us with insufficient revenue even at high employment to balance the budget.

We may find ourselves in a situation where we cannot balance the budget by tax increases alone, at least without severely depressing the economy, and cannot balance the budget by cutting taxes. I am not saying that we are now in such a situation or are likely to be there in the future, but the situation is a possible one and we should consider its implications.

If we were in such a situation, would it be satisfactory to cut taxes by whatever amount might be necessary to pump the economy up to high employment and run persistently whatever deficits that might involve? It would not be satisfactory. High employment is important, but the national objective is more than that. The national objective is high employment and rapid growth. As I have already said, rapid growth requires high private investment. To achieve high employment by persistent deficits means that part of the saving the public does at high employment is absorbed in financing the Government deficit, and does not finance private investment. We would not be growing as rapidly as we might because we would not be investing the available saving. This is the basic reason for not being satisfied to run deficits at high employment. It is, in fact, the basic reason for not being satisfied merely to balance the budget at high employment but to seek a surplus, which will retire public debt and in so doing add to the funds available for private investment.

How are we to get simultaneously, high employment, rapid growth, and budget surpluses? The only solution is a sufficiently strong incentive to invest so that private investment will absorb the savings the public will make plus the Government surplus when employment is high. This is the hard core we reach when we unravel the problems of employment, growth, and the budget.

As we said in our December 1962 policy statement:

“The vigor of the economy has been inadequate and must be strengthened if we are to have high employment and a surplus. We must create an economic climate that will nourish dynamic growth. We believe that the reduction of taxes we recommend will contribute to this condition. But much of the solution to the problem lies outside the field of budget policy. It lies in the whole complex of social and economic conditions, including notably labor policy, that determine the profitability of private investment. We must look to the improvement of these conditions in order to reach the budgetary goal we seek. Until a more favorable climate for investment is created or emerges spontaneously, it is self-defeating to maintain excessively high tax rates that stifle investment and growth.”

I want to make our position clear. We support a prompt, substantial cut of individual and corporate profits tax rates as a step that can now be taken to increase production and investment. We support this step even though it probably means that the deficit will be increased now and that at high employment the budget would have no surplus. But we emphasize that while currently necessary this is not a permanently satisfactory prescription for achieving high employment and rapid growth. When we have made this step we need to turn our attention to the conditions that hold back private investment in the United States. Only by correcting these conditions can we generate a budget surplus, high employment, and rapid growth.

## CONFERENCE ON ECONOMIC PROGRESS

WASHINGTON, D.C., *January 25, 1963.*

Hon. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
U.S. Senate, Washington, D.C.*

DEAR PAUL: In response to your kind letter of January 23, I shall be glad to submit comments with respect to the 1963 Economic Report, in sufficient number, not later than February 15.

With all good wishes,  
Very sincerely yours,

LEON H. KEYSERLING.

### STATEMENT OF LEON H. KEYSERLING<sup>1</sup> IN RE THE PRESIDENT'S ECONOMIC PROGRAM, ESPECIALLY HIS TAX PROPOSALS SUBMITTED TO THE JOINT ECONOMIC COMMITTEE AT ITS REQUEST

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- Deliberate enlargement of the Federal budget deficit now is not desirable per se, without regard for the nature of the enlargement.
- Summary of shortcomings in the current tax proposals.
- The proposed tax program is very small, but sent out to do a giant's job.
  - Low economic growth, 1953-62.
  - Chronic enlargement of the economic slack.
  - Costs of the 10-year economic slack, and costs if it continues.
  - The official reports are excessively optimistic.
  - The reports very seriously underestimate the current production "gap."
  - Needed economic growth, 1962-65.
  - The two reports fail to establish targets for either employment or production, as intended by the Employment Act.
  - The very small size of the tax proposals.
  - The Council's report does not even estimate the economic impact of the proposed tax program.
- The internal composition of the proposed tax program is highly inimical to sustained or balanced economic growth.
  - A few theoretical observations.
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  - Summary of major causes of the chronic disequilibrium.
  - Public policies contributing to the disequilibrium.
  - We are now in danger of perpetuating the undesirable public policies.
  - The severely disequilibrating factors built into the proposed tax program.
- The proposed tax program is socially unjust and highly inequitable.
  - The extremely regressive nature of the proposed personal tax reductions.
  - We must find other ways to help the low income people.
  - Some data on current income distribution.
- The tax proposals involve gross neglect of other equally or even more important programs.
  - Dollar for dollar, increased public outlays are more stimulatory than tax reduction.

<sup>1</sup> Former Chairman, Council of Economic Advisers. Consulting economist and attorney, president, Conference on Economic Progress.



- Tax reduction cannot powerfully restructure the composition of demand, and therefore cannot powerfully meet the challenge of the new technology and automation.
- The key importance of housing.
- The key problem of mass transportation, especially the railroads.
- The proposed tax program cannot help very much to meet our urgent education and health needs.
- Estimate of needed increases in Federal budget outlays for domestic priority purposes.
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- The wage guidelines.
- The static position of the reports with respect to monetary policy.
- My proposals for action now.
- Why we are going wrong now.

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3. The American economy during 10 years: Needed and actual performance, 1953-62.
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## STATEMENT OF LEON H. KEYSERLING

I appreciate this opportunity to set forth my evaluation of the President's economic program, the heart of which is embodied in his recent tax proposals. Although these proposals have been made the subject of a special tax message, the economic basis for them and their

main features and purposes are set forth in the January 1963 Economic Report of the President, and in the accompanying Report of the Council of Economic Advisers. Consequently, my analysis is pointed to these two reports.

I approach this task with mixed feelings. I have a natural reluctance, on many grounds, to being critical of the President's program. Along with so many others, I admire the President's elevated purposes and his courage and discernment, and know from long experience that he must take into consideration many factors which I cannot properly weigh. And my own awareness of the imperative need for vigorous action at this time pulls me toward attempting to widen agreements, rather than toward expressing any note of dissent.

Nonetheless, I am convinced that the President's tax proposals miss the mark so widely that it will be useful to set forth my views clearly and with candor, and that this course can be helpful to the President as well as to others. For I reject, as basically unfair to the President, the widespread notion that this program has been shaped largely by considerations of political strategy; he knows full well that all our domestic and worldwide problems require above all programs whose substantive merit maximizes the likelihood of their success if adopted. Indeed, I feel that the deficiencies in the President's tax program, as I see them, spring primarily from his sincere reliance upon economic advice which appears to me mistaken, and that he will in due course reappraise this advice when it is shown to work no better in the future than it has worked to date.

Meanwhile, this Committee and the Congress, which under our system must bear a high responsibility which is completely acknowledged by the President, are also entitled to utmost frankness on the part of economists. Too many of my friends among economists outside the Government, I fear, have tried to become political strategists, or are too closely allied with those in the Government to exercise the independence which alone can make them valuable.

My entire analysis will concentrate predominantly upon the tax proposals of the President. I will set my critical evaluation of these proposals in the context of the American economy and its problems as I view them.

**DELIBERATE ENLARGEMENT OF THE FEDERAL BUDGET DEFICIT NOW IS NOT DESIRABLE PER SE WITHOUT REGARD FOR THE NATURE OF THE ENLARGEMENT**

It would be superfluous for me to labor the point that I favor a deliberate enlargement of the Federal budget deficit, when our unused productive resources are as large as they are now, and have been so large for so many years. The condition of the national economy is categorically more important than the condition of the Federal budget. Moreover, only by restoration of the national economy to levels of performance much closer to its full potentials, can there be any realistic prospect of balancing the Federal budget.

But just because the foregoing position represents the so-called modern or progressive viewpoint, too many are assuming that it is modern and progressive deliberately to enlarge greatly the size of the Federal deficit, without very much examination of the nature of the program—in this instance, the tax program—designed toward this end. This, in my judgment is a dangerously superficial approach.

When the Government decides to achieve a very much larger Federal deficit by conscious and affirmative policies—as distinguished from the deficits which arise automatically from unexpectedly poor economic performance—the Government is deciding deliberately to collect from the taxpayer much less than the cost of the services rendered to the taxpayer—that is, to the people and the country—by the Government. In terms of realistic analysis, since ordinarily the people are supposed to pay in taxes the cost of services received, deliberate increases in deficit financing are tantamount to subsidies paid by the Government to the taxpayer.

To put this in another way, the tax reductions proposed by the President, in their economic and social impacts, are really the same thing as if tax rates were to remain just where they are now, and if the Government then mailed checks to various taxpayers identical in amount with the tax reductions which they would receive under the President's tax proposals. If this were the case, no one would argue that it really would not make very much difference to whom the checks were mailed and in what amounts, in terms of judging whether these subsidy payments would accomplish the overall economic purposes intended, while at the same time being consistent with our fundamental American standards of equity and social justice.

#### SUMMARY OF SHORTCOMINGS IN THE CURRENT TAX PROPOSALS

Applying this line of reasoning, which appears to me sound, I am reluctantly forced to these summary conclusions:

(1) The President's tax proposals, if adopted in their current form, would fall so far short of providing the needed stimuli to the economy, both as to timing and size, that they would be substantially wasted, and therefore would tend to discredit the sound use of deliberate deficit financing on proper occasions. The proposed tax program is like a pygmy sent out to do a giant's job;

(2) Aside from these quantitative deficiencies as to timing and size, and still speaking in terms of their impact upon the overall economy, the internal composition of the President's tax proposals is based upon so erroneous an analysis of our economic troubles and the means of overcoming them, that these proposals, if enacted in their current form, would entail serious risks of increasing and intensifying rather than reducing and mitigating the imbalances or disequilibriums in the economy which have persisted for a decade and still exist;

(3) Aside from the foregoing overall considerations, the President's tax proposals, if enacted in their current form, would be seriously inimical to those considerations of equity and social justice which no great and rich nation can in good conscience afford to neglect, when undertaking fundamental and enduring changes in the tax structure. Further, for reasons which I shall disclose fully, I believe that tax changes running counter to these considerations of equity and social justice would, because of the very nature of our economic problems, be undesirable also from the viewpoint of overall economic restoration on a sound and enduring basis;

(4) An economic program concentrated so largely on tax reductions, even if these reductions were not in themselves subject to the defects just mentioned, is an economic program which grossly neglects other measures at least as important as tax reduction, whether we are

thinking in terms of overall economic restoration or in terms of our social and human needs. More specifically, we can neither achieve the overall economic restoration nor meet our social and human needs, without a combination of large and wisely designed tax reductions and large and wisely designed increases in Federal outlays directed toward the urgent priorities of our domestic public needs. To restore maximum employment and production, in the face of the new technology and automation, we must create a vast restructuring of the whole pattern of effective demand, and this requires programs entirely different from tax reduction, including but not limited to large increases in Federal outlays for domestic public purposes;

(5) It is a grave error to combine, for purposes of simultaneous action, the proposed tax reductions and the proposed "reforms." In one important sense, the very distinction between tax reduction and tax "reform," when pushed as hard as it is being pushed, represents a serious confusion both in analysis and in objectives. Every tax change, no matter what we call it, should be fashioned to implement the basic purposes of our economic life, which include growth and stability, the meeting of the priority of our private and public needs, and economic justice. No "reform" which does not contribute to these purposes is desirable, and any tax change which contributes to these purposes may be called a "reform." I see no particular reason for saying that a reduction of the tax burden on a low-income family which cannot now maintain a decent American standard of living is not a "reform," but that closing a loophole is a "reform." However, the important thing is not the terminology; it is what tax changes are most urgently needed first. And some of the "reform" proposals, being designed to recoup revenues surrendered by means of the proposed tax reduction, are certainly not stimulatory to the economy, in that they impose somewhere additional burdens and unsettling changes. Thus, while the originators of the proposed tax program properly identify its core objective of getting the American economy moving again, and toward this end are properly putting the restoration of the economy ahead of budgetary consideration, they are simultaneously moving in the opposite direction by injecting the "reforms" in order to make the deliberately contrived deficit smaller and less effective. This seems in substance poor judgment as to relative priorities, and doubly so when the thorny and controversial issues involved in these "reforms"—even if ultimately desirable—threaten to retard or jeopardize or even jettison the whole tax program.

When I come to my own specific proposals with respect to tax policy, I shall suggest what types of tax reductions should come first, and what types of other tax reductions, later on, might be combined with and conditioned upon the proposed "reforms." I think that the cumbersome and complex tax program, as now offered, is a lawyer's skylark, rather than a sound portrayal of relative priorities.

THE PROPOSED TAX PROGRAM IS VERY SMALL, BUT SENT OUT TO DO A GIANT'S  
JOB

Turning now to a more comprehensive examination of my first main point—that the proposed tax program is very small, but sent out to do a giant's job—I must first of all offer for consideration the data and analysis which are most relevant to this first point.

*Low economic growth, 1953-62*

My chart 1 depicts the growth rates of the U.S. economy, over various periods during the past four decades. Its main purpose is to show that, during the 10-year period 1953-62, inclusive, the average annual growth rate in real terms was only 2.7 percent. This was about 23 percent lower than the 3.5 percent annual average during the four decades as a whole, and about 27 percent lower than the 3.7 percent annual average, excluding the great depression era and the war eras; about 41 percent lower than the 4.6 percent annual average during the peacetime period 1922-29; and more than 43 percent lower than the 4.8 percent annual average during the period of peace and limited war 1947-53, which in many respects on the whole is analogous to the cold war period in which we have found ourselves during the past decade, and are likely to be in for some time to come. This chart, I submit, supports my conclusion that, under the conditions of the accelerating technology and automation, and the high growth in the labor force during the years ahead, we need an average annual growth rate of about 5 percent to maintain the maximum use of our resources contemplated under the Employment Act of 1946. And, obviously, we need a much higher growth rate than this until maximum employment and production are restored.

My chart 2 traces the quite consistent pattern of recessions, short-lived and inadequate booms, and periods of stagnation, which have plagued us during the past decade to date. Particularly significant has been the shorter intervals between recessions to date, and the increasingly unsatisfactory character of the recovery movements. For example, the chart shows that, measured in terms of the percentage rise in GNP, the upturn from 1961 to 1962 was considerably smaller than the upturn from 1958 to 1959, and even more below the upturn from 1954 to 1955. The chart also shows the progressive slowdown in the rate of the upturn which commenced early in 1961—a slowdown which is not negated by the fact that the trend from third to fourth quarter 1962 was better than the trend from second to third quarter 1962. My insistence now, as I had forecast earlier, that this latest upturn is the least satisfactory since World War II, does not seem open to serious challenge, and in fact is implicit in the President's tax proposals.

My chart 3 indicates how the performance of the American economy, during the past decade, has at best swung us back periodically to a 2.7 percent growth rate line, but has never swung us back above this line toward the needed growth rate line, which I estimate at slightly above 4 percent a year for the past decade. (This contrasts with the about 5 percent rate which I think will be needed in the years ahead, after full economic restoration, allowing for the new technology and automation, and the more rapid prospective growth in the labor force.)

*Chronic enlargement of the economic slack*

My chart 4 reinforces the proposition that the economic slack represented by idle manpower and plant has been growing chronically larger. In fourth quarter 1962, the true level of unemployment (seasonally adjusted), measured as a percentage of the civilian labor force, was almost 12 percent higher than in 1959 after the recession of 1957-58; more than 37 percent higher than in 1955 after the recession of

1953-54; and 88 percent higher than 1953, even though a recession commenced well within that year.

My chart 5 depicts the high volume of idle plant and machines during the whole period from 1954 through 1962, with comprehensive data through 1961, and, insofar as available, on into 1962.

Combining the idle manpower with the other unused productive resources, and allowing properly for the larger growth in the labor force and in productivity which optimum use of our resources would have called forth, my chart 6 shows that, in 1962, our gross national product was running almost \$75 billion below maximum production, and that, by fourth quarter 1962, this so-called gap was at an annual rate of almost \$80 billion or more than 12½ percent of our potential at maximum production. It is highly significant that this gap in fourth quarter 1962, measured as a percentage of maximum production, was almost 33 percent higher than in 1959, more than four times as large as in 1955, and compared with only a nominal gap in 1953.

*Costs of the 10-year economic slack, and costs if it continues*

My chart 7 estimates the losses occasioned by these 10 years of chronically poor economic performance, and my charts 8 and 9 depict the impact of these losses upon the Federal budget, assuming actual outlays and actual tax rates. The eighth and ninth charts also depict how, under conditions of sustained optimum prosperity, we could have achieved (even with higher expenditures and lower tax rates) a net budgetary position for the decade as a whole about \$54 billion better than was actually achieved.

On the basis of this analysis of the past 10 years—an analysis which I shall refine further as I proceed—chart 10 depicts the enormous if not disastrous losses which we will suffer, during the 4-year period 1963 to 1966, inclusive, if, instead of activating the needed growth rate, we repeat in rough approximation the performance of the past decade. These estimated losses include more than \$290 billion of total national production, and almost 17 million man-years of job opportunity. And as I have said frequently, there is every indication that we will not average better in the years ahead than during the past decade, without drastic changes in private and public economic policies. Indeed, the progressive worsening of each recovery movement which I have already traced, the progressive enlargement of our idle plant and manpower, and the fact that we do not have in reserve some of the plus factors which had accumulated by 1953 for a variety of reasons, lead me to believe that we are in grave danger of averaging worse in the years ahead than in the decade just past, without drastic changes in private and public economic policies.

*The official reports are excessively optimistic*

Contrasting sharply with the foregoing analysis—which I believe to be sound for reasons shortly to be stated—the President's report (pp. ix-x) refers to a "gratifying recovery" which has raised our gross national product from \$501 billion at the start of 1961 to \$562 billion at the end of 1962, and also states (p. xi) that the economic upturn of 1961-62 has carried us above any previous peaks of production. The report also points out (p. ix) that this most recent upturn has reduced unemployment from 6.7 percent of the civilian labor force at the start of 1961 to 5.6 percent at the end of 1962, and that "22

months of steady recovery have already broken this melancholy sequence," referring to the sequence of recessions which followed previous upturns.

I can see little justification for this claim of a "gratifying recovery," nor for the choice of data to support this claim. As the President himself cites (p. ix), there was an upturn of 45 months before the 1953-54 recession, 34 months before the 1957-58 recession, and 25 months before the 1960-61 recession. Thus, "22 months of steady recovery is certainly no substantial evidence that we have overcome" the "melancholy sequence" of increasingly frequent recessions. In fact, as my chart 2 shows, we have not even had "22 months of steady recovery." Broadly speaking, the recovery has slowed down greatly, and we have been in virtual economic stagnation for more than a year. Correspondingly, the growth rate in GNP from the start of 1961 to the end of 1962, cited by the President as "gratifying," has been very disappointingly low, and marks in many respects—as I have already said—the least satisfactory recovery movement since World War II.

And even the admission in the report (p. ix), to the effect that there are still 4,000,000 unemployed, counts only full-time unemployment as recorded by the Census Bureau. It overlooks that the true level of unemployment in fourth quarter 1962, seasonally adjusted, was very close to 7,000,000, as shown by my chart 4. This takes properly into account both the full-time equivalent of part-time unemployment, and the abnormally low growth of the labor force due to the shortage of job opportunity. Nor does the report acknowledge, as I have shown, that unemployment now, while lower than at the end of the most recent recessionary movement, is higher than at a comparable stage of any previous upturn since World War II, and this is the real problem.

Similarly, the report of the Council of Economic Advisers states rather blithely (p. 9) that "\* \* \* we have made significant advances toward the goals of fuller employment and faster growth," and then goes on in documentation of this to state (p. 10) that the GNP rose from 519 billion to 554 billion, or 7 percent, comparing 1962 with 1961. Whether the developments from the start of 1961 to date have been "significant advances," or unsatisfactory confirmation of the chronic pattern since 1953, I have already discussed. Moreover, measured in uniform rather than current dollars, the growth rate from 1961 to 1962 was only 5.3 percent rather than 7 percent—a very discouraging pace, in view of the pace required for full economic restoration within any reasonable period of time.

*The reports very seriously underestimate the current production "gap"*

The President's report states (p. x) that our total national production was running at an annual rate of between \$30 and \$40 billion below our reasonable potentials as of the end of 1962. I maintain, as estimated on my chart 6, that this "gap" in the fourth quarter of 1962 was running at a seasonally adjusted annual rate of about \$80 billion. The difference between the size of the current production "gap," as estimated by the President and by the Council of Economic Advisers, and the size of the production "gap" as I now estimate it, is crucial to the whole issue of economic policy.

The method which the Council of Economic Advisers uses, in estimating the production "gap," is to project from 1953 forward "a 3½ percent trend line through actual output in mid-1955, which is taken as a period of approximately full use of resources" (p. 26 of Council report), and then to contrast where we would stand now if this growth rate had been achieved with where we actually stand now. I find two fatal vulnerabilities in this method:

(1) The method used by the Council in estimating the size of the current "gap," appears to be consistent with the Council's persistent statement that our unsatisfactory performance commenced with 1957 (see p. 22 of Council report), although, as my chart 2 shows, it clearly commenced with 1953, and we were not at "approximately full use of resources in mid-1955." Indeed, as early as 1954 and 1955, I was repeatedly calling to the attention of this committee and others my view that we were becoming frozen into a pattern of abnormally low economic growth. In 1954, I published forecasts that the average annual rate of growth 1953-60 might well average as low as 2.5 percent, which turned out to be exactly right.

(2) The utilization of the 3.5 percent figure by the Council of Economic Advisers (see p. 41 of Council report) is based upon their assertion that a 3.5 percent average annual growth rate would be sufficient to absorb the increments in the labor force and in productivity each year, although the Council does favor a higher growth rate, toward which they urge various special measures. But our whole experience over the past four decades, as shown clearly on my chart 1, is that a growth rate between 4 and 5 percent has been required in recent decades to maintain optimum utilization of our growing productive powers, and probably 5 percent is a more sensible figure for now, after optimum utilization is restored.

The trends in productivity have a very important bearing upon this crucial growth rate issue. The use of the 3.5 percent overall growth rate figure by the Council of Economic Advisers is compounded of a growth rate in the labor force somewhat in excess of 1 percent, and a so-called normative growth rate in productivity somewhat in excess of 2 percent. On the productivity side, the Council is fearfully off the mark. As my chart 11 shows, the growth rate in productivity has tended to accelerate rapidly when called forth by anything approximating reasonably optimum economic performance. The chart clearly indicates that estimates of the GNP growth rate, needed merely to absorb the annual increments in the labor force and in productivity, should factor in an average annual productive growth rate just about twice as high as the one used by the Council of Economic Advisers.

The use of the 3.5 percent figure by the President and the Council, combined with the erroneous use of 1955 as a satisfactory year, therefore results in an estimated "gap" about half the size of the actual "gap" today. Moreover, this gross underestimate of the growth rate required to absorb annual increments in the labor force and in productivity explains why, even during the rather rapid upturn during 1961, idle manpower and plant were reduced by so much less than the Council had forecast.

While there have been some suggestions in past years to the effect that my estimates of the needed growth rate were too high, it appears clearly by now that this was not the case. For if my estimates of the



needed growth rate had been substantially too high, I would have been substantially wrong in my forecasts as to the amount of idle plant and manpower which would result from the extent by which actual growth rate fell below my estimates of the needed growth rate. Instead, my needed growth rate estimates have been vindicated by how closely the actual levels of idle plant and manpower have adhered to my forecasts of what they would be.

*Needed economic growth, 1962-65*

The Employment Act of 1946 establishes maximum levels of employment and production as a prime national objective. And since we have not enjoyed these levels for a decade, it does not seem excessive now to strive for their attainment not later than the beginning of 1965—2 years from now.

As shown on chart 12, this requires that, measured from a 1962 base, man-years of employment be 3.2 million higher in 1963, and 5.7 million higher in 1964. This would absorb the net additional to the civilian labor force, and reduce the true level of unemployment from almost 7 million in 1962 to the neighborhood of 3 million by early 1965, which would mean full-time recorded unemployment close to the 3 percent of the civilian labor force which would be consistent with maximum employment. Thereafter, reflecting growth in the labor force, and complete restoration of maximum employment, employment in 1965 should rise about 1½ million above the 1964 level.

Chart 12 also sets forth the estimate that, consistent with the restoration of maximum employment, total national production, measured in 1961 dollars, needs to rise above the 1962 base by \$50 billion, or 9 percent, in 1963, and then rise another \$46 billion, or close to 8 percent above the 1963 level, in 1964. This would be enough to bring us close to maximum production by early 1965, through a rate of economic growth sufficiently high to absorb the increments in the labor force and in productivity, and, in addition, to close the production "gap" existing in fourth quarter 1962. With maximum production restored by early 1965, the growth rate from 1964 to 1965 should be close to 6 percent, meaning total national production of \$680 billion in 1965, measured in 1961 dollars.

It should be pointed out, however, that these targets factor in a much lower production "gap," as of fourth quarter 1962, than the \$80 billion annual rate referred to earlier. This is because that "gap" included the cumulative damage done to the growth in our productive capabilities by many years of economic slack, and all of this damage cannot be erased even by optimum economic growth in future. In other words, while this \$80 billion "gap" is a proper measurement of how much more we would have been producing by fourth quarter 1962 if we had maintained optimum economic growth from 1953 forward, this does not mean that taking up all of the current economic slack would in itself increase total national production by anywhere near \$80 billion.

*The two reports fail to establish targets for either employment or production, as intended by the Employment Act*

Although the Employment Act requires, as the first essential step toward its implementation, that needed levels of employment and production (compatible with maximum employment and production) be defined, neither of the two reports makes any substantial attempt to

do this. The departure from this requirement is one of the most complete and abrupt since the law was enacted.

The President's report (p. xii), assuming the benefits of the tax reduction proposals, forecasts a GNP for 1963 of \$578 billion, or 4½ percent above the 1962 level. But this is in current dollars; in real terms, the forecast is only about 3½ percent. But this pure forecast is not a target or "needed level" within the context of the Employment Act. It can hardly be a target within the meaning of the act, for the Council of Economic Advisers admits (p. 35 of its report), as I have already pointed out, that the actualization of this pure forecast would leave us with as much idle productive potentials a year from now as we have now. This represents no movement toward maximum production.

Similarly, the Council's report (p. 38) estimates that 3.1 million net additional jobs would be needed to reduce unemployment to 4 percent of the civilian labor force by the end of 1963. And while this purely mathematical exercise follows, curiously, immediately upon a heading "Goals for High Employment and Faster Growth," it is not a goal at all. The Council expects that, even if the President's program is adopted, unemployment at the end of 1963 will probably be just as high as it is now.

Looking beyond 1963, although the tax proposals cover a 3-year period, neither report sets forth any quantitative targets (or even forecasts) beyond 1963, with respect to employment or production, much less maximum employment or production. Yet the very core of the Employment Act is that needed policies shall be derived from and related to needed levels (i.e., maximum levels) of employment and production. Indeed, without attempting to do this, how can the Council really defend the policies it espouses?

#### *The very small size of the tax proposals*

When, in early 1961, I used the term "pygmy" to describe the economic programs then under consideration, I was pleasantly taken to task by some of my best friends in the Government. But at that time, they were forecasting that, in consequence of those programs (the really relevant ones of which were largely adopted), unemployment would be reduced to 4 percent of the civilian labor force by early 1963. Today, these same friends of mine are hoping that, if the new proposals now under discussion are adopted, the 4-percent target may be reached after 1965—though they do not say this explicitly. On the other hand, in early 1961, viewing the proposals which I then called "pygmy," I forecast that unemployment would be near 6 percent in early 1963. So I hope that I will not be chided again for calling the tax program very small. I intend no offense; I am merely worried about the future of my country.

Before evaluating the impact of the tax proposals, let us appraise the outlook if our national economic policies were to be left approximately in status quo. Dr. Heller and others have said publicly that this might well result in a recession within 1963—and I agree. If one came within 1963 or shortly thereafter, it would confirm my view that current policies portend no basic change in the chronic pattern of the past 10 years. In that event, an average annual growth rate somewhat below 3 percent would be in the cards for the few years following 1962. Applying such a low growth rate uniformly year by year,

instead of trying to guess the exact timing of the recession, the result would be a GNP of about \$562 billion in 1963, about \$577 billion in 1964, and about \$593 billion in 1965, measured in 1961 dollars. Such developments would be about \$35 billion below the optimum target which I have set forth above for 1963, about \$65 billion below for 1964, and about \$87 billion below for 1965. And by 1966, as depicted on my chart 10, total national production would be an estimated \$104 billion below maximum production, and full-time unemployment would be about 3.7 million above the level consistent with maximum employment, or about 6 million. The true level of unemployment might be about 8½ million.

Now, how much better off than this would we be by virtue of the tax proposals, if adopted? With respect to 1963, the President's report (p. xvi) says that the proposed tax program—assuming prompt enactment—would increase disposable personal income at an annual rate of about \$6 billion during the second half of the year. This would have a value of about \$3 billion for 1963 as a whole. Against this must be set off the increases in social security taxes which have recently gone into effect, and this would probably reduce the net disposable-income value of the proposed tax reduction to somewhere between \$1 and \$2 billion during 1963 as a whole. Then, the President's report (p. xvi) and the Council's report (p. 51) estimate that every dollar thus added directly to the flow of consumer income would, through the concomitant increase in consumer spending, and its indirect effects, result in close to twice that large an addition to GNP. I think that this may be a serious overestimate in view of the composition of the proposed tax reduction, which I shall discuss shortly. But in any event, even if this estimate is accepted, the proposed tax reduction would add somewhere between \$2 and \$4 billion to GNP in 1963. Moreover, the \$1 and \$2 billion increase in disposable income (which leads to the stated GNP result) would be substantially reduced by the upward movement of State and local taxes, and indirect taxes of various sorts.

In any event, the most generous estimate of the GNP impact of the proposed tax reductions in 1963 is a mere bagatelle, compared with the \$35 billion representing, as set forth above, my estimate of the difference between a proper GNP target for 1963 and the GNP which would actually result if policies were left about as they are now. And even this estimate of the difference assumes, for reasons stated above, close to a 3 percent growth rate in 1963, even without policy change. It is beyond my comprehension, how the Council of Economic Advisers estimates that, without the proposed tax reduction, there is real danger of an absolute recession in 1963, but that, with the picayune impact which the tax reduction would have on GNP, there is likelihood of a real 3½ percent growth rate in 1963.

Let us now move from 1963 to 1965. The President's report (p. xvi) and the Council's report (p. 51) state that the personal income tax reductions, when fully effectuated would as of 1965 have the effect of increasing disposable personal income by about \$8 billion at an annual rate, and that the additional consumer spending thus induced would (including the accelerator effects) increase GNP at an annual rate of about \$16 billion.

There again, no allowance is made for the countereffects of rising social security taxes, State and local taxes, and various indirect taxes.

Further, the estimate ignores analysis of the effect upon consumer spending of the composition of the proposed personal income tax reductions.

The President's report (p. xvi) says that "Americans as a whole regularly spend between 92 and 94 percent of the total after-tax (disposable income) they receive." But this comment neglects the vital point that families at different income levels spend for consumption different proportions of their incomes. At the bottom of the income structure, millions of families actually "dissave," which means that they spend more than their disposable incomes. A substantial proportion of our total population, beginning from the bottom of the income structure and moving upward, spend in the aggregate at least 100 percent of their disposable incomes, and a very large proportion spend in the aggregate nearly 100 percent. Correspondingly, families higher up in the income structure spend a smaller proportion of their incomes and save more for purposes of investment. My analysis of the composition of the proposed tax reduction, which I shall discuss shortly, makes me very dubious of the proposition that 92-94 percent of it will enter immediately into the consumer spending stream.

But even accepting the official estimate that, by 1965, the personal income tax reductions would have an annual GNP impact of about \$16 billion, this figure needs to be contrasted with the \$87 billion difference, set forth above, between needed GNP in 1965 and the estimate of where GNP would then be if our national economic policies remained about in status quo—that is, if the tax program were not put into effect.

Of course, the President's report (p. xvi) points out that the stimuli to investment which would be provided by the increased consumer demand, and by the direct concessions to investors also embodied in his tax proposals, must also be taken into account. He indicates, among other things, that each additional billion dollars of investment adds at least a billion dollars to spending for consumer goods, through "a derived chain reaction." But how much additional investment would actually be induced by the proposed tax program, in view of the overcapacity which is certain to persist if the stimulation of ultimate demand in the form of consumer outlays remains so woefully small, and if, as I shall indicate subsequently, the increase in ultimate demand through the increase of public outlays remains so woefully inadequate, is a matter which I shall discuss shortly.

And even assuming the most favorable impact of the tax program upon the investment process, and adding this to the President's own estimates of the direct impact of investment upon consumer spending, it is not surprising that so many others are so deeply concerned about the dangerous quantitative inadequacies of the proposed tax program.

To illustrate, on page 120 of *Business Week* of February 9, 1963, the following statement is made in an editorial which reflects the judgment of very careful and competent analysts, who are not predisposed toward wild deficit spending:

"The facts that the tax program, as it stands, will not do what President Kennedy himself has been talking about—remove the drag that an outdated tax structure has put upon the economy. The tax reductions it proposes are too small and too slow to give a substantial lift to production and employment for several years, if at all."

This comment by Business Week leads me to make still another point: The impact of the program in the first year 1963—the matter of timing—is even more important than its estimated projected impact when fully in effect in 1965. Obviously, if a patient needs an injection of 100 units now, the same result is not obtained by giving him 33 units now, a similar amount a year from now, and another similar amount 2 years from now. Thus, not only is the proposed tax treatment pitifully small as to 1963; in addition, its potentials are further diminished by spreading it over far too long a period of time.

*The Council's report does not even estimate the economic impact of the proposed tax program*

Although the Council estimates, as indicated above, the GNP impact of the proposed personal income tax reduction, this would be so inadequate that the Council relies largely upon the investment stimuli which the program would provide. But the Council does not really venture to quantify this meaningfully, and I believe that to do so would reveal the startling inadequacy of the tax proposals as a whole—when measured against needed production and employment targets which the Council does not quantify either.

Thus, the Council report says (p. 51):

“No one can pretend to estimate with precision the ultimate impact of a program so far reaching. \* \* \* Our study of the program, and our tentative projections based upon it do, however, convince us that the program measures up to the challenge that the 1960's present to our economy; that it will surely set us on a path toward our interim employment target; and that it will lay the foundation for more rapid longrun growth.”

Despite this expression of confidence, it should be noted that the Council admits that even the full tax program dose, over 3 years, will only set us on a path toward an interim employment target of 4 percent—which would not be maximum employment. So, as against the Council's early 1961 target of 4-percent unemployment by early 1963, we now have an admission that this is unlikely even by 1965. And when, under these circumstances, would maximum employment arrive?

THE INTERNAL COMPOSITION OF THE PROPOSED TAX PROGRAM IS HIGHLY INIMICAL TO SUSTAINED OR BALANCED ECONOMIC GROWTH

Other things being equal, tax reduction proposals, of pygmy size related to the need, might nonetheless be desirable as a starter, although I fear the long-range consequences of discrediting an appropriate medicine through its quantitatively deficient use. But I have an even more serious objection to the proposed tax program, on the ground that its internal composition, when viewed in its entirety, is based upon an entirely erroneous analysis of what our economic troubles have been and still are, with corresponding errors in the proposed remedy.

*A few theoretical observations*

On this score, I need now to make a few remarks in the area of theoretical economics, although usually I keep away from this. Theoretically, our deficient economic performance during the past decade cannot be explained on the grounds of an inadequate totality of pur-

chasing power, and/or the desire to use it on the part of consumers, investors, and governments. Theoretically, any given level of production generates enough purchasing power to take the product fully. Theoretically, a lower or higher level of total purchasing power, measured in dollars, would result in a lower or higher level of prices, but not much change in the physical performance of the economy. So what we have suffered from, during the past decade, has not been so much a deficiency in total purchasing power and/or the disposition to use it, but rather a maldistribution in the purchasing power and/or in the disposition to use it, which have thrown the economy out of balance by destroying the economic equilibrium. I shall shortly detail just how this has happened.

It follows that, in the contest of the current and foreseeable economic situation, changes in tax policies have very useful potentials, not mainly because they can add to the total of purchasing power by increasing the Federal deficit, but rather because they can help to improve the balance or relations among the various main components of purchasing power, and thus help to maintain a better economic equilibrium. Conversely, if the net long-range effect of the tax changes, based upon faulty diagnosis of the economic problem, results in maintenance or even worsening of the disequilibrating factors, the tax changes will tend to be in large part wasted, and in some substantial part even pernicious.

This is another way of saying, as was most commonly recognized some time back but which unfortunately so few are willing to affirm now, that our American economic problems are very largely problems of distribution, or problems of the allocation of resources at any particular time. A fiscal policy, including tax policy, is a prime instrument in dealing with this distributive or allocations problem. We recognized this during wartime; we need also to recognize it now, even though the criteria which apply in determining the workable distribution of income and the workable allocation of resources are different now from what they were in wartime.

#### *The utility of an equilibrium model*

To get substantively into this problem, let me now proceed further with my own economic analysis, as I have developed it over the years and tested it pragmatically against actual developments. What I have done is this: I have constructed a so-called equilibrium model at the beginning of each year, representing optimum economic performance. I have then compared this model with actual developments during the year, to test whether the actual developments refuted my model, or whether unfavorable consequences resulting from the differences between my equilibrium model and the actual performance tended to vindicate the model. Then, I have corrected the model from year to year. That the model has been reasonably sound is indicated, as I have already said, by the high degree of correctness of my forecasts and other estimates in years gone by, with many of which this committee is particularly familiar.

The methodology which I am describing is really the same thing as proper utilization of those provisions of the Employment Act of 1946 which call for the balanced projections of estimated needed levels of employment, production, and purchasing power, as a guide to

needed policies. Obviously, these needed levels must be broken down into meaningful components.

The series of charts which I shall now discuss set forth my results.

*How the investment-consumption imbalances have developed*

Chart 13 shows that a deficit rate of growth in private consumer spending has been quantitatively the dominant factor in our total GNP deficiencies or gaps. For fourth quarter 1962, for example, I estimate a consumer spending deficiency of more than \$58 billion, as part of the GNP deficiency of almost 80 billion.

My chart 14 shows, and this is very relevant to the tax problem, that the growing deficiencies in consumer spending have resulted primarily from inadequacies in consumer disposable incomes, rather than mainly from a propensity of consumers as a whole to spend too small a share of their disposable incomes and to save too large a share. Of course, as I have indicated, the distribution of disposable consumer income also affects the propensity to spend as against the tendency to save for purposes of investment. Thus, both the inadequacies in total consumer incomes, and the unsatisfactory distribution after taxes, have contributed to the periodic imbalances between consumption and investment which I shall now discuss.

It is true, as shown on chart 15, that gross private domestic investment, and particularly the investment in plant and equipment which expands our productive power, has been deficient on the average during the past decade as a whole. This is really a truism; in an economy growing only 2.7 percent a year when it should have grown more than 4 percent, almost everything has been deficient. But the crucial element in the analysis of investment is why this has happened. It has not happened because profits and other incentives to investments, or other funds available for investment, were deficient during the upturn or boom periods. Nor has it happened because the tax structure bore down too heavily upon investment. As the bottom half of my chart 15 shows clearly, in each of the major upturn periods, including the current upturn period, investment in plant and equipment rushed forward very much more rapidly than total demand for ultimate products in the form of private consumer outlays plus total public outlays at all levels. Only when this process resulted in severe overcapacity was investment cut back sharply. Then, these investment cutbacks, combined with the more enduring deficiencies in the demand for ultimate products, led to stagnation and then recession, with the profit squeeze associated with these conditions. It follows that it is entirely inappropriate to look backward after the event, in analyzing investment trends, thus reaching the oversimplified conclusion that investment and profits have averaged too low, instead of applying a more dynamic analysis to how these things actually happened, as a basis for corrective action.

My chart 16 presents some additional data with respect to the relative fluctuations in gross national product and in various types of domestic investment. I have included the capital expenditures of railroads, because later on I want to discuss the transportation problem—as well as the housing problem—as these bear upon the whole issue of appropriate economic policies.

Chart 17 shows how rising prices and profits fed the boom in investment in plant and equipment prior to the 1957-58 recession—a boom

which was inordinately out of line with the much lower growth in ultimate demand which I have already depicted.

Chart 18 shows how an inordinate or nonsustainable investment boom in plant and equipment occurred again before the 1960-61 recession, despite substantially reduced prices and profits—albeit from levels that were too high. This reinforces my position that the main conditioning factor bearing upon the trends in this type of investment are not the trends in prices and profits so much as the investor appraisal with respect to current and prospective levels of demand for the products which their plants turn out. In short, under any recent or foreseeable circumstances, our investors in the main do not confront a situation where their investments are held back by anything basic except inadequate demand for ultimate products.

Chart 19 makes the same type of demonstration during the most upturn period for which adequate data are available, from the first quarter of 1961 through the third quarter of 1962. This chart teaches the same lesson in a different way, namely, that even enormously rising profits after taxes—enjoyed despite stable or declining prices—do not induce corresponding investment enthusiasm, in view of very serious plant overcapacity and the unlikelihood of enough expansion of ultimate demand to take up the slack.

#### *Significant current data in re profits and other financial factors*

Chart 20 indicates how high and rewarding profits after taxes now are in most of our key industries, despite very large unused capacities. Similarly, chart 21 indicates the very satisfactory current nature of profit-sales ratios, indicating that the only real problem is more volume rather than higher profit margins after taxes, or tax reduction pointed toward this result. Chart 22, which also has an important bearing upon funds available for investment purposes, reflects the very extraordinary tendency of American corporations, during the past decade, to finance larger and larger portions of their total fund requirements out of sources representing the combination of depreciation and amortization and retained profits and depletion allowances.

#### *Wage aspects of the investment-consumption problem*

There are still other ways of demonstrating that the heart of our economic problem has been the tendency of investment in the means of production to outrun the demand for ultimate products, and thus to bring on stagnation and recession. A very important aspect of the tendency of consumer incomes and outlays to lag behind the growth in our productive powers is dealt with in chart 23. Here it is shown that the average annual growth in wages and salaries during the 10-year period 1953-63 as a whole has only been 3 percent, contrasted with a needed average growth rate of about 5 percent which would have been consistent with my equilibrium model for sustained optimum economic growth. The chart also shows that, by fourth quarter 1962, a deficiency in wages and salaries at an annual rate of about \$60 billion (seasonally adjusted) was by far the major segment in the deficiency in total consumer incomes before taxes running at an annual rate of more than \$74 billion, and squaring with the deficiency in total consumer outlays running at an annual rate of more than \$58 billion, allowing for taxes and savings.

Because wages are so large a factor in the total consumption picture, and because I attach such prime importance to the investment-



consumption relationship, it is useful also to compare the trends in wages with the trends in profits and in investment. As shown by chart 24, during the period leading up to the 1957-58 recession, both profits after taxes and investment in plant and equipment far outran wage rate increases, and the contrast between the investment trends and the wage rate trends were very extreme. They were so extreme as to make it very clear why this type of investment during this period grew so much faster than aggregate wages and total consumer incomes and spending, even after proper allowance is made for the fact that, with some increase in employment, total wages would grow more than the advance in wage rates alone would provide.

Chart 25, dealing with the period leading up to the 1960-61 recession, shows again how investment in plant and equipment advanced enormously more rapidly than wage rates. This happened despite some reduction in profit levels, indicating again that no inadequacy of profits after taxes has served as a barrier to very ebullient investment when business judgment was optimistic with respect to the trends in demand for ultimate products.

Chart 26, dealing with the current economic upturn, again shows investment in plant and equipment advancing in general much more rapidly than wage rates, although the contrast is not so vivid as in the earlier periods just reviewed, because of the increasing awareness of overcapacity. The chart also shows profits after taxes advancing tremendously more rapidly than wage rates, and also advancing tremendously more rapidly than investment. This demonstrates once again that even very handsome profits after taxes do not stimulate investment much, in the face of large overcapacity which has become more clearly chronic.

#### *Summary of major causes of the chronic disequilibrium*

The purpose of this lengthy analysis is to bring to the front the central and dominating explanation of our poor economic performance during the past decade. It has not been due to a tax system which has borne down too heavily upon investments or profits. Despite the actual tax burden, investments and profits have risen too rapidly, relative to the other sectors of the economy, whenever the economy has been moving substantially forward. The slowdowns or cutbacks in the investment process have come only when large overcapacity resulted from the inadequacies in ultimate demand, composed both of private consumer demand and public outlays at all levels. It has been only when this fundamental difficulty has become abundantly apparent, that investment has been cut back, unemployment consequently increased, and some "profits squeezes" suffered.

The whole analysis also shows that the relationship between wage costs and prices has never yielded too low a margin of profit per unit of production and sales. Indeed, this margin in general has tended to be too high, thus refuting the thesis that price increases have been necessary in view of wage rate increases. When aggregate profits have been "squeezed" or unduly reduced, it is only because of the periods of stagnation or recession, resulting from the disequilibriums in the economy of the kind which I have indicated, and excessively high profit margins after taxes have been a factor in this disequilibrium.

*Public policies contributing to the disequilibrium*

Many public policies during the past decade, have contributed to this disequilibrium. The tax policy has done so, not by placing too heavy a burden upon profits and investments, but rather by being too regressive in its impact, and thereby contributing to the maldistribution in income flow. Even the tax reductions of 1948 and 1954, while providing some temporary stimuli, have contributed to the regressive trends. And I believe that the Council of Economic Advisers neglects this entirely, in its review of fiscal policy. If the Council, instead of looking at fiscal policy in isolation, and measuring only its direct quantitative implications in the aggregate, had set its review of fiscal policy in the framework of the kind of analysis of the whole economy in operation which the Employment Act of 1946 calls for, I believe that the Council would have reached conclusions more similar to mine.

In addition to tax policy, many other public policies contributed to the poor economic performance during the past decade. These included the various bonanza concessions to stimulate business investment by more liberal amortization or depreciation allowances; the regressive impact of the tight money policy with rising interest rates; the excessively tight Federal budget, especially on the outlays side; the relative neglect of programs designed to expand private consumption, such as social security, minimum wage improvement, and housing and welfare programs. The whole difficulty, in short, may be summed up in the proposition that relatively too much emphasis was placed upon helping investment and profits directly, and not nearly enough emphasis was placed upon the expansion of private consumption and public demand for needed goods and services which cannot be privately supplied.

*We are now in danger of perpetuating the undesirable public policies*

It might have been anticipated that, viewing this 10 years of experience, the economic program now put forward by the President and by the Council of Economic Advisers, and especially the tax program, would have sought vigorously to correct this basic and profound chronic disequilibrium, which is manifest in the economy even today, as some of my charts have demonstrated. And if one were to rely only upon what the reports of the President and of the Council say, one would be led to believe that this desirable reconstruction of policy is taking place. For example, the President's report says (p. xvii) that " \* \* \* the most important single thing we can do to stimulate investment in today's economy is to raise consumption by major reduction of individual income tax returns." The Council's report states (pp. 15-17) that the biggest error in the Council's forecast for 1962, made at the beginning of that year, was with respect to business investment, and that the disappointing performance of business investment was due to inadequate demand. Apparently responsive to this statement, the Council's report states (p. 44) that "the largest part of the total reduction (in taxes) will be received by the lower and middle income groups of taxpayers." And on page 31 of the Council's report, it is pointed out that since 1957, in contrast with earlier years, corporate investment has not kept pace with gross

returned earnings, which is an admission that investment has not been inhibited by inadequate profits nor by excessive tax burdens.

But other parts of the two reports move in the opposite direction. Thus the President's report (p. 17) says this:

"In recent years, business as a whole has not been starved for financial accommodation. But global totals mask the fact that thousands of small or rapidly growing businesses are handicapped by shortages of investment funds. As the total impact of the tax program takes hold and generates pressures on existing capacity, more and more companies will find the lower taxes a welcome source of finance for plant expansion."

This statement seems to me correct in pointing to the special tax problems of small business, which I feel should receive more attention. But this, in my view, is no justification for pouring out billions of dollars in tax-concession bonanzas to businesses of all sizes which do not need them. And while the President's statement is correct in implying that business in recent years has not been starved for financial accommodation, which implies that the tax concession bonanzas will not do much good so long as there is so much excess capacity, the statement seems wrong in implying that these tax bonanzas will be needed to stimulate investment when there is more pressure on existing capacity. For almost all experience shows that, when there is real pressure on existing capacity, profits and investments under the now existing tax laws have moved far ahead of ultimate demand, and under such conditions should be relatively restrained, instead of being encouraged to get still further out of line by wasteful tax concessions.

Similarly, it appears to me that the Council of Economic Advisers is in error, when it urges once again (p. 62 of its report) the desirability of attaining a higher ratio of private investment to GNP than during the past 5 years, in order to attain a growth in potential output at an annual rate of about 4 percent. In support of this proposition, the Council Report (p. 29) points out that business fixed investment averaged a higher ratio to GNP during 1949-57 than during 1957-60.

In the first place, even if it is assumed that the ratio of private investment to GNP has been too low in most recent years, this would be expected during a period of very low economic growth. But as I have already shown, the forces which have repressed investment unduly during this period have not been burdensome taxes nor inadequate profit margins after taxes, but rather the high overcapacity and the large and dominant deficiency in demand for ultimate products.

In the second place, the idea of the Council that a higher average annual overall growth rate than 3.5 percent requires a higher ratio of investment to GNP than a 3.5 percent growth rate would require is also erroneous. The appropriate (i.e., sustainable) ratio of investment to GNP is not determined by the desired rate of GNP growth in an economy like the United States, but is determined by the ratio which will keep the expansion of production and the expansion of ultimate demands in equilibrium. If we want to accelerate the rate of overall economic growth, or our potentials toward this end, we need to take

measures accordingly, but these would not change the sustainable ratio of investment to GNP. In view of the increased productivity of capital, which means that each dollar of new investment tends to add more to the output potential than it used to, we may well need a lower ratio of investment to GNP than was averaged during other periods of optimum total resource use. The Council makes no satisfactory analysis, empirical or otherwise, of this whole problem.

Third, the ratio of investment to GNP during 1949-57 was governed by many factors, including the deliberate rapid build up of the investment base during the Korean war, which cannot be accepted without analysis for now or the foreseeable future.

Fourth, advocating a higher ratio of investment to GNP, when now and for the foreseeable future we are confronted with the challenge of large unused plant capacity, is manifestly erroneous, in that it would accentuate the disequilibria which have existed for many years and still exist.

*The severely disequilibrating factors built into the proposed tax program*

In my analysis of how further disequilibrating factors are built into the structure of the proposed tax program as a whole, I shall first consider this program including the "reform" elements in it, and then look at the tax reduction program without including these "reforms." Both of these two approaches are essential.

First of all, the tax concessions granted to investors in 1962, by legislative and administrative action, must be taken into account. These have an annual value in excess of \$2 billion per year, according to the President's Economic Report (p. xvii). Second, the reduction of the corporate tax rate from 52 to 47 percent would in itself (taking account of proposed structural changes or "reforms") decrease corporate tax liability by about \$1 billion at an annual rate. So these steps, taken alone, would decrease corporate tax liability in the neighborhood of \$3 billion, annual rate.

It is much more difficult to evaluate the relative impact which the proposed personal income tax reductions would have upon saving and investment, and consumption, respectively. It is too bad that the Council of Economic Advisers does not attempt to shed real light upon this profoundly important question. In a table on page 46 of its report, the Council indicates that, in recent years, consumers have tended to spend between 92 and 94 percent of their disposable income. This implies that only about 6 to 8 percent of the proposed personal tax reductions would go into saving and investment. But this implication may well be very misleading, by not taking account of the distribution of the proposed personal income tax reductions, for (as I have said) high income families save much more than 6 to 8 percent of their disposable incomes, while millions of families save nothing.

I have therefore attempted to prepare table 1, which may shed some light upon how the proposed personal income tax reductions would be used. The top half of this table assumes enactment of the proposed "reforms." On this assumption, the table indicates that, out of a total personal income tax reduction of about \$8.6 billion, more than 36

percent, or about \$3 billion, would go to families with incomes from \$10,000 up—and these families constitute only about one-fifth of the total multiple-person families in the United States. There is no way of estimating with any accuracy what proportion of this \$3 billion would increase immediate consumer outlays, and what proportion would be saved or invested. But if one credits most of this \$3 billion to consumer spending side, the appropriate question is what considerations of equity or social justice permit allocating a \$3 billion increase in consumer spending and living standards to the one-fifth of our families at the top of the income structure, and only about \$5½ billion to the four-fifths of our families who are lower down in the income structure. I shall have more to say about this, when I discuss in more detail the separate question of equity and social justice.

Therefore, if there is any justification for allocating \$3 billion of the proposed personal income tax reduction to the one-fifth of the families at the top, it must be on the ground that a large part of this amount will help to activate savings and investment. Let us then say that \$2 billion of this \$3 billion would move in that direction. Adding this \$2 billion to the \$3 billion representing the tax concessions to corporations granted in 1962 and the reductions in corporate tax rates now proposed (after offsetting “reforms”), one arrives at a total of \$5 billion allocated to the investment function, as against about \$6½ billion allocated to the consumption function.

The second half of the same table 1 looks at the proposed personal income tax reductions without taking account of the proposed “reforms.” This may indeed be the more reasonable method, because there is very strong sentiment for enacting the proposed tax reductions before the proposed “reforms.” And there is doubt as to how much of the “reform” program will ever be adopted. Beyond this, it seems that some parts of the “reform” program are just as regressive as many parts of the tax reduction program, but the “reform” program is so bewilderingly complex that I have not yet had time to analyze its significance in detail.

Putting aside the “reforms,” the second half of my table 1 shows that more than 45 percent of the proposed \$11 billion personal income tax reduction would flow to the one-fifth of the families at the top of the income structure (for example, incomes of \$10,000 and over), coming to about \$5 billion. Let us assume, for reasons that I have already stated, that about \$3½ billion of this would be allocated to the investment function. Add to this figure the approximately \$4½ billion (annual value) of the tax concessions to investors granted in 1962 and those proposed in the new tax program (before taking account of structural changes or “reforms”). This results in a total of \$8 billion allocated to the investment function, as against only \$7½ billion to the consumption function (for example, \$1½ billion to the above \$10,000 families, and \$6 billion to those lower down).

The President’s tax message indicates that the net effect of personal tax reductions (in 1965) would total \$8,600 million and have the following incidence:

Table 1

[Dollars in millions]

(1) Adjusted gross income level	(2) Present tax	(3) Proposed tax <sup>1</sup>	(4) Difference		(5) Difference	
			Amount	Percent of total	Cumulative percent	Complementary percent
0 to \$3,000.....	\$1,450	\$890	-\$560	6.5	6.5	100.0
\$3,000 to \$5,000.....	4,030	2,900	-1,130	13.1	19.7	93.5
\$5,000 to \$10,000.....	18,300	14,510	-3,790	44.1	63.7	80.3
\$10,000 to \$20,000.....	12,710	10,790	-1,920	22.3	86.0	36.3
\$20,000 to \$50,000.....	6,760	5,940	-820	9.5	95.6	14.0
\$50,000 and over.....	4,170	3,790	-380	4.4	100.0	4.4
Total.....	47,420	38,820	-8,600	100.0		

<sup>1</sup> A slight change in the standard deduction for low-income families, as proposed by Dillon on Feb. 6, 1963, would reduce slightly the amounts of the proposed tax for some incomes below \$5,000. At higher levels the effect would be nominal except for large families with incomes below \$7,500.

Considering only the effects of the proposed cuts in rate (and not the proposed changes in rules) the total is \$11,040 million having the following incidence:

[Dollars in millions]

(1) Adjusted gross income level	(2) Present tax	(3) Proposed tax <sup>1</sup>	(4) Difference		(5) Difference	
			Amount	Percent of total	Cumulative percent	Complementary percent
0 to \$3,000.....	\$1,450	\$1,040	-\$410	3.7	3.7	100.0
\$3,000 to \$5,000.....	4,030	2,940	-1,090	9.9	13.6	96.3
\$5,000 to \$10,000.....	18,300	13,780	-4,520	40.9	54.5	86.4
\$10,000 to \$20,000.....	12,710	10,020	-2,690	24.4	78.9	45.5
\$20,000 to \$50,000.....	6,760	5,350	-1,410	12.8	91.7	21.1
\$50,000 and over.....	4,170	3,250	-920	8.3	100.0	8.3
Total.....	47,420	36,380	-11,040	100.0		

<sup>1</sup> A slight change in the standard deduction for low-income families, as proposed by Dillon on Feb. 6, 1963, would reduce slightly the amounts of the proposed tax for some incomes below \$5,000. At higher levels the effect would be nominal except for large families with incomes below \$7,500.

The conclusions which I draw from the foregoing analysis is that the proposed composition of the tax changes, personal and corporate combined, are in thorough defiance of the lesson which we should draw from careful analysis of the past decade. Such a pattern of tax change, in my view, might provide some temporary fanning up of the rate of economic activity, substantive and psychological. But in the longer run, the disequilibriums which this pattern of tax change would maintain or even augment would offer no large prospect of improvement in our long-term growth rate. In short, the proposed program is regressive in its overall economic impact, and that is not what our economy needs.

Correspondingly, the proposed tax program involves billions of dollars of wasteful giveaways, in the form of tax subsidies to those who have no need for them, or whose need for them is infinitely less than those who are being relatively starved. I pointed out at the outset why a large and deliberate increase in the Federal deficit is a subsidy operation; such subsidies are justified only when they comport with a clear and defensible economic purpose.

*The proposed tax program is socially unjust and highly inequitable*

Having concluded my discussion of the proposed pattern of tax changes, from the viewpoint of their impact upon the overall economy, I now turn to an evaluation of these proposed tax changes in terms of equity and social justice. Of course, there are some who say that, in our so-called affluent society, equity and social justice have become of secondary consideration, and that, in any event, the overriding purpose of improving our overall economic performance should take precedence. I agree with none of this, because too many among us are not affluent, and because we are already rich enough as a Nation to afford to be just. But I need not dwell upon this, because the highly undesirable pattern of the proposed tax changes from the viewpoint of overall economic considerations leaves us plenty of room to go into the question of equity and social justice.

*The extremely regressive nature of the proposed personal tax reductions*

Unfortunately, a good deal of propaganda has created the impression that the proposed personal income tax reductions would be highly progressive in their effects. The method used in arriving at this incorrect conclusion is to point out that, measured as a percentage of taxes actually paid, the lower income people would receive more tax reduction than the higher income people. For example, as shown on my table 2, under the proposed tax reduction program, the \$3,000-a-year family would receive a 100-percent reduction in taxes paid, the \$5,000 family a 33.3-percent reduction, and the \$200,000 family only a 17.5-percent reduction. These computations do not take account of the reform proposals, but many of the proposed reforms are unlikely of enactment, and some of them would be regressive rather than progressive in their impact. Further, I submit that tax reduction should come before reform. In any event, my analysis indicates the error in the ways of those who, even without taking account of the reforms, insist that the tax reduction proposals themselves are progressive rather than regressive.

This error resides in the fact that the ultimate matter is not the percentage decrease in taxes paid, but the percentage of increase in disposable income by virtue of the tax reduction. It is the increase in disposable income which affects the family, and it is the increase in disposable income which is available for entry into the spending stream by way of stimulating the overall economy. And as my table 2 shows, the proposed personal income tax reductions would result in extremely regressive increases in disposable income, measured properly on a percentage basis. The \$3,000 family would obtain only a 2-percent increase in disposable income; the \$5,000 family a 3.1-percent increase; the \$10,000 family a 3.5-percent increase; the \$50,000 family a 6.3-percent increase, the \$100,000 family a 11.2-percent increase, and the \$200,000 family a 23.8-percent increase.

TABLE 2.—President's proposed tax structure in 1965 compared with present structure (1962), at various tax levels (for married couple with 2 children)

(1) Taxable income level	(2) Present tax <sup>1</sup>	(3) Present income after tax	(4) Proposed tax <sup>2</sup>	(5) Proposed income after tax	(6) Percent tax reduction	(7) Percent increase in after-tax income	(8) Percent tax to income	
							Present	Proposed
\$3,000.....	\$60	\$2,940	0	\$3,000	100.0	2.0	2.0	0
\$5,000.....	420	4,580	\$280	4,720	33.3	3.1	8.4	5.6
\$7,500.....	377	6,623	663	6,837	24.4	3.2	11.7	8.8
\$10,000.....	1,372	8,628	1,068	8,932	22.2	3.5	13.7	10.7
\$15,000.....	2,486	12,514	2,076	12,924	16.5	3.3	16.6	13.8
\$25,000.....	5,318	19,682	4,605	20,395	13.4	3.6	21.3	18.4
\$35,000.....	9,037	25,963	7,814	27,186	13.5	4.7	25.8	22.3
\$50,000.....	15,976	34,024	13,837	36,163	13.4	6.3	32.0	27.7
\$100,000.....	44,724	55,276	38,542	61,458	13.8	11.2	44.7	38.5
\$200,000.....	115,224	84,776	95,072	104,928	17.5	23.8	57.6	47.5

<sup>1</sup> Assuming 10-percent deduction for taxes, interest, contributions, medical, etc.

<sup>2</sup> Assuming President's proposal, as revised by Dillon's testimony, of \$400 minimum deduction for married couple and \$100 for each child; 10 percent for incomes between \$6,000 and \$10,000; \$1,000 flat deduction between \$10,000 and \$20,000; and 5-percent deduction for \$20,000 and up.

Actual slight deviations from these workable assumption would not in the slightest change the general import of the analysis.

*We must find other ways to help the low income people*

Of course, I recognize that, if there is to be any across-the-board tax reduction, the people higher up in the income scale must receive larger dollar increases in their disposable incomes than the people lower down. But why should they receive larger percentage increases in disposable incomes? What social or equitable consideration can possibly support the conclusion that the Government, through deliberately enlarging the Federal deficit, should subsidize a 23.8 percent increase in the disposable income of the \$200,000 family, while the \$3,000 family with an income only about half of that required to maintain a decent standard of living receives only a 2 percent increase in disposable income?

I know that some of the mathematicians and technicians will point out that it is impossible to give the low-income family as big a percentage increase in disposable income as the high-income family, because the disposable income of the low-income family is not increased much even if its tax is wiped out entirely. I admit the mathematics. But what this demonstration really shows is that we need other programs far more than we need this kind of tax reduction program.

If this kind of tax reduction program, by the very nature of its mathematics, produces such huge subsidies to those who need no more than they now have, and so utterly neglects millions who need so much more than they now have, then the Government should turn more largely to programs other than tax reduction which do what ought to be done, instead of doing what is entirely indefensible.

A few billion dollars less in tax reduction for the one-fifth of the families above \$10,000, and a few billion dollars more of programs other than tax reductions, which would improve the distribution of income and help those at the bottom to come closer to an American standard of living, would be infinitely more desirable, not only by the test of equity and social justice, but also by the test of what would be good for the overall economy. For it is manifestly clear that a tax



reduction program which adds a larger percentage increase to the disposable incomes of those at the top than to the disposable incomes of those at the bottom will actually worsen and make more regressive the distribution of disposable income now in effect. And this is not what we need.

Many competent authorities have recently pointed out that the distribution of income in the United States has been worsening in recent years. Most of these studies deal with income before taxes. Despite the so-called progressive nature of the Federal income tax structure, there are many who believe that the distribution of disposable income is even more unsatisfactory than the distribution of income before taxes. This is due to the impact, not only of State and local direct taxes, but especially of sales taxes and other taxes which seldom enter into the analysis of income distribution. And as these types of regressive taxes are now trending substantially upward, this in itself is another powerful reason why we should be very careful in what respects we alter the Federal tax structure.

It is noteworthy that, on various occasions, the President and the Council of Economic Advisers have indicated that the proposed tax program will leave more room for the collection of more taxes at other levels of government. For the reasons I have just given, the invitation to this shift is very undesirable. Parenthetically at this point, it seems that the invitation to this shift is inconsistent with the avowed purpose of the proposed tax reductions to stimulate the overall economy by adding to the consumer spending stream.

*Some data on current income distribution*

Let us look for a moment, in this connection, at the current distribution of income in the United States. My chart 27 shows that, in 1960, 10.4 million American multiple-person families lived in poverty. These families constituted almost a quarter of all U.S. multiple-person families, but received only 7½ percent of the total income of all U.S. families. About 4 million unattached individuals also lived in poverty. These were almost 37 percent of all U.S. unattached individuals, but received only 11.7 percent of the total income of all unattached individuals.

On top of this, my chart 28 shows that, in 1960, in addition to those living in poverty, almost 23 percent of all U.S. multiple-person families lived in deprivation in varying degrees, but their income was less than 15 percent. The chart also shows that the multiple-person families who enjoy affluence or something still better, with incomes of \$15,000 and over, were only 7.3 percent of all U.S. multiple-person families in 1960, but enjoyed almost 24 percent of total multiple-person family income.

The basis of my income classifications are explained fully in a recent publication prepared under my direction, entitled "Poverty and Deprivation in the United States."

The complete unwillingness of the Council of Economic Advisers, apparently, to relate this problem of income distribution in the United States to overall economic analysis disturbs me greatly. Without going deeply into this matter, it is, in my view impossible to develop either an economically sound or a socially just economic program, and this comment certainly applied to fiscal policy and to tax policy. I do note that the Report of the Council (p. xvi) says that "a reduction of corporate taxes would provide a further increment to the

flow of household incomes as dividends are enlarged." I wish that the Council would make a study of the prospective distribution to families at various income levels of the increased dividends which would flow from the proposed reduction of corporate taxes.

THE TAX PROPOSALS INVOLVE GROSS NEGLECT OF OTHER EQUALLY OR EVEN MORE IMPORTANT PROGRAMS

I have already implied that our economic and social needs both call for not only a different kind of tax reduction but many other programs besides tax reduction. I have already made it clear why these other programs are the only practical way to improve the lot of those other millions who are low down in the income structure. I will not elaborate this point further, but turn instead to why programs other than tax reduction are needed to improve our overall economic performance. And when these programs are properly identified, it will also be clear that they are needed from the social perspective of helping those who need help most.

*Dollar for dollar, increased public outlays are more stimulatory than tax reduction*

First of all in this connection, the report of the Council of Economic Advisers (pp. 73-74), says this: "A cut in expenditures reduces market demand directly by the full amount of the cut, while an equal reduction in taxes expands market demand by a smaller amount, because a part of the reduction will be added to personal and business saving."

This statement is, of course, correct. But it is then equally true that an increase in Government expenditures expands demand directly by the full amount of the increase, while equal reduction in taxes does considerably less.

*Tax reduction cannot powerfully restructure the composition of demand, and therefore cannot powerfully meet the challenge of the new technology and automation*

But there are more important reasons than this as to why other programs besides tax reduction are needed. The Council of Economic Advisers is indeed correct when it says (p. 25 of its Report) that "the source of the high unemployment rates in recent years, even in periods of cyclical expansion, lies not in labor market imbalance but in the markets for goods and services." This would be a good reason for placing relatively less weight upon labor training and retraining programs, and much more weight upon expanding market demand than the proposed program does.

But insisting properly that the main difficulty is not in the structure of the labor force is quite consistent with recognizing—as the Council's Report gives no sufficient signs of doing—that a very important problem is the structure of ultimate demand. The trends in automation and technology in most of our key mass-production industries, and the likely consumer demand for their products even in a fully operating economy, are such that there is relatively little opportunity for vast expansion of employment in most of these industries. This is well illustrated by the fact that the automobile industry has recently increased production very far above the 1955 level, but with several hundred thousand fewer workers.

Thus, the only way to absorb fully the unemployed and the new entrants into the labor force, especially with technology and automation advancing at an accelerating pace, is to restructure the nature of private investment so that much more of it will flow, both absolutely and relatively, into those areas where our needs are so great now and for the years ahead that not even the rate of technological change will stand in the way of vast expansion of employment.

#### *The key importance of housing*

By far the most important of these opportunities is in the field of housing and urban renewal, which provides immense opportunity for the expansion of private investment, and also provides an unusually high ratio between each dollar invested in housing and urban renewal and other dollars of private investment stimulated thereby. As shown on my chart 12, in accord with my equilibrium "model" for economic restoration, residential nonfarm construction alone should advance \$4 billion above the 1962 level in 1963, and \$8 billion above the 1962 level in 1964. Yet the report of the Council (p. 33) says that the outlook for home construction in 1963 is approximate maintenance of the 1962 level, and this the Council regards as favorable. The same sentiment appears in the President's Report (p. xii).

#### *The key problem of mass transportation, especially the railroads*

Next to housing, the greatest opportunity for the expansion of private investment and employment is probably in the area of the improvement and expansion of our mass transportation facilities. I have given a good deal of attention to this problem recently, in the course of studies of the railroad industry. The U.S. railroads as a whole, during the past decade, have budgeted their services, facilities, and employment seriously downward. While this has been compatible in the main with the actual requirements of an American economy moving forward at half speed—although, even under these general economic conditions, the railroads have increasingly deprived many communities, shipper, and passengers, of adequate service—it is nonetheless true that our total railroad services, facilities, and employment are very far short of what we would now require if our economy as a whole were performing adequately.

Moreover, the proposals for massive railroad mergers, such as in the Pennsylvania-New York Central case, evince an absolute clear intent to budget services, facilities, and employment much further downward, which would bring them even further short of our requirements for overall economic growth. And, of course, there is an interacting process here. For the very fact that industries as important as the railroad industry discount our potentials for economic growth, and the very decisions which flow from this discount, militate against the growth itself.

In a more general sense, the further suppression of genuine competition, embedded in these great railroad merger proposals, and their adherence to high returns per unit of traffic, rather than any commitment to an expansion of volume, are in themselves a vital case study of what is going wrong with so much of the American economy.

To be sure, the President's Report (p. xii) refers very briefly to "new problems requiring urgent attention in the field of transportation," and refers also to the recommendations contained in his "Transportation Message" to the Congress, April 1962.

But utilization of the opportunity to expand investment and employment through needed improvements in transportation, just as the utilization of the opportunity to expand housing and urban renewal, cannot come mainly in the form of the proposed tax changes. Insofar as these tax changes are translated into more consumer spending, this will be largely irrelevant to the actions needed for sufficiently vast expansion of these two great areas. And even insofar as the proposed tax reductions flow into more investment, this too would be in the more conventional areas, rather than in these two great areas which require very different kinds of investment inducements.

Approximate expansion of housing and urban renewal, and of mass transportation, require stimulation of new types of venture capital, which in turn requires public policies reducing the cost of money and the rate of interest. Especially as to housing and urban renewal, these expansions require not only Federal legislation toward this end, but also new admixtures of private and public effort, which necessarily involves large increases in Federal public outlays. These large increases in Federal public outlays are also needed to develop a high enough rate of expansion in the construction of decent housing for low-income families, which is an indispensable element in the adequate expansion of our total housing efforts.

*The proposed tax program cannot help very much to meet our urgent education and health needs*

The changing structure of demand, essential to economic restoration, requires also that a much larger part of the labor force be drawn into a wide variety of service occupations, especially education and health services. These, in turn, require not only more personnel, but also more facilities. None of this will be appreciably accelerated by the kinds of tax reduction now under consideration. Such acceleration would require, on a long-range basis, an admixture of private and public efforts, and, at the very core of this, vast and progressive increase in Federal public outlays.

An "Economic Report" by the President, and especially a report by the Council of Economic Advisers, which discusses the problem of economic growth without any penetrating analysis of these structural problems, and with a deep silence regarding the economics of the expenditures as distinguished from the tax side of the fiscal picture, leaves much to be desired.

*Estimate of needed increases in Federal budget outlays for domestic priority purposes*

By way of illustration, my chart 29 attempts to depict, within the perspective of an equilibrium model, the needed trends in the expenditure side of the Federal budget in the years immediately ahead. It indicates the need for a level of Federal outlays in fiscal 1964 about \$3 billion above the level proposed in the President's "Budget Message," and a level by calendar year 1966 of more than \$16 billion above the level proposed in this "Budget Message."

Chart 30 portrays these needs, apportioning them among the main priorities of purpose, both on a per capita basis and measured as percentages of total national production under conditions of optimum performance. In the field of education, for example, the goal set forth on the chart would involve Federal outlays of \$10.15 per capita

in fiscal 1964, contrasted with only \$7.80 per capita as set forth in the President's fiscal 1964 budget. In the field of housing and community development, the President's proposals for fiscal 1964 come to \$1.40 per capita, while the needed goal indicated on my chart is \$5.07 per capita. These contrasts indicate how far we are falling short, in my view, of any realization of the magnitude of the efforts which we must commence in those fields which are most relevant to the whole problem of economic growth and the real unmet needs of our people.

Yet I would point out, as indicated on my chart 29, that total Federal outlays under my proposals (allowing for my suggested tax changes) would decline over the years as a percentage of our total national production if we achieve the optimum production which such outlays would help us to achieve, and that the national debt as a percentage of our total national production would decline very substantially.

*The reports commit us, for some years ahead, to further neglect of our great domestic priorities*

In contrast to these clear needs as I see them, the President's report (p. xviii) calls for "the careful pruning of civilian expenditures for fiscal 1964—those other than for defense, space and debt service—to levels below fiscal 1963." Allowing for population growth, the cutback would be even greater. Particularly when we recognize realistically that the President is committed himself to this expenditure policy not only for fiscal 1964 but for several years ahead, I find all of this very hard to reconcile with the stirring and valiant cries of so many distinguished economists and other leaders on behalf of our relatively starved domestic public services. I find it hard to reconcile it with the eloquent statements of the Council of Economic Advisers, at least on earlier occasions, bearing upon the foundational importance of these domestic public services in promoting economic growth.

Some of the best arguments against this expenditure policy are contained in the very reports which embrace the policy. On page xxi of his report, the President says that "the total of State and local government expenditures has expanded 243 percent since 1948—in contrast to 166 percent for the Federal Government; their debts by 334 percent—in contrast to 18 percent for the Federal Government."

On page xviii of his report, the President states that "the gross debt itself as a proportion of our total GNP has also fallen steadily—from 123 percent in 1946 to 55 percent last year. Under the budgetary changes scheduled this year and next these ratios will continue to decline." On the same page in his report, the President points out that, since the end of 1946, the Federal debt held by the public has risen \$12 billion, while net State-local debt has risen by \$58 billion, net corporate debt by \$237 billion, and net total private debt by \$518 billion."

I cannot see very much value in the learned discussion by the Council of Economic Advisers, bearing upon the relationships between various types of private and public debts, when it does not lead the Council to the conclusion that, taking into account the foregoing figures as cited by the President, the new expenditure policy means most clearly that we shall not meet our national needs.

This has been happening for much too long already, as shown by chart 31. While the declines in national security and international outlays per capita have been sharp, comparing 1962 with 1954, not enough of this decline has been transferred into per capita increases in domestic outlays. Thus, total budget outlays per capita have fallen from about \$514 in 1954 to about \$472 in 1962.

#### THE UPSIDE-DOWN APPROACH TO THE WAGE PROBLEM

All economists must certainly understand the function of wages in our economy. As a business cost, they should not be so high as to force up prices. And as by far the most important single factor in consumer incomes, they must be high enough in the aggregate to make their proper contribution to an adequately growing level of consumer income and expenditures, without being so high as to generate demand inflation. The general formula that wage rate increases should be kept in line with productivity gains is merely a convenient though not perfect measuring rod, in helping to determine whether wage trends are neither deficient nor excessive.

*Productivity is advancing much more rapidly than wage rate increases*

The preoccupation of the Council of Economic Advisers, and, at least partly in response to their advice, the preoccupation of the President, with preventing wages from moving too fast, to the complete neglect of the problem of helping them not to move too slowly, is almost inexplicable. And it is doubly so when, in view of the limited utilization of fiscal policy, relative to the size of our economic problems, we are committed fundamentally and predominantly to the expansion of the private sector for the achievement of economic restoration.

The materials which I have already presented undertake in detail to portray what seems to me unanswerable fact—that during the past decade, inadequate increases both in wage rates and in aggregate wages have been a prime factor in the entire economic disequilibrium. A part of this demonstration has devoted itself to refutation of the unfounded but widespread claim that excessive wage rate increases have necessitated the price increases which have occurred. Quite to the contrary, the periodic tendency of prices and profits and investments to outrun consumer demand so damagingly points in the opposite direction.

The same conclusions result from any fair comparison of wage rate trends with productivity trends. As shown on chart 32, for the period 1947–62 as a whole, viewing the whole nonfarm economy, the trends in productivity advance and in changes in wage and salary rates per employee hour have been practically identical. More important, during the 5 years 1957–62, the average annual increase in productivity has been 3.1 percent, while the average annual increase in wage and salary rates has been at the much lower average annual rate of 2.7 percent.

In manufacturing, where the hue and cry has been most vehement about excessive wage rate increases forcing up prices, the trends are even more significant. For the period 1947–62 as a whole, the productivity trends and wage and salary rate trends have again been identical. But for the most recent period from 1957 through 1962, the disparity has been truly startling. Productivity has advanced at

an average annual rate of 3.4 percent, while wage and salary rates have advanced at an average annual rate of only 2.2 percent.

These disconcerting trends make it almost impossible to understand why the two reports here under review, far from being concerned about the obvious economic implications of these growing disparities, are asking for more of the same.

#### *The Council's views about wages*

The Council's report (p. 88) points out that changes in yearly earnings in manufacturing industries "have been considerably reduced in the past 5 years." In support of this, the Council points out an average annual increase of only 2.9 percent per year from first quarter 1958 through fourth quarter 1962, and only 2.2 percent per year from first quarter 1961 through fourth quarter 1962. But instead of being worried about these trends, the Council warns us against "overconfidence in their continuation."

If the Council were to make estimates of the needed levels of purchasing power as required by the Employment Act, this could not possibly lead to the conclusion that a continuation of an annual rate of wage rate increases in manufacturing in the neighborhood of 2.2 percent could possibly be squared with an overall economy expanding at the required annual rate of about 5 percent a year—or at least the 4 percent a year which the Council seems to think would be sufficient. The gap in purchasing power, which this lag in wage rate increases would cause, would be so enormous in short order that only scores of billions of dollars of annual increase in the Federal deficit could counteract their repressive effects. This is the simple mathematics of it.

For these reasons, if it were held to be desirable, on the spurious ground that we are affluent in our private lives but starved in our public services, to repress severely the rate of expansion of private consumption in order to make room for the needed expansion of public services, how can this possibly be squared with the President's proposal to hold the line with respect to our domestic public services for a number of years ahead?

Yet if one looks at the discussion of wages in the Council's report on pages 84–86, and at the President's report on page xix, it would seem that our only economic danger on the wage front is the danger of inflation. This is really ironical, in view of the fact that the President was gradually led by the economic advice he received into a situation where he had no other course but to force back steel prices—this final action evolving by slow degrees because of preoccupation with the inflationary danger rather than with the deflationary gap. And now, reaction to this forceback of steel prices is offered by some as an explanation of why the administration, seeking now to "restore the confidence of the business community," cannot commit itself to a more vigorous and socially minded economic program which would be much better for the business community—and all of us—than what is now being proposed.

#### *The wage guidelines*

Because the problem at hand is to prevent wage deficiencies which are real rather than wage excesses which are in the main imaginary, the guidelines offered on page 86 of the Council's report are highly irrelevant or misdirected. These guidelines deal only with holding

down wages as an aspect of business costs, and do not even recognize the problem of wages as a factor in economic expansion.

This being the case, it is unnecessary to discuss in detail, as I have on previous occasions, the unrealism of attempting to set a nationwide productivity standard for wage rate increases in particular industries, which is almost tantamount to suggesting a nationwide standard for profits in particular industries. Equally unrealistic is the expression of hopefulness by the Council, and by the President, that industries will reduce their prices when their productivity rates of advance exceed the nationwide average while they benefit by holding wage rate increases down to the nationwide average.

The most important point, however, is that, if the Government should succeed in holding down wage rate advances in the most highly endowed industries with respect to their rates of productivity advance, the average rate of wage rate increases throughout the economy would obviously fall way below the nationwide productivity advance—as indeed they have been doing in recent years. This would not be so bad, perhaps, if the administration were proposing sufficient enlargement of public programs, directed to well-being, to bring to those who cannot obtain good wage advances the benefits of the resources made available if other workers were enduringly to accept wage-rate increases far below their own productivity advances.

#### THE STATIC POSITION OF THE REPORTS WITH RESPECT TO MONETARY POLICY

Reading pages xi and xviii of the President's report, and page 55 of the Council's report, one detects a high degree of satisfaction with our monetary policies as they have been and seem likely to remain, and even an invitation to the Federal Reserve System to continue along its accustomed ways.

On previous occasions, in detail which I cannot repeat here, I have attempted to depict the enormous damage which the tight money and high interest rate policies have done to our prospects for economic growth and our principles of social justice. Billions of dollars have been deliberately transferred, in the form of rising interest rates both private and public, out of the pockets of those who would use these dollars in accord with our economic and social needs, and into the coffers of those who have had no need whatsoever for this income enlargement. The annual expansion of the non-Federal held money supply has at no time within the past decade been compatible with support of the economic growth rates which the President and the Council espouse.

On page 79 of the Council's report, it is pointed out that interest payments on the total debt, as shown in the administrative budget, have risen from \$5.6 billion in 1950 to \$6.5 billion in 1955, to \$9.3 billion in 1960, and to \$9.6 billion in 1962, and that interest payments on the debt held by the public have for the same years risen from \$4.3 billion to \$4.8 billion to \$6.7 billion to \$6.9 billion. Commenting on these trends, the Council says that they have occurred "primarily because of the necessity of refinancing, at higher current interest rates, debt incurred during World War II."

This has not been necessity; it has been choice, and very unwise choice.



An increasing body of informed economists have expressed their concern, lest further decisions in the monetary field, consistent with the avowed policies of the Federal Reserve System, negate in large part the intended benefits of the deliberately large increases in the Federal deficit now sought by the President. This being the case, the Federal Reserve System needs something besides increasingly glowing accolades from the administration.

#### MY PROPOSALS FOR ACTION NOW

My suggestion for revising the President's program emerge clearly from the foregoing analysis.

(1) I suggest that the Federal budget, for fiscal 1964, lift domestic public outlays by about \$3 billion above the fiscal 1964 level proposed by the President, as a start towards lifting them by about \$16 billion by calendar 1966. The suggested apportionment of these increases, in accord with our great national priorities, are set forth on my charts 29 and 30. Acceptance of my suggestion, by affirming that the servicing of our great priorities of public needs, with appropriate help from the Federal Government, should grow as our population and our per capita productive resources grow in consequence of the advancing technology, would remove the most objectionable feature of the President's whole program—that these Federal domestic outlays in the aggregate be frozen for several years ahead, which actually means a cutback when measured against population growth and a growing GNP. Moreover, in the years immediately ahead, the increasing Federal outlays, in accord with my suggestion, would provide a substantial stimulus to the economy during the interval when we shall not yet have attained maximum employment and production, and in my view a much more effective stimulant, both as an activating economic force and in terms of the ultimate product results, than the kind of spreadout tax changes contained in the President's program.

(2) I suggest that first priority and immediate tax changes be limited to the following: (a) Cutting the 20 percent flat rate, applicable to the first \$2,000 of taxable income, to an average rate of less than 15 percent, with much larger reduction in the rate applicable to the first \$1,000 than to the second \$1,000, and (b) acceptance of the President's proposal which broadens the 10 percent standard deduction in a manner which is most favorable to lower income groups. The effect of my suggestion would be to make the tax reduction very much more progressive than it is in the President's program, by concentrating it very much more heavily in the low and middle-income groups. My proposal would be a one-shot affair, and would have an annual value of about \$7 billion to \$8 billion. This, combined with my \$3 billion suggested increase in public outlays above the President's budget, would be a deliberately contrived net increase in the Federal Deficit of \$10 billion to \$11 billion, or about the amount which the President would spread out over 3 years through his tax program, but in an entirely different pattern. The concentration of this stimulus to the economy within a 1-year period would be enormously more effective than spreading it out over 3 years, and I submit also that the pattern which I suggest is much better adjusted to

the restoration of economic equilibrium and to considerations of social justice and equity than the pattern proposed by the President.

(3) I suggest that, after this first priority tax reduction is accomplished as rapidly as feasible, reforms in the personal and corporate tax structure should thereafter be undertaken, with the recoupments due to these reforms roughly equivalent to further reductions in tax rates, applicable to higher income families, and in corporate tax rates. This would have the merit of deferring, until what is needed most is accomplished first, that which is important but secondary and also extremely complex, time-consuming, and fraught with many uncertainties to ultimate enactment. However, I do not mean to infer, by my suggestion, that all of the reforms proposed by the President are desirable at any time. Some of these seem undesirable in that they appear to repeat some of the imbalances and inequities contained in the President's proposals for tax reduction.

(4) I suggest that the administration—and the Congress if necessary—exert all needed pressure upon the Federal Reserve System, toward a much more liberal monetary policy and toward much lower interest rates. The balance of payments and gold problem can better be dealt with in entirely different ways from those which have been used to date, and which have so grievously damaged the whole U.S. economy.

(5) I suggest that the Council of Economic Advisers be directed by the President to formulate a long-range set of quantitative targets for economic growth, with meaningful components, with due regard for the great priorities of our national needs, and with due emphasis upon the central problem of the need to induce changes in the structure of demand which will be responsive to the challenge of the new technology and automation. This alone, in accord with the express intent of the Employment Act of 1946, would provide proper guides to all needed national economic policies.

#### WHY WE ARE GOING WRONG NOW

What would seem to be the central reasons why people so capable, so well-informed, and so well-intentioned as those who are helping the President in economic matters are moving so far afield from what they should be doing and saying? I suggest two basic reasons:

(1) Economic policies in Government, no less than in business, should be a means rather than an end. In order that the policies be relevant and adequate, the ends must first be stated in terms of meaningful and thorough quantitative targets or end objectives, both long-range and short-range. The relevant targets, in this instance, are the needed levels of employment, production, and purchasing power, broken down into major components, and projected for a reasonable number of years ahead. This the Employment Act of 1946 not only contemplates, but indeed requires. The Council of Economic Advisers, in its current report, has abandoned even some tentative and fragmentary efforts to do this, which it earlier had commenced.

The explanation of this abandonment is not available to me; the consequences should be apparent to all. Policies not carefully adjusted to well-developed targets, related to our potentials and our needs, are policies flying in the dark; lacking integration one with another; excessively responsive to the inertia of outdated thinking;

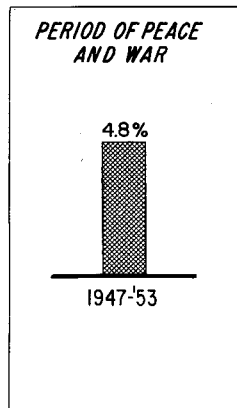
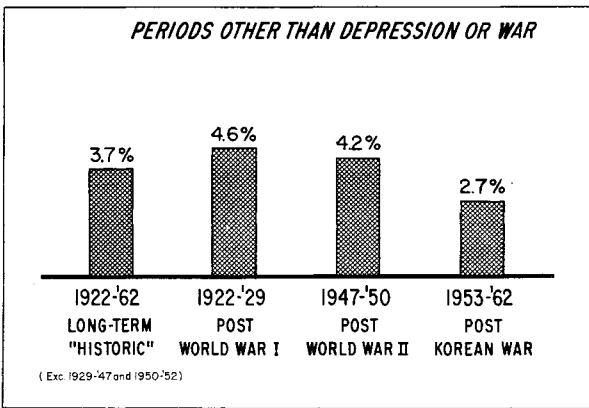
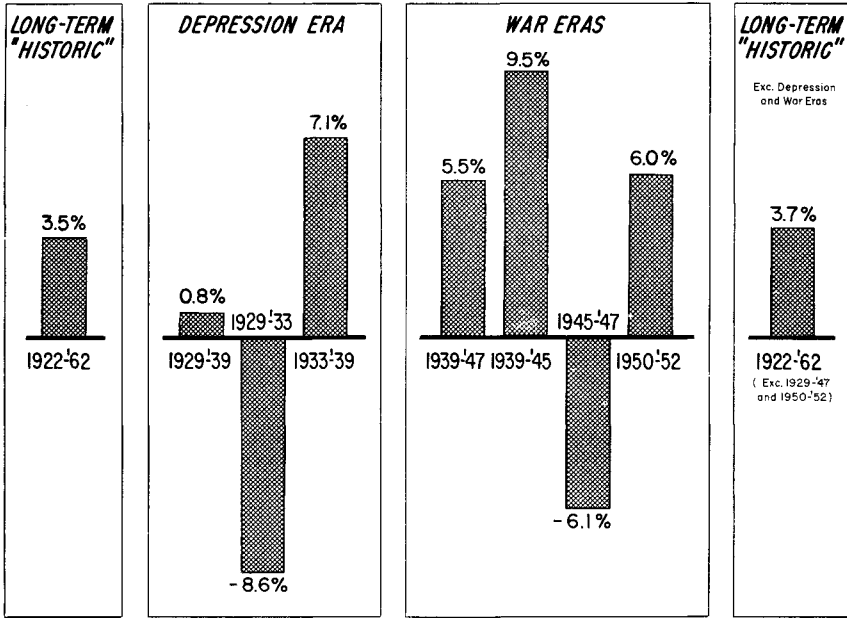
and unduly responsive to the desire to do that which the most people will agree to without being informed, instead of seeking to inform them. Economic education, emanating in proper degree from national leadership, is the hallmark of the evolution of sound national economic policies;

(2) The second explanation resides in the artificial dichotomy between economic and social purposes, resulting in two reports so disappointingly devoid of adequate policies expressly related to these social purposes. It is not enough to say that everybody will be better off, and our social purpose thus served, if our economic performance is improved. For the very nature of our chronic and current economic trouble is that those social programs which add directly to human well-being, which improve the distribution of the fruits of our production, are at the very heart of potentially successful economic efforts.

After all, the real challenge of the unused resources, resulting from not meeting this problem, is in the form of opportunity—the opportunity to eradicate the poverty and deprivation which still afflict two-fifths of our population, and to lift all Americans to decent levels of living compatible with our soaring power to produce; to take millions of families out of slums; to provide them with more educational opportunities and better health services in line with our technical competence to do so; to cleanse their cities and purify their waters; to enlarge their security in their old age; to enable them to be transported more conveniently; to improve the natural resources which will be the heritage of their descendants; and even to enable a larger proportion of them to enjoy the more conventional material comforts of life, and to enjoy more leisure—and not in the form of involuntary unemployment. These are not merely the byproducts of a successful economy program; they are an essential and major portion of the implementation of such a program. An economic program which does not recognize this sufficiently will fall far short of economic restoration, because it does not accurately sense the very nature of the task. And it will not rally the American people fully to the task, because it does not come close enough to their most profound needs and aspirations.

# GROWTH RATES, U.S. ECONOMY, 1922-1962

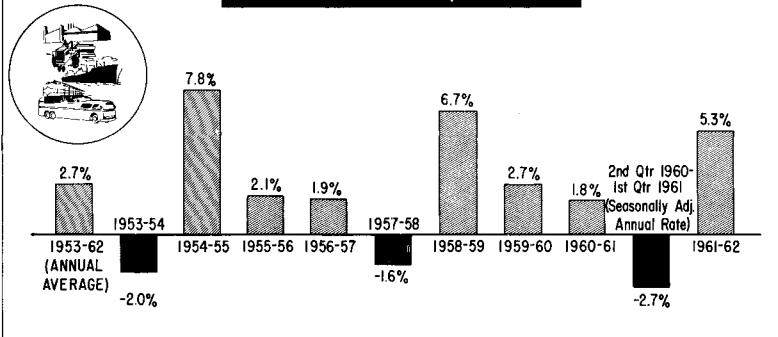
Average Annual Rates of Change in Gross National Product  
In Uniform 1961 Dollars



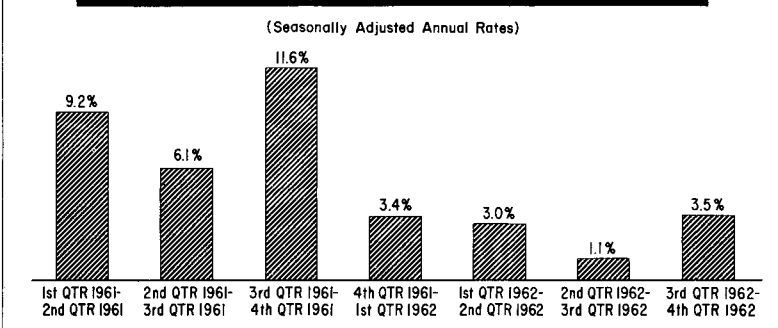
# RECESSIONS, BOOMS, STAGNATIONS, 1953-'62: RATES OF CHANGE IN G. N. R

In 1961 Dollars

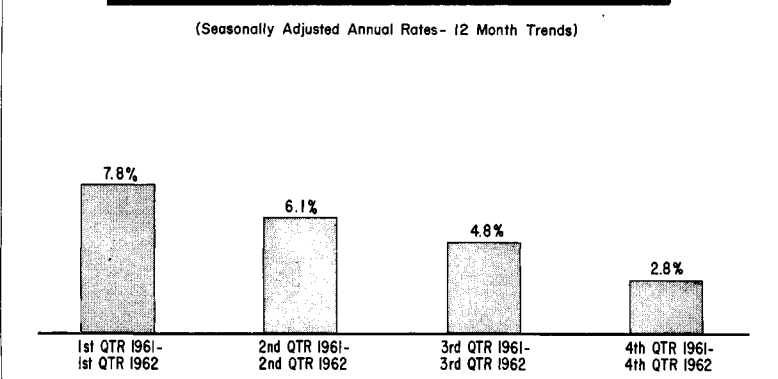
## LONG-TERM RECORD, 1953-1962



## SHORT-TERM RECORD, 1st QUARTER 1961-4th QUARTER 1962

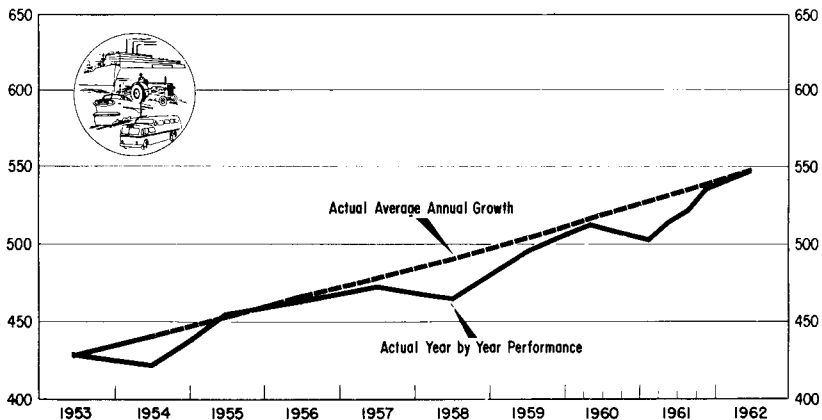
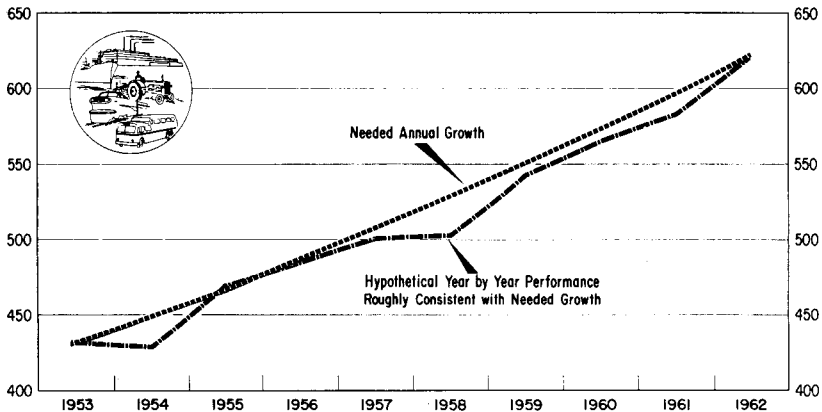
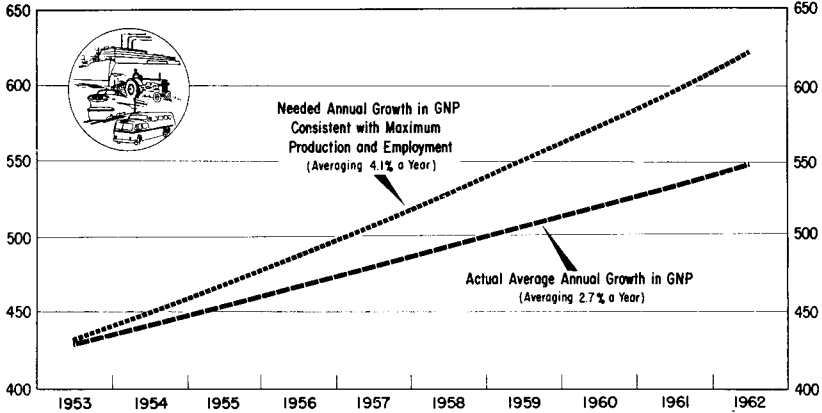


## BOOM AGAIN MOVES TOWARD STAGNATION 1961-1962



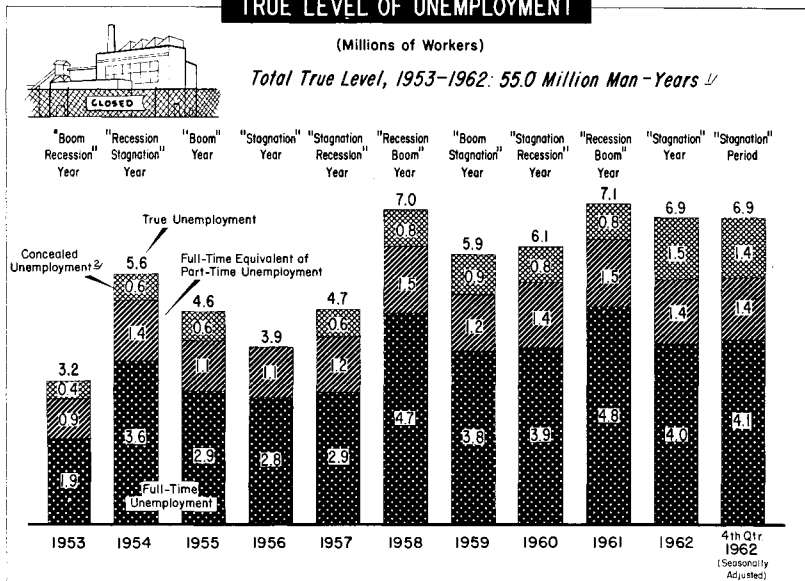
# THE AMERICAN ECONOMY DURING 10 YEARS NEEDED AND ACTUAL PERFORMANCE, 1953-1962

Billions of 1961 Dollars

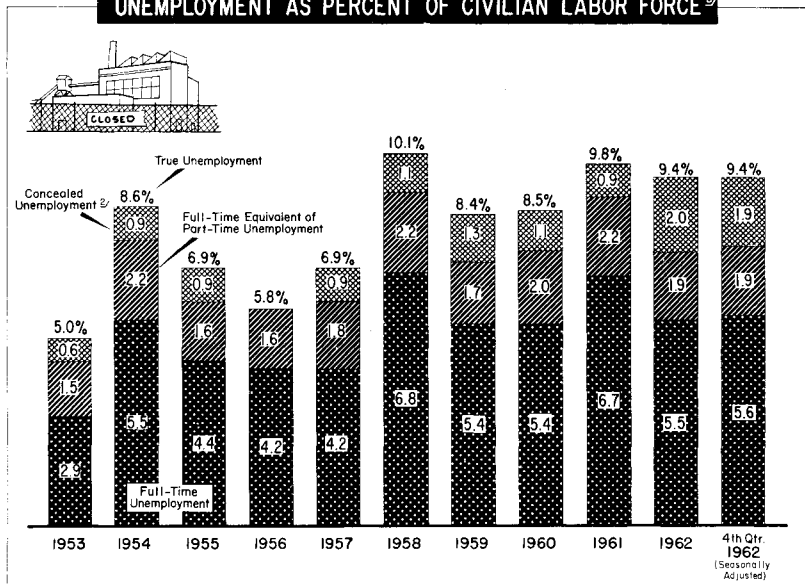


# CHRONIC RISE OF UNEMPLOYMENT, 1953-1962

## TRUE LEVEL OF UNEMPLOYMENT



## UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE <sup>3/</sup>

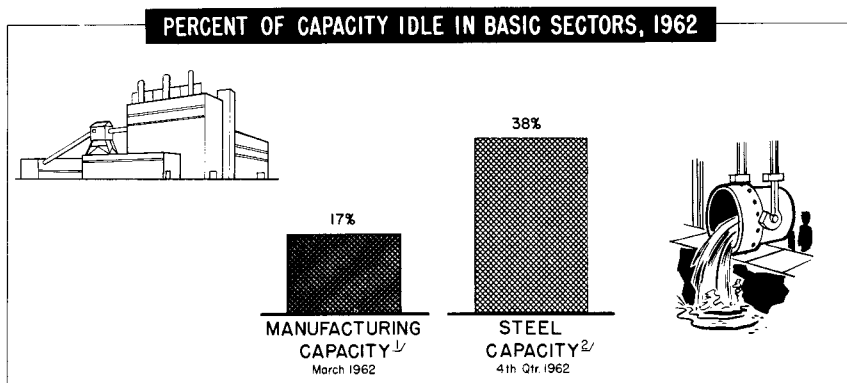
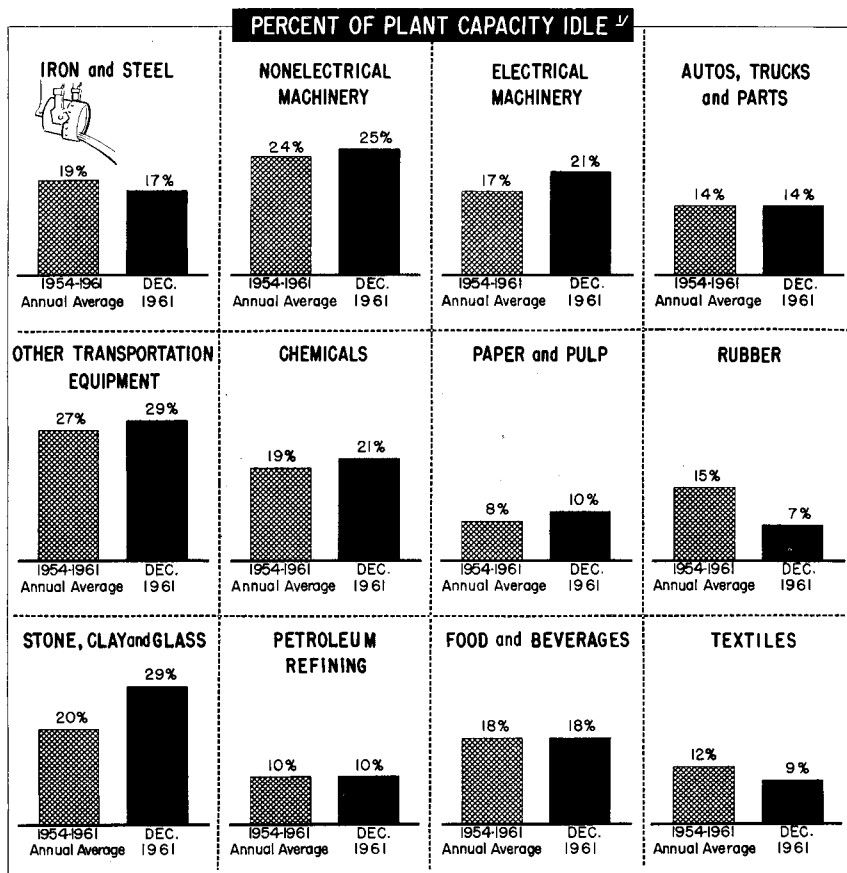


<sup>1/</sup> About 28.5 million man-years of unemployment (true level) would have been consistent with maximum employment.

<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



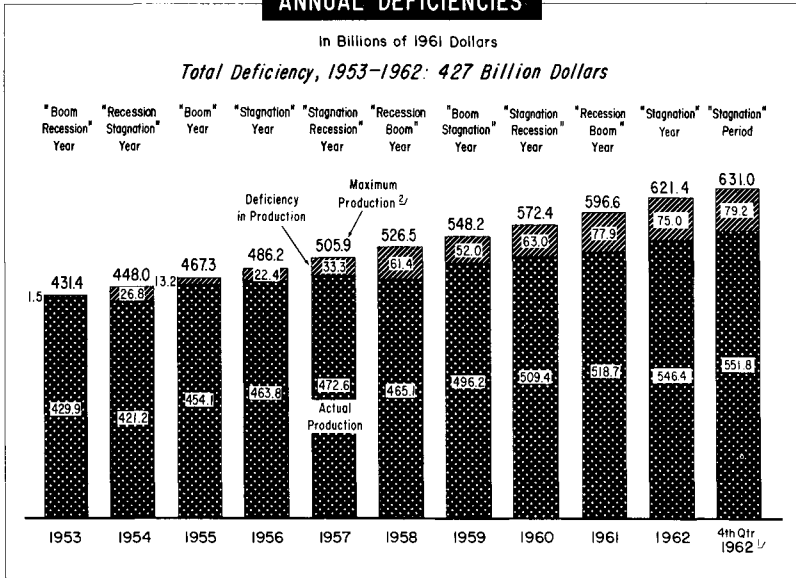
<sup>1/</sup> McGraw-Hill Annual Surveys, which provide end of period estimates.

<sup>2/</sup> Est. based on Am. Iron and Steel Inst. data.

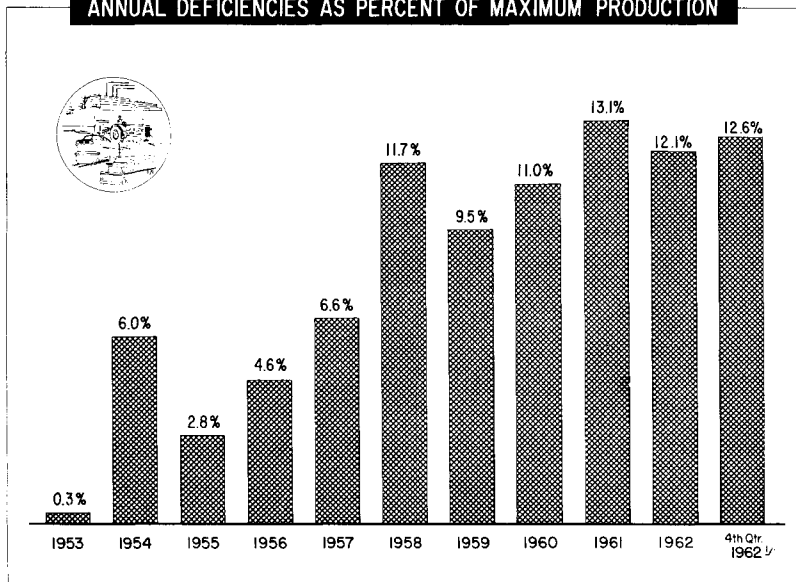


## CHRONIC RISE OF OUR UNUSED PRODUCTIVE POWERS (G.N.P.), 1953-1962

### ANNUAL DEFICIENCIES



### ANNUAL DEFICIENCIES AS PERCENT OF MAXIMUM PRODUCTION



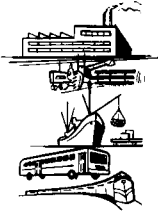
✓ Seasonally adjusted annual rate.

⊆ 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.

## LARGE NATIONAL ECONOMIC DEFICITS DURING TEN-YEAR PERIOD 1953-1962

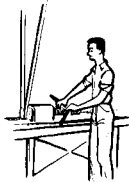
Dollar Items in 1961 Dollars

**TOTAL NATIONAL PRODUCTION**  
(GNP)



**\$427 Billion**  
Too Low

**MAN YEARS OF EMPLOYMENT**



**26.5 Million**  
Too Low

**PRIVATE BUSINESS INVESTMENT**  
(Incl. Net Foreign)



**\$108 Billion**  
Too Low

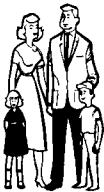
**PRIVATE AND PUBLIC CONSUMPTION** <sup>1/</sup>



**\$319 Billion**  
Too Low

## ... THESE HAVE LED TO LARGE LOSSES TO ALL ECONOMIC GROUPS

**AVERAGE FAMILY INCOME**  
(Multiple-Person Families)



**\$6,700**  
Too Low

**FARM OPERATORS' NET INCOME**



**\$64 Billion**  
Too Low

**WAGES AND SALARIES**



**\$285 Billion**  
Too Low

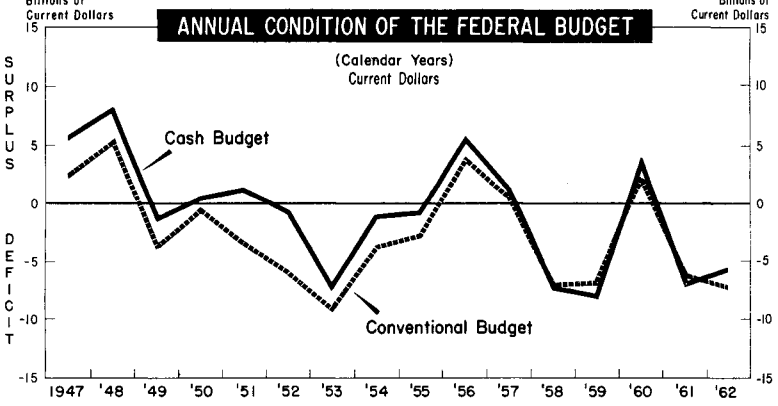
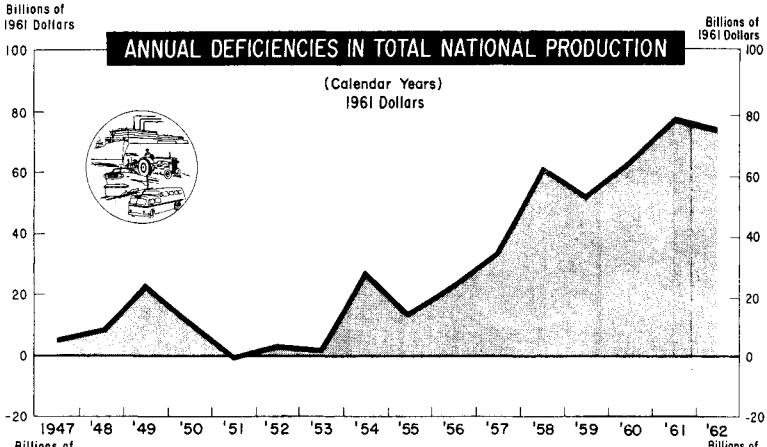
**UNINCORPORATED BUSINESS AND PROFESSIONAL INCOME**



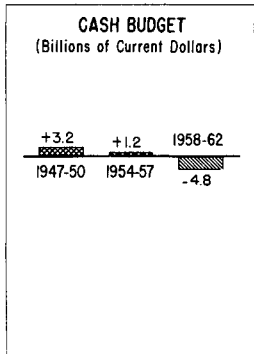
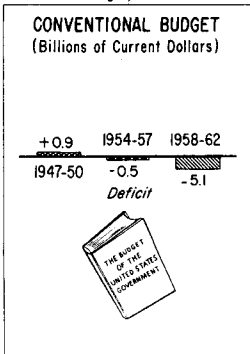
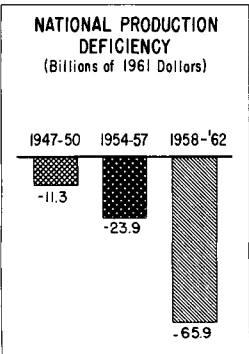
**\$30 Billion**  
Too Low

<sup>1/</sup> Includes personal consumption expenditures plus government (Federal, state, and local) expenditures. (281 and 38 billions, respectively).

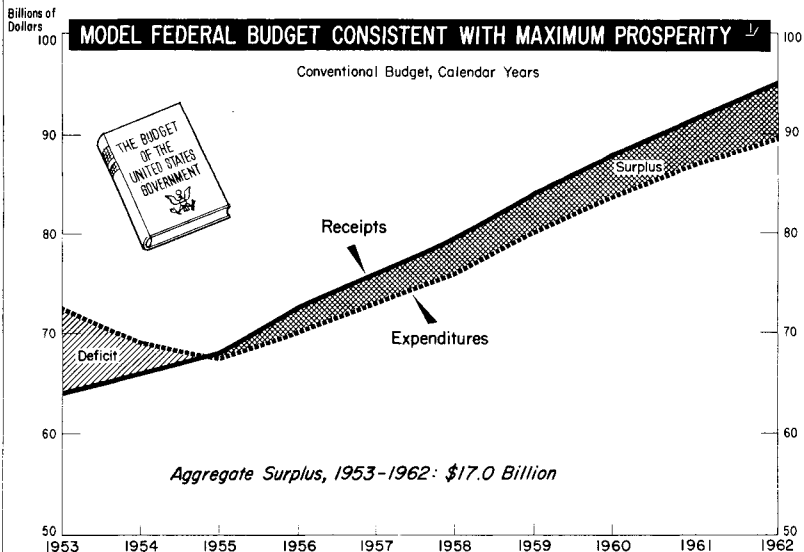
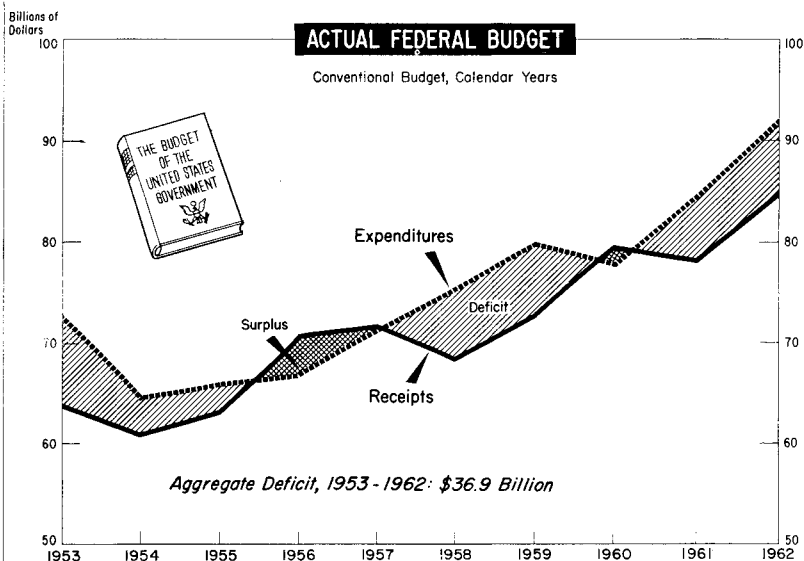
# THE FEDERAL BUDGET REFLECTS NATIONAL ECONOMIC DEFICIENCIES



**FEDERAL DEFICITS GROW WITH NATIONAL ECONOMIC DEFICIENCIES**  
(Annual Averages, Calendar Years)





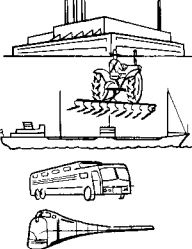
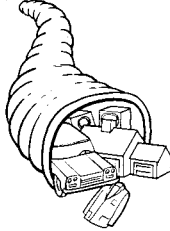
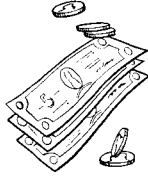
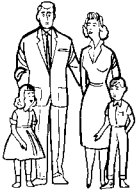




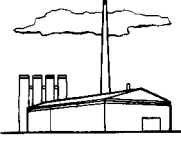
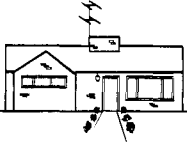
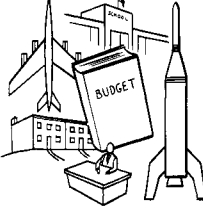
## A BALANCED FEDERAL BUDGET DEPENDS UPON A MAXIMUM PROSPERITY ECONOMY



⌞ 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.

# 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

<p><b>EMPLOYMENT</b> <sup>1/</sup> (In millions of man-years)</p>  <p><b>5.6</b> <i>16.8</i></p> <p><b>UNEMPLOYMENT</b> <sup>1/</sup> (In millions of man-years)</p>  <p><b>3.7</b> <i>10.9</i></p>	<p><b>TOTAL PRODUCTION</b></p>  <p><b>\$104 Billion</b> <i>\$291 Billion</i></p>	<p><b>CONSUMER SPENDING</b></p>  <p><b>\$65 Billion</b> <i>\$180 Billion</i></p>	<p><b>PERSONAL INCOME</b></p>  <p><b>\$83 Billion</b> <i>\$231 Billion</i></p>
<p><b>FAMILY INCOME</b> (Average)</p>  <p><b>\$1,200</b> <i>\$3,600</i></p>	<p><b>WAGES and SALARIES</b></p>  <p><b>\$48 Billion</b> <i>\$143 Billion</i></p>	<p><b>NET FARM INCOME</b></p>  <p><b>\$15 Billion</b> <i>\$38 Billion</i></p>	<p><b>TRANSFER PAYMENTS</b></p>  <p><b>\$13 Billion</b> <i>\$36 Billion</i></p>
<p><b>BUSINESS and PROFESSIONAL INCOME</b></p>  <p><b>\$7 Billion</b> <i>\$18 Billion</i></p>	<p><b>GROSS PRIVATE DOMESTIC INVESTMENT</b> <sup>2/</sup></p>  <p><b>\$27 Billion</b> <i>\$76 Billion</i></p>	<p><b>RESIDENTIAL NONFARM CONSTRUCTION</b></p>  <p><b>\$10.3 Billion</b> <i>\$27 Billion</i></p>	<p><b>FEDERAL, STATE, AND LOCAL GOV'T OUTLAYS FOR GOODS AND SERVICES</b></p>  <p><b>\$12 Billion</b> <i>\$35 Billion</i></p>

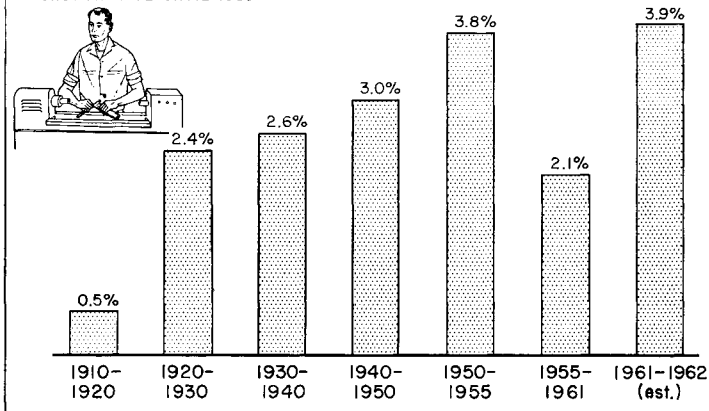
<sup>1/</sup> High growth rate would draw more persons into the labor market than low growth rate.  
<sup>2/</sup> Including net exports of goods and services.

# TRENDS IN OUTPUT PER MAN-HOUR -OR PRODUCTIVITY -1910-1962

Average Annual Rate of Productivity Growth  
for the Entire Private Economy

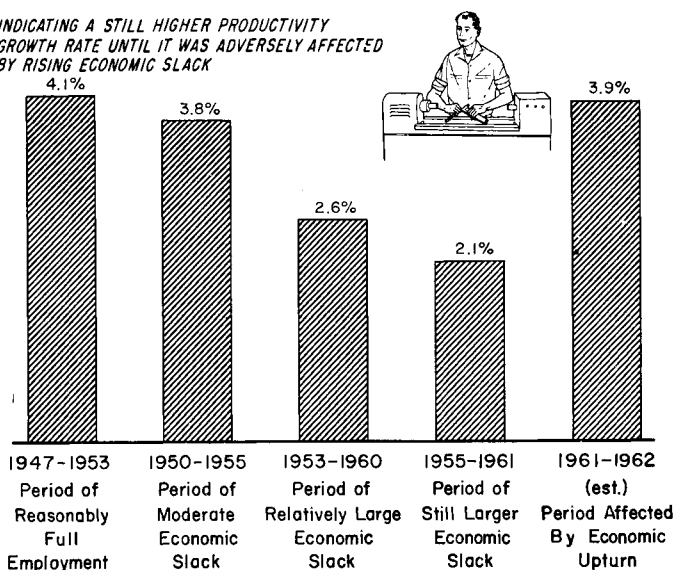
## THE RECORD 1910-1962

INDICATING AN ACCELERATING PRODUCTIVITY  
GROWTH RATE UNTIL 1955



## THE RECORD SINCE WORLD WAR II AND RECONVERSION

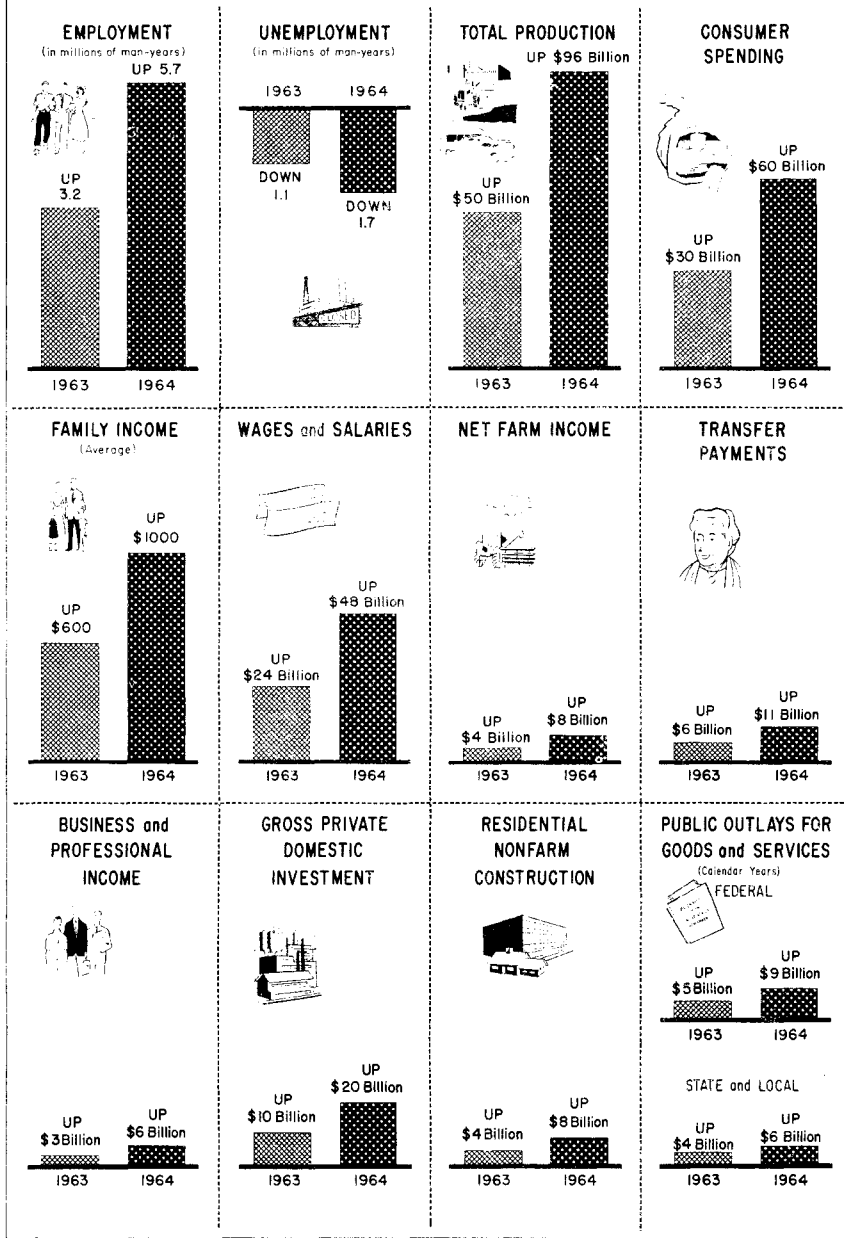
INDICATING A STILL HIGHER PRODUCTIVITY  
GROWTH RATE UNTIL IT WAS ADVERSELY AFFECTED  
BY RISING ECONOMIC SLACK



Note: Based on U.S. Department of Labor estimates, relating to man-hours worked.

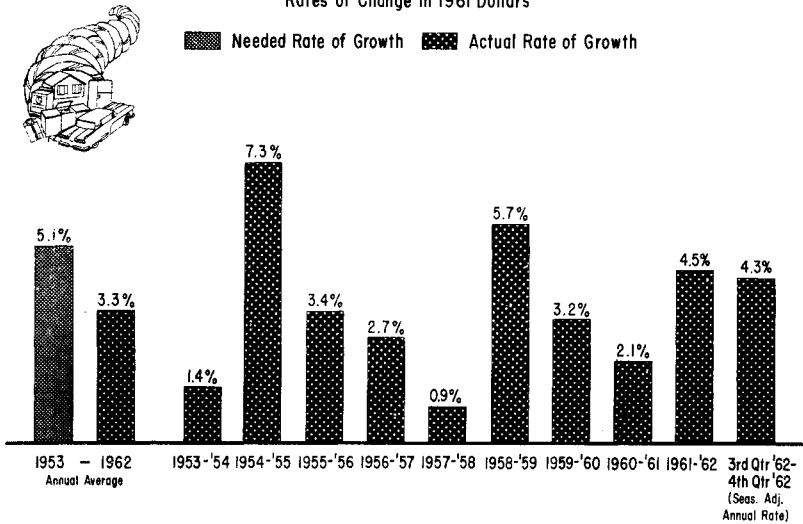
# GOALS FOR 1963 AND 1964, CONSISTENT WITH LONG-RANGE GOALS THROUGH 1966

1963 and 1964 Goals Compared with Estimated 1962  
Dollar Figures in 1961 Dollars



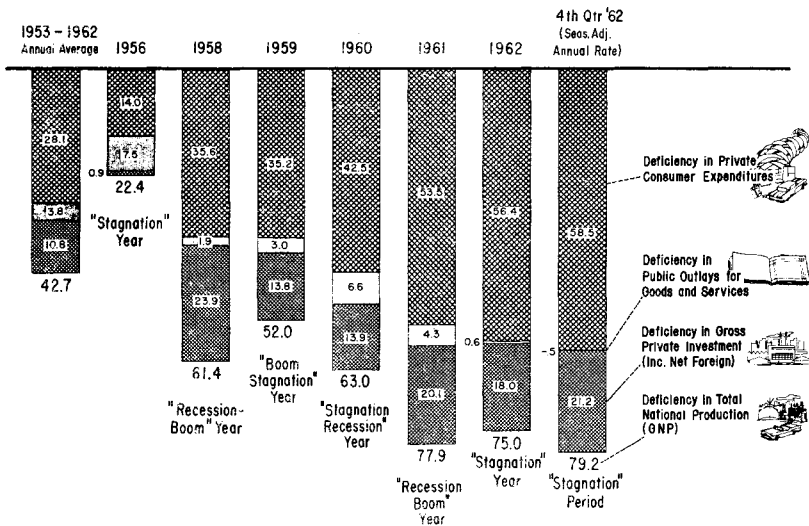
## DEFICIENT RATE OF GROWTH IN PRIVATE CONSUMER SPENDING, 1953 - 1962

Rates of Change in 1961 Dollars



## THE PRIVATE CONSUMPTION DEFICITS DOMINATE THE DEFICITS IN THE TOTAL ECONOMY

Billions of 1961 Dollars

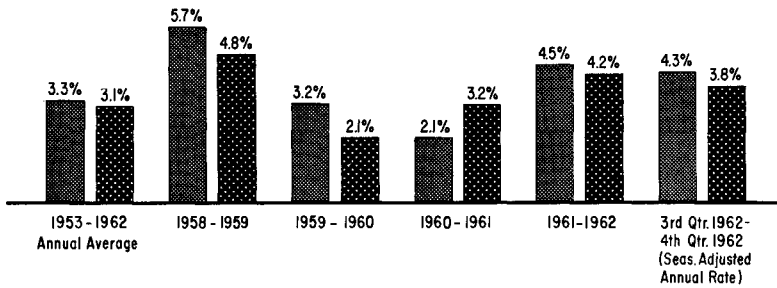




## LOW GROWTH IN PRIVATE CONSUMPTION REFLECTS LOW GROWTH IN INCOMES

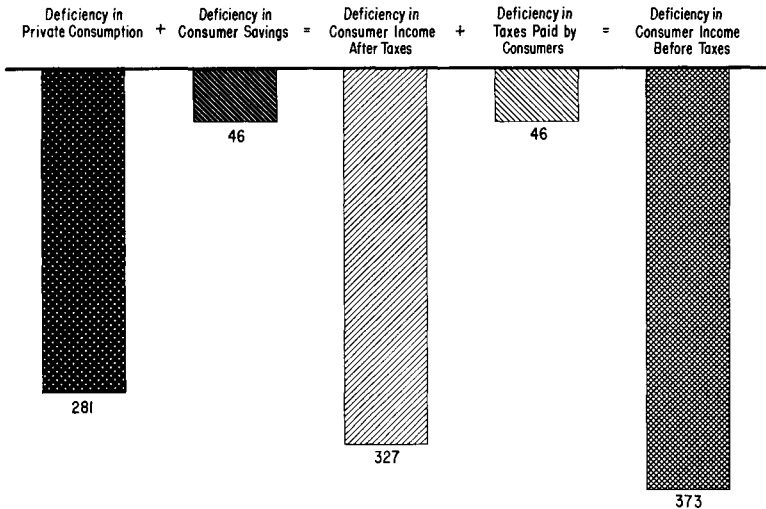
Rates of Change in 1961 Dollars

■ Total Private Consumer Spending ■ Total Personal Income After Taxes



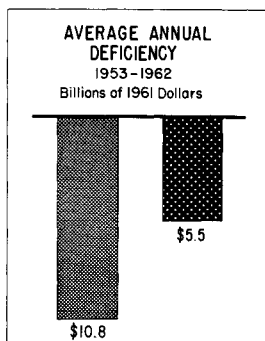
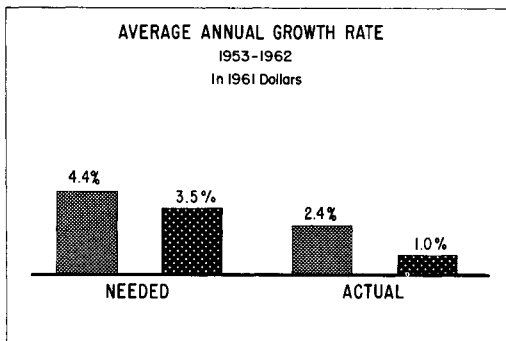
## THE PRIVATE CONSUMPTION DEFICIENCY OF \$281 BILLION, 1953 - 1962 REFLECTED A \$373 BILLION INCOME DEFICIENCY

Billions of 1961 Dollars



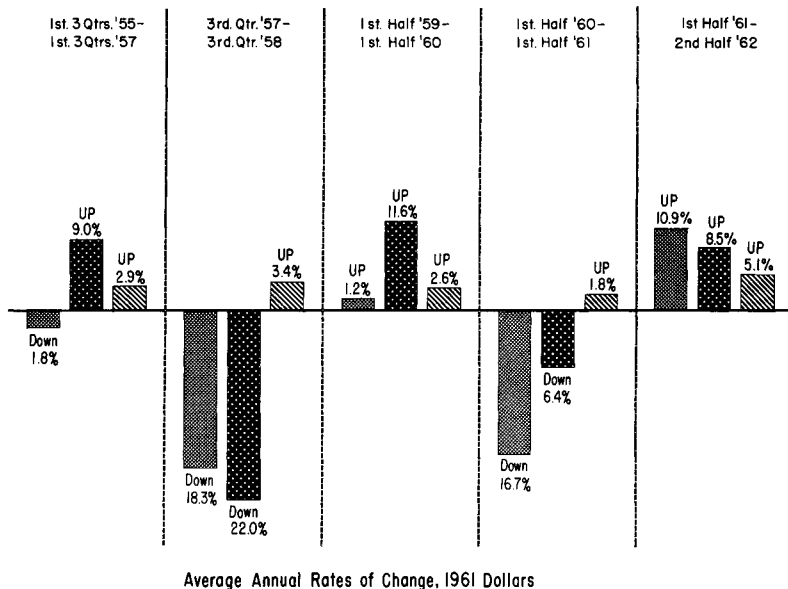
## GROSS PRIVATE DOMESTIC INVESTMENT WAS DEFICIENT DURING 1953-1962 AS A WHOLE

■ Gross Private Domestic Investment ■ Investment in Plant and Equipment



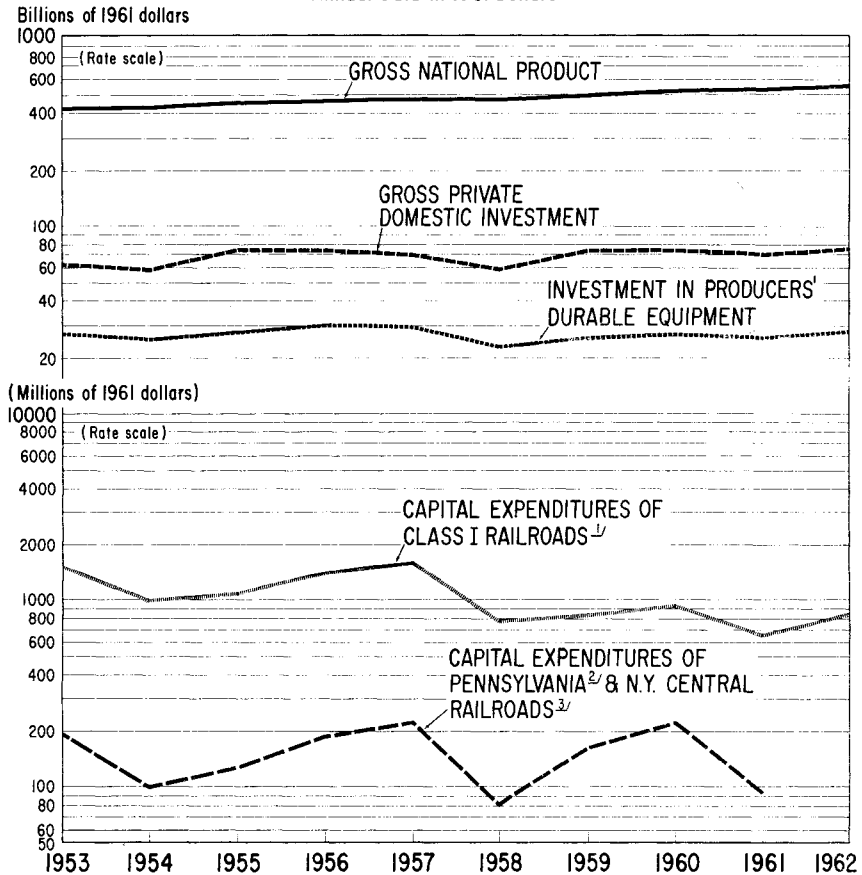
## BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN ULTIMATE DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS

■ 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



# FLUCTUATIONS IN GNP AND IN TYPES OF INVESTMENT, 1953-1962

Annual Data in 1961 Dollars



<sup>1/</sup> 1962 estimated by ICC from Company reports, Sept. 1962.

<sup>2/</sup> includes leased lines.

<sup>3/</sup> 1962 data not available.




Note: Conversion of capital expenditures of Class I R.R.'s from current to 1961 dollars by means of implicit deflator for gross private domestic investment, conversion of Penn. and N.Y. Central data by means of implicit deflators used in Symes Exhibit for Eastern District R.R.'s.

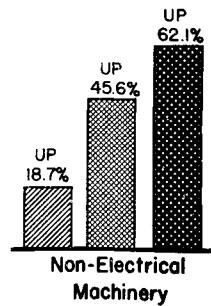
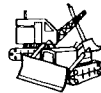
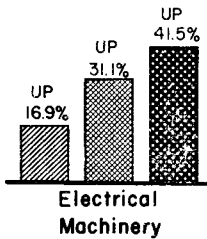
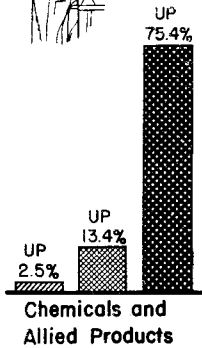
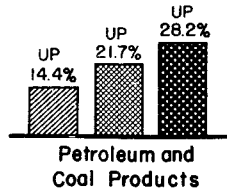
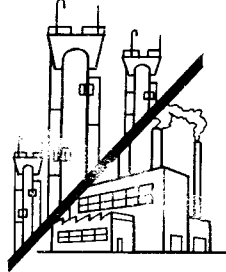
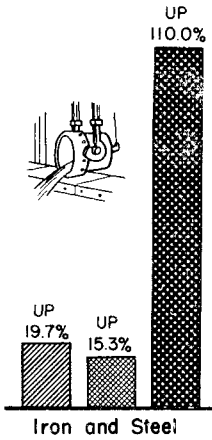
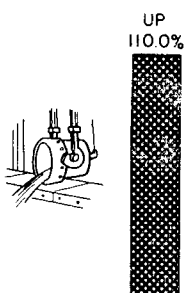
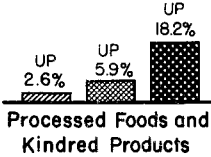
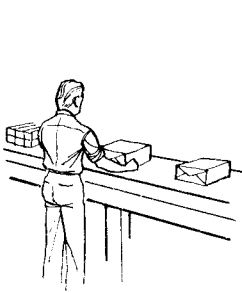
Economic data: U.S. Dept. of Commerce R.R. data: Current dollar investment figures, Merger Exhibits (Ward and Grant) (See note for conversions to 1961 dollars)

# 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>

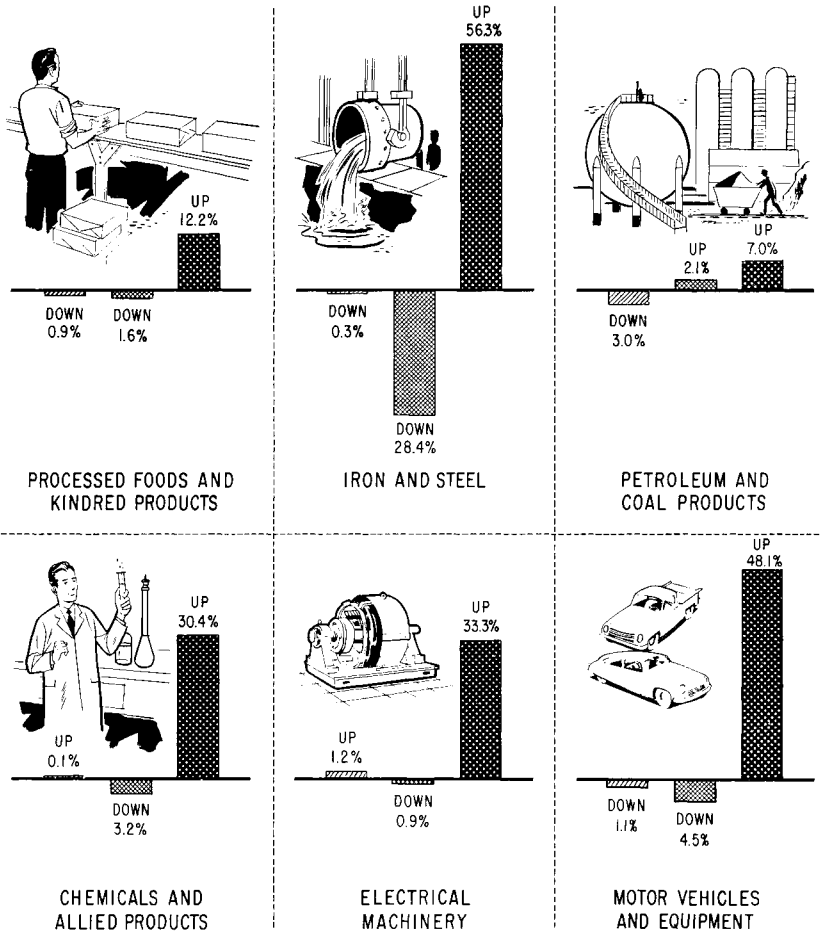


<sup>1/</sup> Bureau of Labor Statistics, (U.S. Dept. of Labor), Commodity Wholesale Price Indexes.  
<sup>2/</sup> Securities and Exchange Commission, Profit Estimates.  
<sup>3/</sup> Securities and Exchange Commission estimates of expenditures for plant and equipment.

## 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>

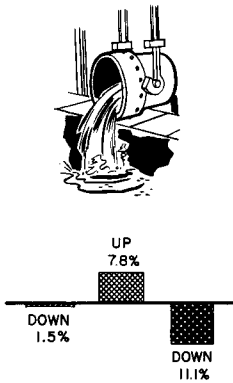


<sup>1/</sup> U. S. Dept. of Labor, Bureau of Labor Statistics, commodity wholesale price indexes.  
<sup>2/</sup> Securities and Exchange Commission, profit estimates  
<sup>3/</sup> Securities and Exchange Commission, estimates of expenditures for plant and equipment.

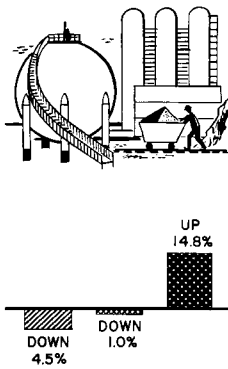
# PRICE, PROFIT AND INVESTMENT TRENDS DURING CURRENT ECONOMIC UPTURN

1st Quarter 1961-3rd Quarter 1962

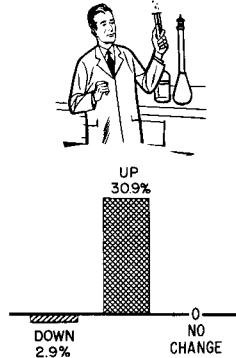
▨ Prices;<sup>1/</sup> ▩ Profits after Taxes;<sup>2/</sup> ▤ Investment in Plant and Equipment<sup>3/</sup>



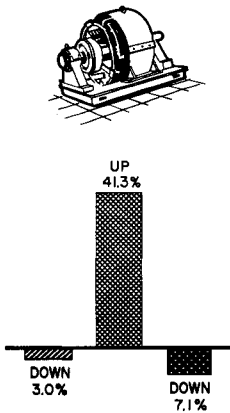
**IRON and STEEL**



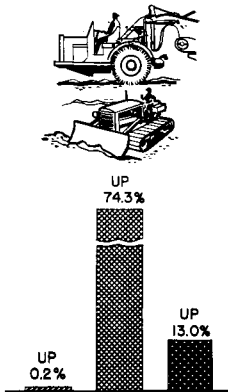
**PETROLEUM and COAL PRODUCTS**



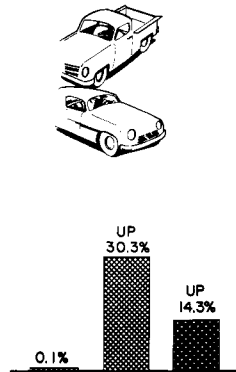
**CHEMICALS and ALLIED PRODUCTS**



**ELECTRICAL MACHINERY**



**NON-ELECTRICAL MACHINERY**



**MOTOR VEHICLES and EQUIPMENT**

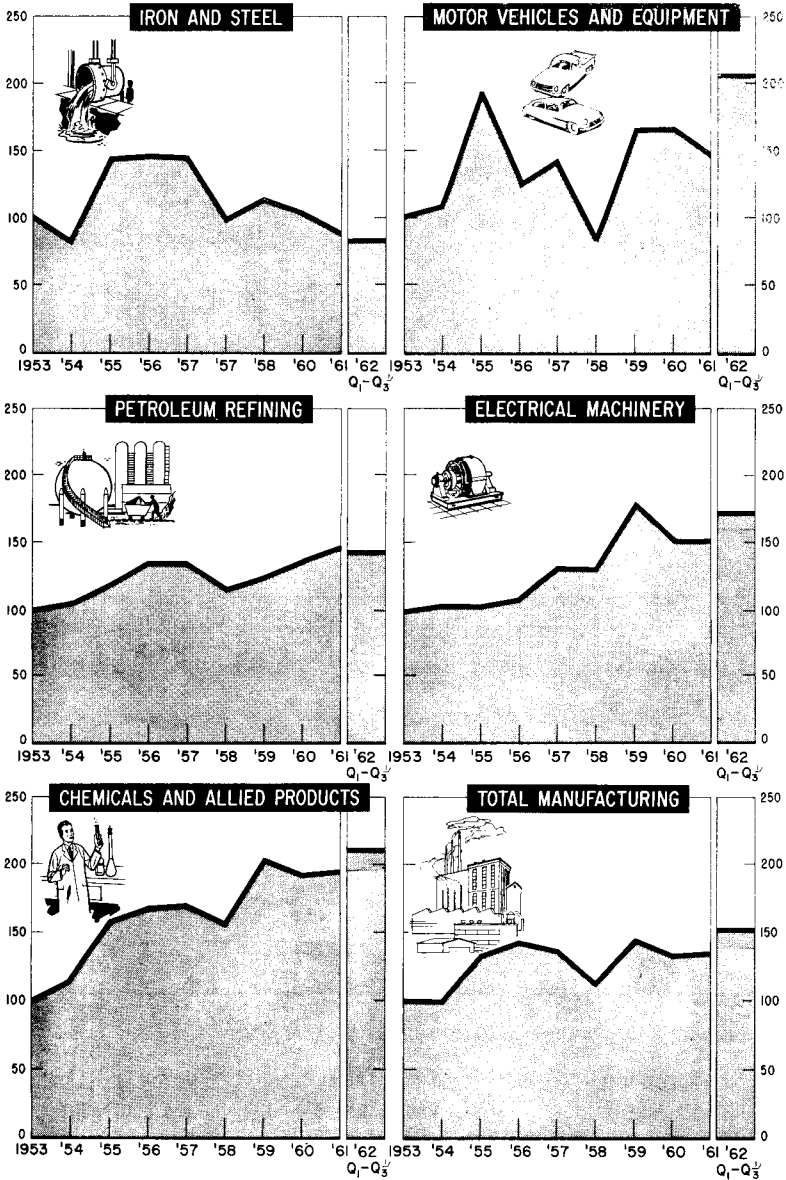
<sup>1/</sup> Data: U.S. Dept. of Labor, wholesale commodity price indexes.

<sup>2/</sup> Data: Federal Trade Commission—Securities and Exchange Commission.

<sup>3/</sup> Data: U.S. Dept. of Commerce and Securities and Exchange Commission; seasonally adjusted.

# KEY PROFITS AFTER TAXES ARE HIGH DESPITE LARGE UNUSED CAPACITIES

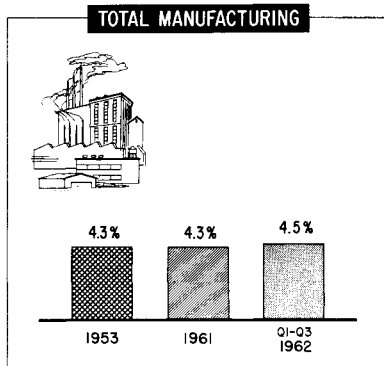
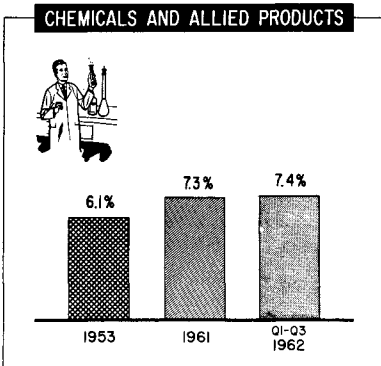
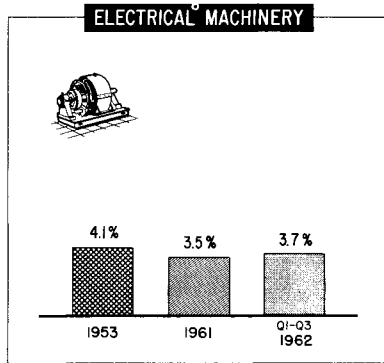
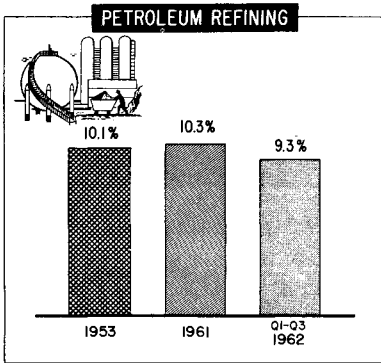
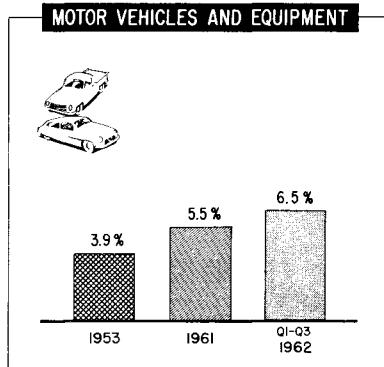
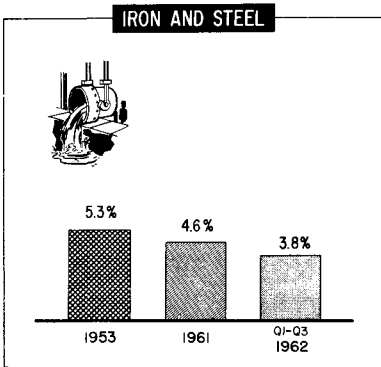
1953=100



<sup>J</sup> First three quarters of 1962 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

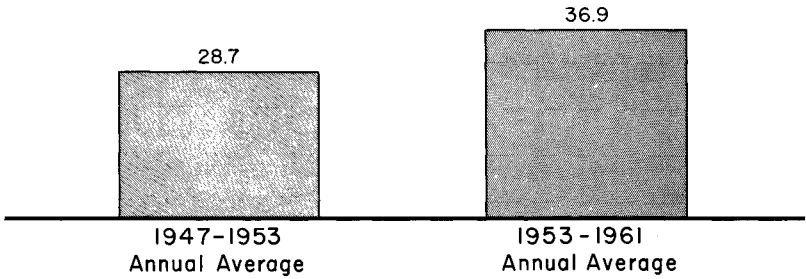


Data: Federal Trade Commission, Securities and Exchange Commission.

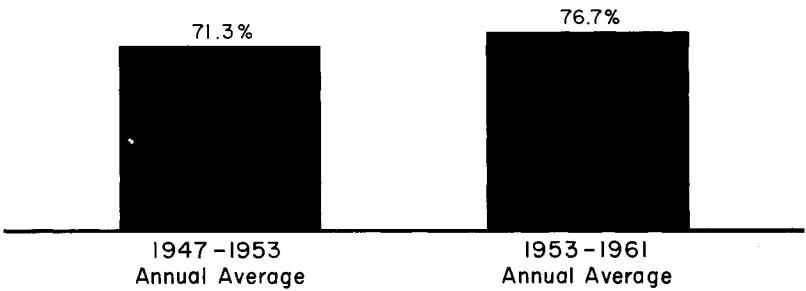


### TOTAL FUNDS USED BY CORPORATIONS HAVE INCREASED

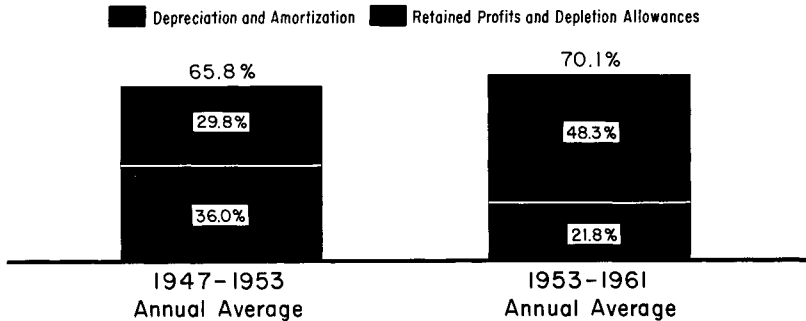
Billions of Current Dollars



### PORTION OF THESE FUNDS USED FOR PLANT AND EQUIPMENT HAS GROWN



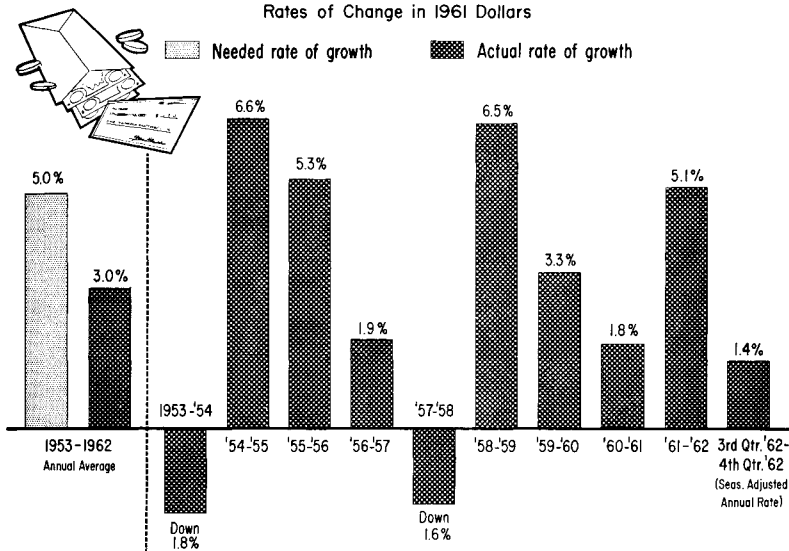
### PORTION OF CORPORATE FUNDS DRAWN FROM INTERNAL SOURCES HAS RISEN



Data: Department of Commerce.

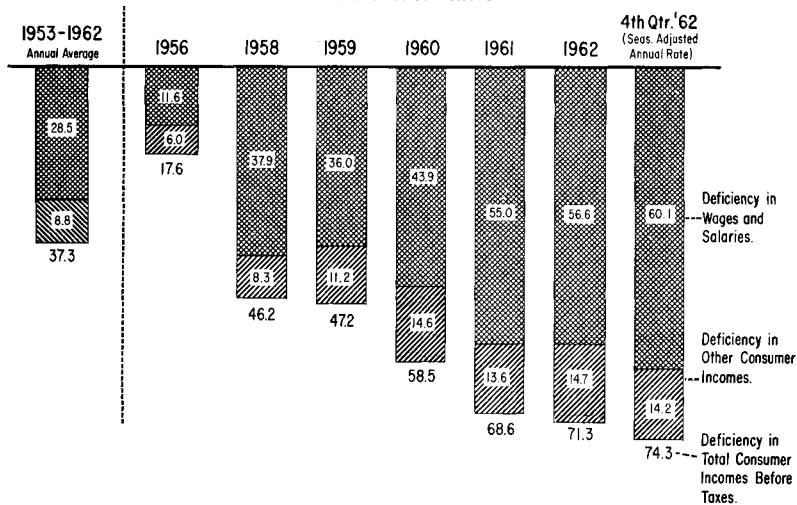
## DEFICIENT RATE OF GROWTH IN WAGES AND SALARIES, 1953-1962

Rates of Change in 1961 Dollars



## DEFICIENCIES IN WAGES AND SALARIES ARE LARGE SHARE OF DEFICIENCIES IN TOTAL CONSUMER INCOMES BEFORE TAXES

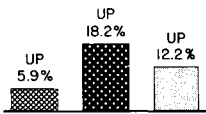
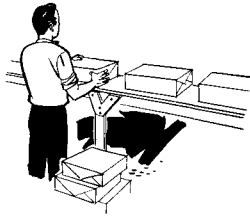
Billions of 1961 Dollars



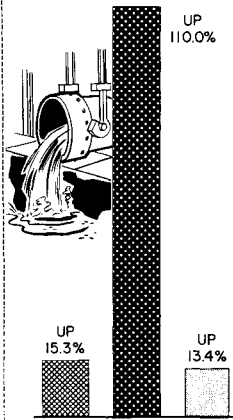
# BEFORE THE 1957-1958 RECESSION, PROFITS AND INVESTMENT OUTRAN WAGES—BASIC TO CONSUMPTION

First Three Quarters 1955—First Three Quarters 1957

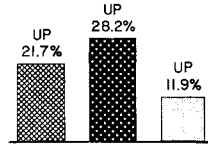
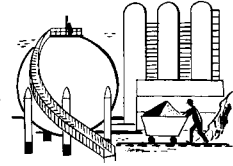
▒ Profits after Taxes,<sup>1/</sup> ■ Investment in Plant and Equipment,<sup>2/</sup> □ Wage Rates<sup>3/</sup>



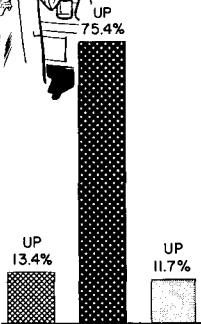
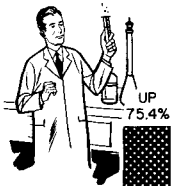
**PROCESSED FOODS  
and KINDRED PRODUCTS**



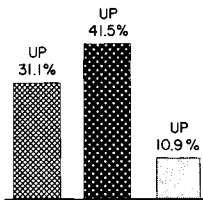
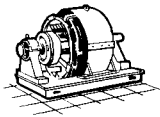
**IRON and STEEL**



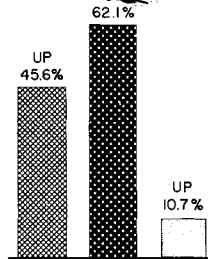
**PETROLEUM  
and COAL PRODUCTS**



**CHEMICALS  
and ALLIED PRODUCTS**



**ELECTRICAL  
MACHINERY**



**NON-ELECTRICAL  
MACHINERY**

<sup>1/</sup> Data: Securities and Exchange Commission.

<sup>2/</sup> 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.

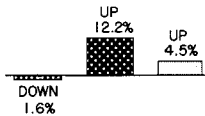
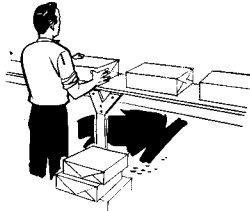
# BEFORE THE 1960-1961 RECESSION, DESPITE REDUCED PROFITS, INVESTMENT OUTRAN WAGES—BASIC TO CONSUMPTION

First Half 1959 - First Half 1960

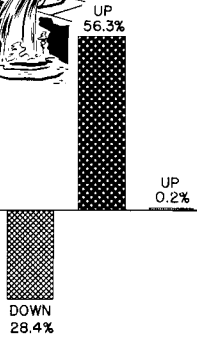
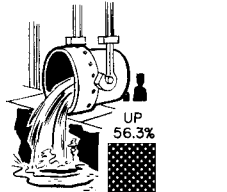
Profits after Taxes<sup>1/</sup>

Investment in Plant and Equipment<sup>2/</sup>

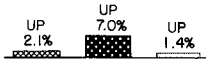
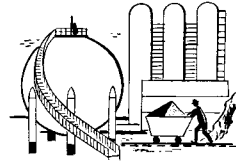
Wage Rates<sup>3/</sup>



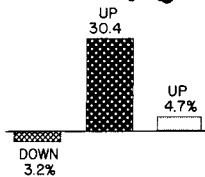
PROCESSED FOODS and KINDRED PRODUCTS



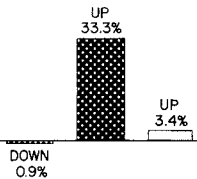
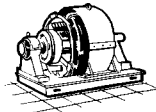
IRON and STEEL



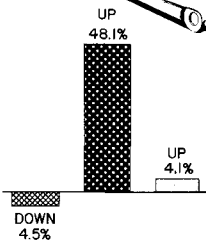
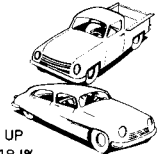
PETROLEUM and COAL PRODUCTS



CHEMICALS and ALLIED PRODUCTS



ELECTRICAL MACHINERY



MOTOR VEHICLES and EQUIPMENT

<sup>1/</sup> Data: Securities and Exchange Commission

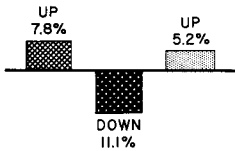
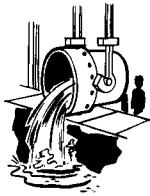
<sup>2/</sup> Data: U. S. Dept. of Commerce and Securities and Exchange Commission

<sup>3/</sup> Average hourly earnings of production workers Data: Dept. of Labor

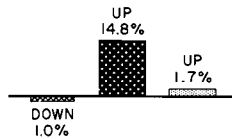
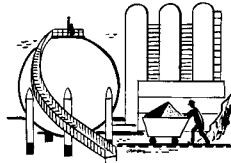
# PROFITS AND INVESTMENT DURING CURRENT ECONOMIC UPTURN OUTRUN WAGES—BASIC TO CONSUMPTION

1st Quarter 1961—3rd Quarter 1962

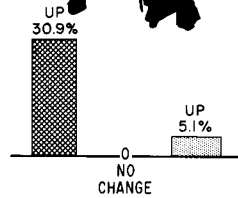
Profits after Taxes <sup>1/</sup>
 Investment in Plant and Equipment <sup>2/</sup>
 Wage Rates <sup>3/</sup>



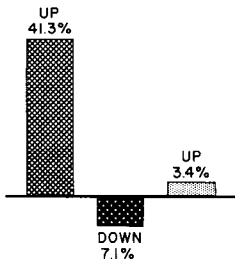
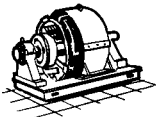
**IRON and STEEL**



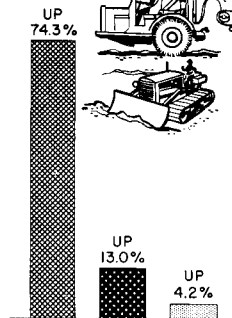
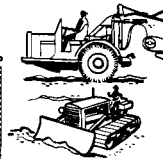
**PETROLEUM and COAL PRODUCTS**



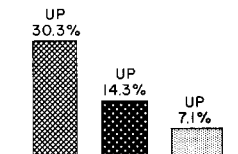
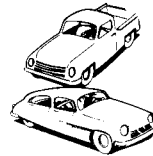
**CHEMICALS and ALLIED PRODUCTS**



**ELECTRICAL MACHINERY**



**NON-ELECTRICAL MACHINERY**



**MOTOR VEHICLES and EQUIPMENT**

<sup>1/</sup> Data: Federal Trade Commission—Securities and Exchange Commission.

<sup>2/</sup> Data: U.S. Dept. of Commerce and Securities and Exchange Commission; seasonally adjusted.

<sup>3/</sup> Average hourly earnings of production workers. Data: U.S. Dept. of Labor.

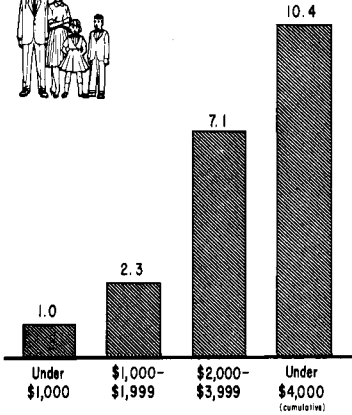
# AMERICANS LIVING IN POVERTY, 1960

Annual Incomes, Before Taxes, In 1960 Dollars <sup>L/</sup>

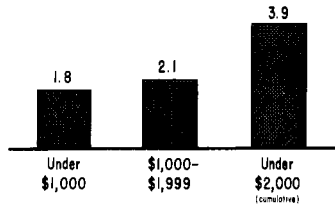
## NUMBER OF CONSUMER UNITS

(In Millions)

### MULTIPLE-PERSON FAMILIES



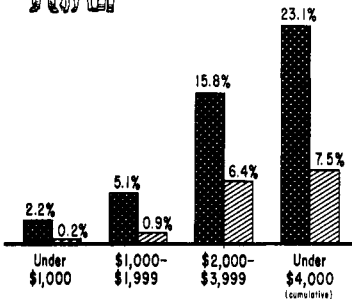
### UNATTACHED INDIVIDUALS



## PERCENTAGE DISTRIBUTION

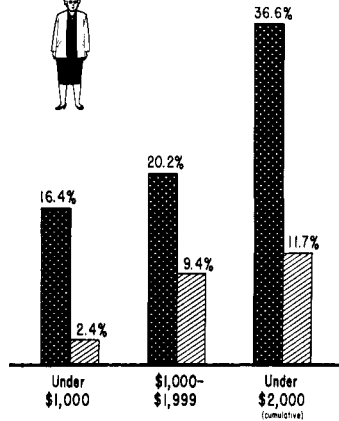
### MULTIPLE-PERSON FAMILIES

■ Percent of All Families  
 ▨ Share of Total Income of All Families



### UNATTACHED INDIVIDUALS

■ Percent of All Individuals  
 ▨ Share of Total Income of All Individuals



<sup>L/</sup> Includes, in addition to cash income, the monetary value of food and fuel produced by farm families for their own use, and other nonmoney income.

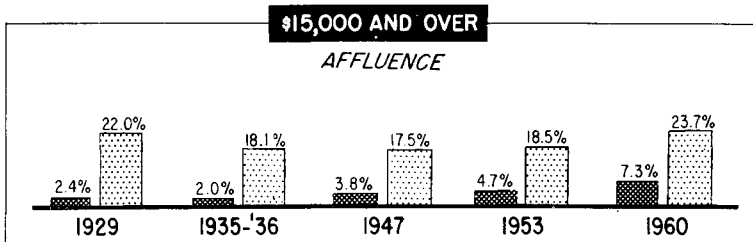
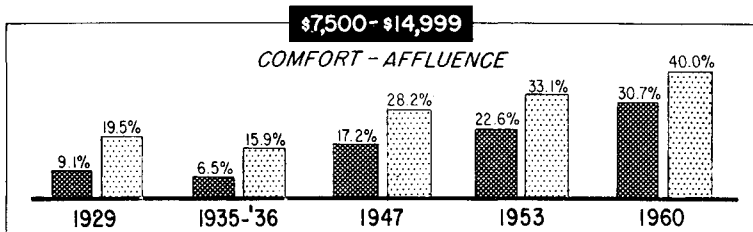
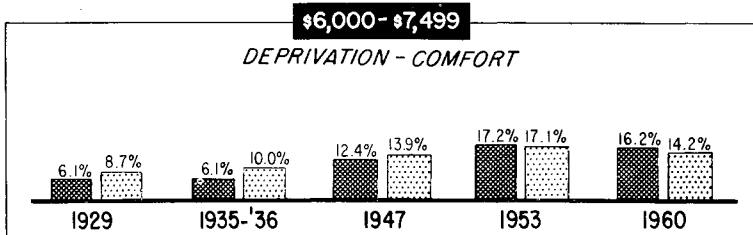
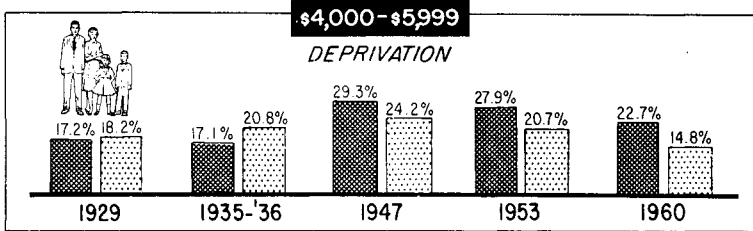
Data: Department of Commerce, except that numbers of consumer units in "under \$1,000" and "\$1,000-\$1,999" groupings are estimated by CEP on basis of Commerce Department data for families and individuals with incomes "under \$2,000". CEP has also estimated shares of income for "under \$1,000" and "\$1,000-\$1,999" groupings.

## PERCENT OF FAMILIES ABOVE POVERTY AND THEIR SHARE OF INCOME, 1929-1960

Percent of Multiple Person Families with Annual Incomes<sup>1/</sup> of \$4,000 and Over, Before Taxes, and Their Share of Total Family Income, In 1960 Dollars

■ Percent of All Families

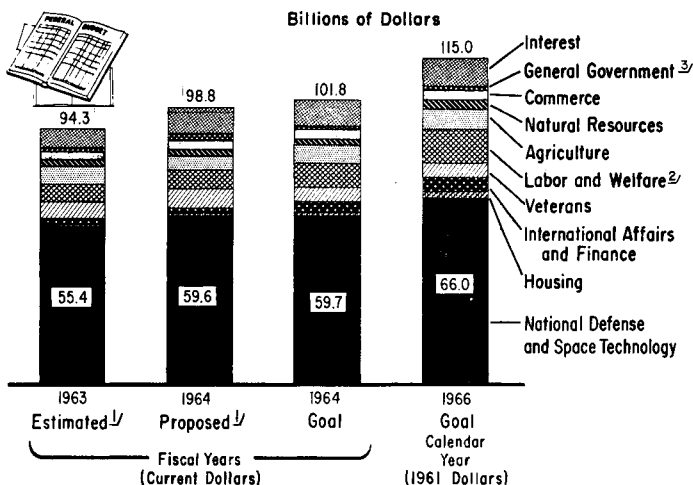
▤ Their Share of Total Income



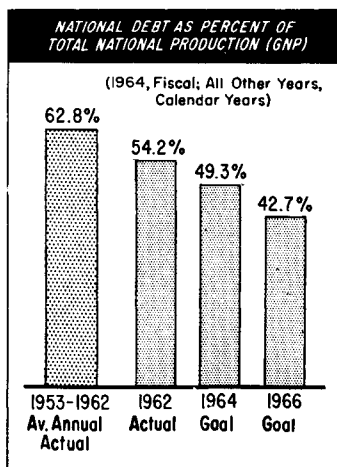
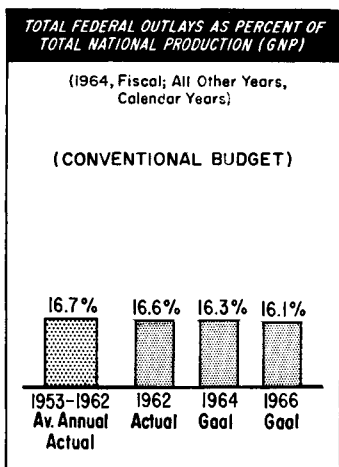
<sup>1/</sup>Includes in addition to cash income the monetary value of food and fuel produced and consumed on the farm, and other nonmoney income.

Data: 1929 and 1947-'60, Dept. of Commerce. 1935-'36, Nat'l. Bureau Economic Research. 1960 distribution partly CEP estimated. Conversions to 1960 dollars, CEP.

## 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 Message of Jan. 17, 1963

<sup>2/</sup> Including education and health services

<sup>3/</sup> Including contingencies and less interfund transactions



# A FEDERAL BUDGET GEARED TO JOBS FOR ALL AND ADEQUATE PUBLIC SERVICES

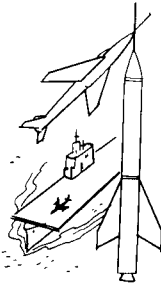
1964, Fiscal Year; 1966, Calendar Year  
Per Capita Outlay in 1961 Dollars

## TOTAL FEDERAL OUTLAYS



Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	16.60	501.24	
1964 Goal	16.29	516.45	
1966 Goal	16.10	575.00	

## NATIONAL DEFENSE, SPACE TECHNOLOGY AND ALL INTERNATIONAL



Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	10.47	316.12	
1964 Goal	10.18	322.65	
1966 Goal	9.94	355.00	

## EDUCATION



Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	.26	7.80	
1964 Goal	.32	10.15	
1966 Goal	.63	22.50	

## HEALTH SERVICES AND RESEARCH



Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	.28	8.33	
1964 Goal	.32	10.15	
1966 Goal	.45	16.00	

## PUBLIC ASSISTANCE



Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	.51	15.34	
1964 Goal	.51	16.23	
1966 Goal	.52	18.50	

## LABOR AND MANPOWER, AND OTHER WELFARE SERVICES



Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	.16	4.81	
1964 Goal	.16	5.07	
1966 Goal	.15	5.50	

## HOUSING AND COMMUNITY DEVELOPMENT



Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	.05	1.40	
1964 Goal	.16	5.07	
1966 Goal	.32	11.50	

## ALL DOMESTIC PROGRAMS AND SERVICES



(Includes also  
Agriculture;  
Natural Resources;  
Veterans; Commerce;  
Interest; General  
Government, etc.)

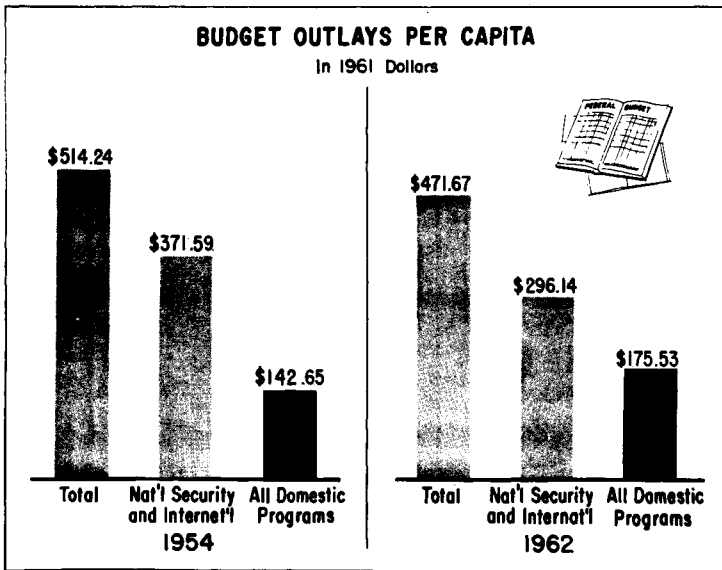
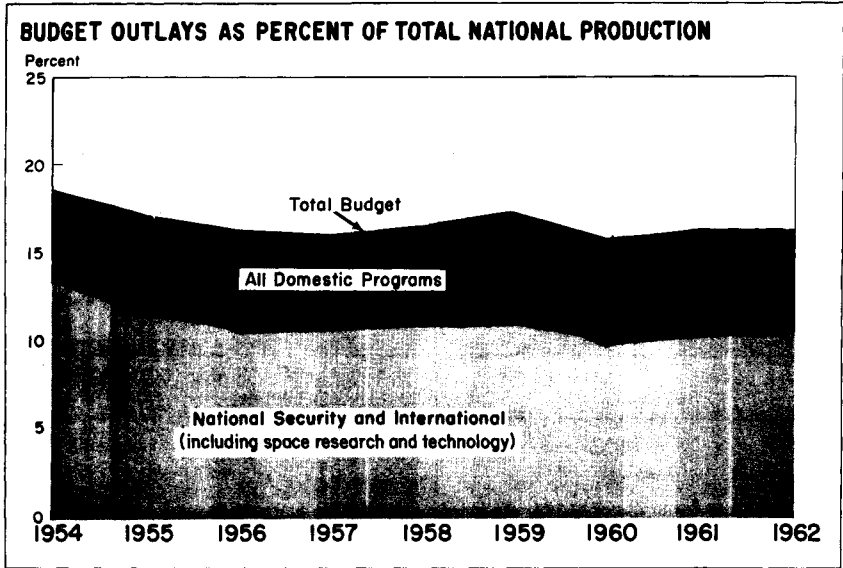


Year	% of Total	Per Output	Per Capita
1964 Adm. <sup>1/2</sup>	6.13	185.12	
1964 Goal	6.11	193.80	
1966 Goal	6.16	220.00	

<sup>1/2</sup>Administration's proposed budget as of Jan. 17, 1963.

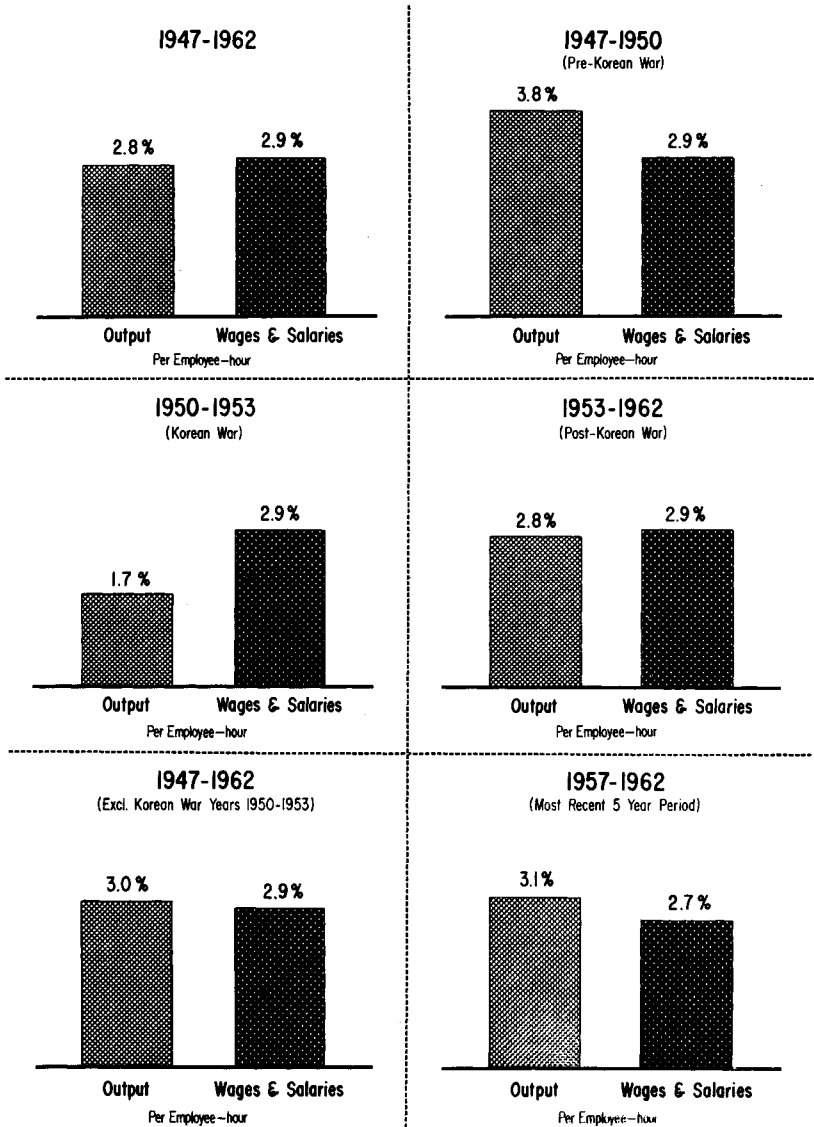
# FEDERAL BUDGET HAS SHRUNK RELATIVE TO TOTAL OUTPUT AND NEEDS, 1954-1962

Fiscal Years



## RATES OF CHANGE PER EMPLOYEE-HOUR IN NONFARM OUTPUT AND WAGES AND SALARIES, 1947-1962 <sup>1/</sup>

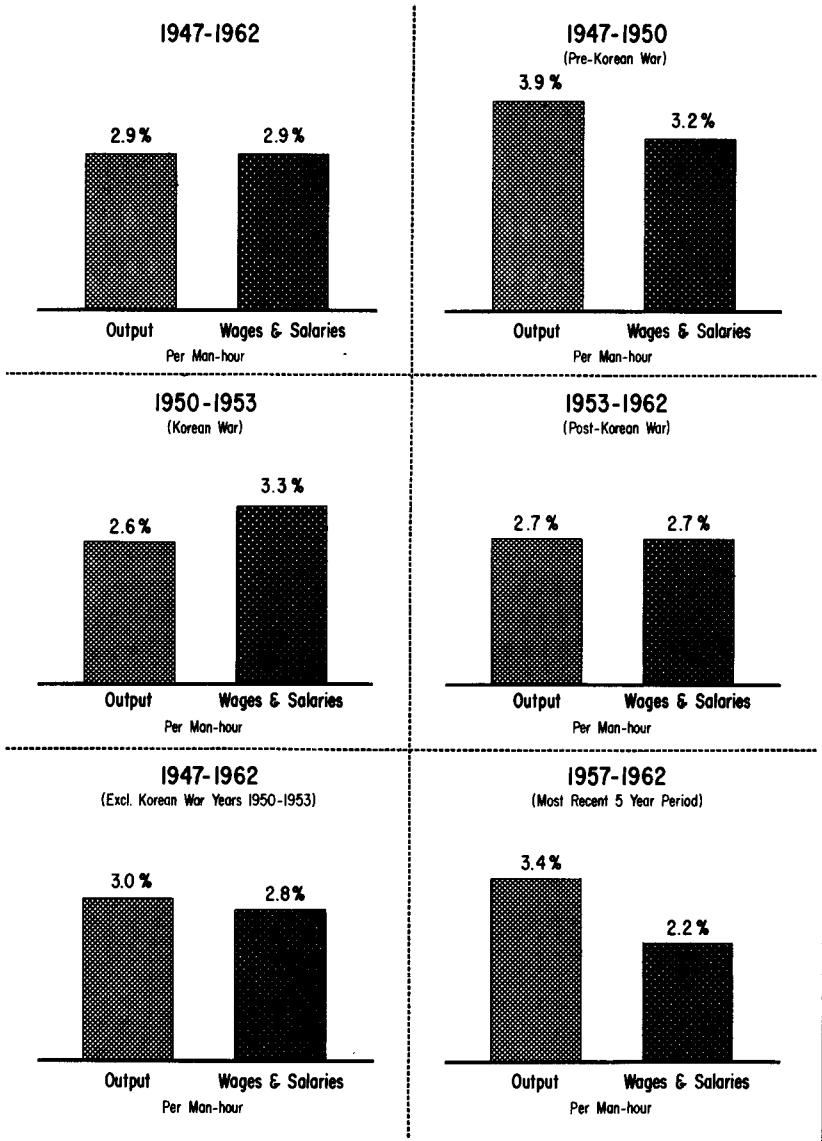
Annual Average Rates of Change, Measured in Uniform Dollars



<sup>1/</sup> 1962 estimated

## RATES OF CHANGE PER MAN-HOUR IN MANUFACTURING OUTPUT AND WAGES AND SALARIES, 1947-1962 <sup>↓</sup>

Average Annual Rates of Change, Measured in Uniform Dollars



<sup>↓</sup> 1962 estimated



## FEDERAL STATISTICS USERS' CONFERENCE

WASHINGTON, D.C., *February 15, 1963.*

Senator PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
New Senate Office Building,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: The Federal Statistics Users' Conference appreciates your kindness in extending an invitation to comment on the Economic Report of the President.

Members of the Federal Statistics Users' Conference have joined together because of their common interest in the development of a Federal statistics program of optimum usefulness at minimum cost. The Conference's statement is limited to comments on the Federal statistical program which provides the informational background for the Economic Report.

Sincerely yours,

MARVIN FRIEDMAN, *Chairman.*

### STATEMENT BY THE FEDERAL STATISTICS USERS' CONFERENCE FOR THE JOINT ECONOMIC COMMITTEE, FEBRUARY 15, 1963

The Federal Statistics Users' Conference is composed of 150 organizations which use Federal statistics and are interested in their improvement. Members of the conference are drawn from all sectors of the economy: from business, labor, farm, and nonprofit research groups. Because of the diversity of their interests, members of FSUC have diverse views about the substance of any given Economic Report and can offer the committee little help in evaluating these aspects of the report.

The conference would like to take this opportunity to present some views on the statistical materials which make up the factual background of the report. Despite a diversity of interests and views on economic policy, we have a common interest in the development of adequate statistical materials from Federal sources. This is the storehouse of information from which we all draw in the conduct of our various activities. It is the same storehouse from which the President and his Council of Economic Advisers draw in developing the Economic Report. It is the same storehouse from which you draw in evaluating that report, in performing your legislative functions as members of this committee and in dealing with substantive policy issues.

Basically, the President's Economic Report uses the national economic accounts framework for its analysis. GNP and national income have become household words. There is a danger that these important concepts may become empty shibboleths instead of useful tools of analysis. There is a tendency on the part of some users both in and out of the Government to find easy mechanistic relationships among the components of the gross national product and to make easy

assumptions about the effect of this or that possible public or private policy on the overall total GNP.

Nothing could be more dangerous. There is no substitute for penetrating analysis of GNP in detail. The very popularity of GNP should cause us all to be concerned about changes taking place within the economy which are reflected in the components of GNP but which are slow to make an impact in the overall GNP figure.

The Office of Business Economics has been working at this job. Over the last few years it has received some additional funds for this purpose. The President's budget proposes another modest infusion of dollars.

Money is necessary, and even more will be needed in the future if OBE is to play its proper role. The basic problem, however, is to obtain the necessary increase in economic talent which is more than a matter of financial resources.

OBE has still to receive proper recognition of its importance, or its potential, either within the Government or the Department of Commerce. It has had a talented staff, and it is not surprising that it has been subject to drains on that talent. It must be helped to minimize those losses and aided in recruiting new talent.

To look on OBE as merely the compiler of the national economic accounts and the balance of payments and the publisher of the Survey of Current Business is the road to nowhere. It will become more and more difficult to recruit talented people to replace those who retire or drift away to other agencies or to nongovernmental positions. A bigger burden will be placed on those whose stubborn, professional pride and sense of dedication will compel them to try to do the impossible.

Instead, OBE must be given a job to do. It must be told that it is responsible for improving the national economic accounts, not merely for maintaining them, for making deeper and more meaningful analyses of the data it turns out and for organizing more useful data structures. It can be told to delve into its figures on consumer expenditures, to look at the factors affecting business investment, to make a sharper appraisal of the impact of Government expenditures on the economy. In short, it can be told to keep users aware of the booby-traps hidden in an uncritical reliance on the global totals of GNP and national income. OBE has been doing this job in part. It can do more.

At best it would take several years to build an adequate staff to do this, and it would take additional appropriations maybe up to twice those OBE has been spending in the recent past.

We can ill afford an OBE that is only routinely doing what it has done in the past, that finds it most difficult to recruit and retain high caliber personnel, that turns out a product which is important, yet only moderately satisfactory. The country can afford more money to do a job that needs to be done, which OBE can do, and which it should be equipped to do. This is a matter deserving of the Joint Economic Committee's most careful attention.

## EMPLOYMENT AND UNEMPLOYMENT STATISTICS

During the past year and a half, Federal statistics on employment and unemployment have been subjected to a degree of criticism and investigation of unparalleled intensity. The Economic Statistics Subcommittee of the Joint Economic Committee devoted 3 days of hearings to this subject in December 1961. This review was followed by a detailed examination of the data by the President's Committee To Appraise Employment and Unemployment Statistics.

Both of these reviews came to the same basic conclusion that existing data are founded on sound concepts and are prepared by competent objective personnel. Both reviews concluded, however, that present-day problems and present-day uses of the data require more penetrating inquiries than have been made in the past.

The President's budget proposes to embark on a number of programs designed to achieve some of the objectives recommended both by the subcommittee and by the President's Committee. The bill for doing the job is large in comparison with past expenditures. It looks even bigger because it comes in a year in which substantial increases in Federal pay rates are making themselves felt for the first time. But the job won't become any cheaper in the future. It costs money to improve State and local area employment figures, to press the man who says he is unemployed to tell what he has really done to look for a job, and to work up some reasonably reliable and detailed figures on employment by occupation, to find out something about what causes people to enter or leave the labor force, or to find out whether it is practical to develop some regular repetitive information on job vacancies.

One aspect of the proposed program is worth particular attention. A substantial part of the increase would be used to develop a household survey sample about half as large as the Current Population Survey which is the vehicle for the Monthly Report on the Labor Force. This sample would be used for experimentation necessary to the achievement of some of the objectives sought in the recommendations which both you and the President's Committee made.

This is a useful purpose, but the Bureau of Labor Statistics needs to make clear how it intends to use this sample in the future. Experimentation for a reasonable period of time followed by the use of this sample as a regular source of data is understandable because experimentation is necessary and because the present sample has become so loaded with questions that it is being pressed to its practical limits. A permanent experimental sample or one carried for several years would be more difficult to justify as a sound proposition since the experimental sample would cost about one-third of the total amount being spent to get monthly data from household surveys.



## LOCAL AREA INFORMATION

As is customary, the statistical information included in the President's Economic Report is of a summary character, limited to national aggregates. This is as it must be for purposes of the Economic Report. As members of this committee know, the country's problems are not evenly distributed geographically. On numerous occasions members of the committee, and staff reports from the committee, have noted the lack of adequate local area information on a current basis.

The President's budget has recognized this need, and contains several proposals to develop significant current economic indicators for a number of metropolitan areas. Population, retail trade, personal income, housing vacancies, and employment data are some of the important kinds of information which would be supplied either for the first time or in greater quantity or of better quality than heretofore. Since both public and private policy must take account of the differential impact of economic phenomena in various parts of the country, we hope that this committee will offer continuing encouragement to the efforts proposed in the President's budget.

## AGRICULTURAL STATISTICS

This year's Economic Report does not linger very long on the problems of agriculture. Consequently, the only statistical information is that which is regularly included in the appendix.

Problems associated with agriculture give rise to some of the most controversial issues of the day. There seems little likelihood that controversy will be stilled in the foreseeable future. It is time to take a searching look at agricultural statistics to make sure that the information being produced corresponds to that which is needed or will be needed within a few years.

## BETTER USE OF EXISTING SOURCES

It often seems that new needs for information mean just more statistics instead of more meaningful statistics. This is frustrating to those who are asked to fill out new reports and to those who can't understand why informational needs can't be met out by revising existing programs.

In many cases new reports are required, but considerations of cost and respondent reaction should impel statistics producers to utilize existing data sources to the utmost.

The use of tax returns as a source for basic economic information has been expanded substantially in quantity and has improved substantially in timeliness over the last few years. Much more in the way of valuable and useful information can still be mined from this source at minimum cost and efforts to use it even more effectively should continue.

We deeply appreciate the efforts which this committee has made to obtain more effective use of these data. Statistics of Income is a far more valuable series today than it was a few short years ago and County Business Patterns looks as though it may finally get out of the rut of tardiness.

In connection with the latter, it is worth noting that the President's budget proposes the production of County Business Patterns as an annual publication. This will be a substantial step forward. It would be even more useful if its timeliness could be improved. Since employer reports (Form 941: Employer's Quarterly Federal Tax Return) on which County Business Patterns is based are on punch cards, it would be worth while investigating the practicality of entering the number of employees on the card along with total taxable wages paid. If this were found to be practical, it should be possible for Census to begin work on County Business Patterns some 4 or 5 months earlier than is now the case.



## MACHINERY & ALLIED PRODUCTS INSTITUTE

WASHINGTON, D.C., *February 13, 1963.*

HON. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
New Senate Office Building,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: In accordance with your invitation of January 23 the Machinery & Allied Products Institute is pleased to present to the Joint Economic Committee its comments on the materials and recommendations contained in the 1963 Economic Report of the President, including the appended Report of the Council of Economic Advisers. Twenty copies of the MAPI statement are enclosed as requested.

If we can be of further service please call on me.

Cordially,

CHARLES STEWART, *President.*

STATEMENT OF THE MACHINERY & ALLIED PRODUCTS INSTITUTE ON THE ECONOMIC REPORT OF THE PRESIDENT, SUBMITTED TO THE JOINT ECONOMIC COMMITTEE BY GEORGE TERBORGH, RESEARCH DIRECTOR, FEBRUARY 13, 1963

Mr. Chairman and gentlemen, we appreciate your invitation to comment on the 1963 Economic Report of the President, which we assume to include for this purpose the Annual Report of the Council of Economic Advisers.

Since the central issue in both reports is the administration's tax program, and since it promises to be a principal preoccupation of the Congress at this session, we have chosen to limit our observations to this issue. We want particularly to explore some of the basic economic assumptions underlying the program.

### 1. OVERSIMPLIFICATION IN OFFICIAL PRESENTATIONS

We should like to begin with a few comments on the oversimplification of the issues in official presentations.

Federal tax reduction at this time involves a deliberate increase in an already substantial deficit. Since this runs counter to traditional concepts of fiscal probity, and strikes many people as dangerous and irresponsible, it is obvious that the administration confronts a major "selling" effort. Obviously also, the time for this effort is short if action is to be had at this session of Congress.

Under the circumstances, it is understandable that in its effort to expound sophisticated doctrines on matters beyond the knowledge of the layman, the administration should present its thesis in white and black. In the Economic Report, as in other state papers submitted to Congress recently—the state of the Union message, the special message on tax reduction and reform, etc.—the impression is created that

there is more certainty than in fact exists both as to the diagnosis of our economic ills and as to remedies. Disputed and controversial propositions appear with the aura of established truth.

*Reason for recent slackness*

One oversimplification has to do with the reasons for the unsatisfactory performance of the economy since 1957. The administration attributes this primarily to the repressive effect of heavy Federal taxes. This is one theory, but there are others. Indeed there is a whole list of factors given varying weight and emphasis by different economists. Some have to do with developments prior to the period of slackness, others to events occurring within it.

One of the antecedent developments was the exhaustion by 1957 of the special stimuli to demand carried over from World War II and the great depression. Another was the overexuberance of the 1955-57 capital goods boom, which left a good many industries with excess capacity. Among the events within the period, there was the setback to the 1958-59 recovery by a 4-month steel strike and a highly restrictive monetary and credit policy. During the recovery now underway, we have had the steel price episode, a stockmarket shakeout, a sluggish growth of the money supply, a profit squeeze, etc. Individual analysts will expand the list to suit their taste. The point is that there are plenty of explanations around other than the weight of the Federal tax load.

We should be the last to minimize the burden of Federal taxes on the economy, which is certainly onerous, not only because of its magnitude, but because of its distribution. We have a tax structure that bears heavily on enterprise, risk-taking, and productive investment. It exerts a continuous drag on economic progress. It does not follow, however, that this is the principal reason for the failure of the 1958-59 recovery to reach completion, or for the sluggishness of the current recovery. We may point out that the Federal tax structure and rates in both of these recoveries were practically the same as in the recovery of 1954-55, which was an exceptionally vigorous one. Something else must have changed in the meantime.

*Adverse swings in budget position*

The administration makes much of the drag on the current recovery and the preceding one from adverse shifts in the Federal budget position. The wide swings from deficit to surplus as the economy expands are deemed too repressive. They are said to choke off recovery before completion.

This theory must reckon with the rather disconcerting fact that adverse budget swings have been relatively smaller in the two most recent recoveries than in earlier ones that carried through to completion. If we take the total swing (decrease of deficit plus increase of surplus) during each of the postwar recoveries as a percentage of the increase in the gross national product over the interval, we get the picture on the following page.<sup>1</sup>

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<sup>1</sup> The swing is measured in terms of the so-called national-accounts budget, now favored by the administration in discussions of this subject.

*Adverse budget swing as percentage of GNP growth*

[From quarterly figures]

Recovery	A	B
	During the 12-month period of greatest swing <sup>1</sup>	During the 18-month period of greatest swing <sup>2</sup>
1949-50.....	58	39
1954-55.....	47	48
1958-59.....	25	34
1961-62.....	9	10

<sup>1</sup> 1949-III to 1950-III; 1954-I to 1955-I; 1958-II to 1959-II; 1961-I to 1962-I.<sup>2</sup> 1949-III to 1951-I; 1953-IV to 1955-II; 1958-III to 1960-I; 1961-I to 1962-III.

Certainly the adverse budget swing is a dubious explanation for the sluggishness of the present recovery. It has been by far the smallest of the lot; indeed during 1962, when the recovery slowed up, there was no adverse swing at all.

*Surplus at the end of the swing*

If we turn from the total swing to the size of the Federal surplus attained at the top of the swing, we also get nowhere. The current recovery is the only one in the postwar period that has not developed a surplus. The budget position has remained in deficit, and promises to do so for some time.

*Peak surplus as percent of GNP <sup>1</sup>*

Recovery :	Quarterly figures
1949-50.....	6.4
1954-55.....	1.6
1958-59.....	1.6
1961-62.....	-.1 (Minimum deficit)

<sup>1</sup> 1951-I, 1956-I, 1960-I, 1962-II.

If neither the total adverse swing in the budget position nor the surplus reached at the end of it appear to have much explanatory value in the present situation, it is obvious that other diagnoses are in order.

We recite these facts, not to advance a position of our own, but to emphasize the oversimplification of the official presentation. We suggest that it deserves the critical scrutiny of the Committee before the proposed remedy is adopted.

## 2. POSTWAR SURPLUSES AND DEFICITS IN RELATION TO ECONOMIC TRENDS

There is danger that the administration's educational campaign will lead to a naive, even mystical, exaggeration of the potency of Federal deficits as an economic stimulant. History does not warrant such enthusiasm. We need only cite the fact that in the thirties the Federal Government ran deficits for 10 years in a row, at an average rate exceeding 3 percent of the gross national product, and that the economy finished the period still depressed. (A comparable deficit

today would be \$17 billion a year.) To take a more recent example, the economy has run slack since 1957 notwithstanding an accumulated deficit of \$20 billion over the interval. Whatever may be said of deficits (and we do not prejudge the question at this point), there is clearly no magic in them.

This conclusion is confirmed by postwar history. The chart which follows compares the change in the gross national product from the preceding quarter with the position of the Federal budget in the current quarter.

### *Analysis*

If Federal deficits are stimulative of the economy, and surpluses repressive, we might expect to find expansion predominant during deficit periods and contraction predominant during periods of surplus. A glance at the chart fails to show any general pattern of this character. The relation between the budget position and economic trends has been highly variable and irregular. There have been extended periods (a year or more) with rising GNP and budget surpluses,<sup>2</sup> others with rising GNP and deficits.<sup>3</sup> There have been periods with falling GNP and deficits,<sup>4</sup> others (a short one) with falling GNP and surpluses.<sup>5</sup> Of 51 quarters with a rising GNP, more than half (28) were associated with a Federal surplus, 23 with a deficit, while of 13 quarters with declining GNP, nearly all (12) were associated with a deficit.

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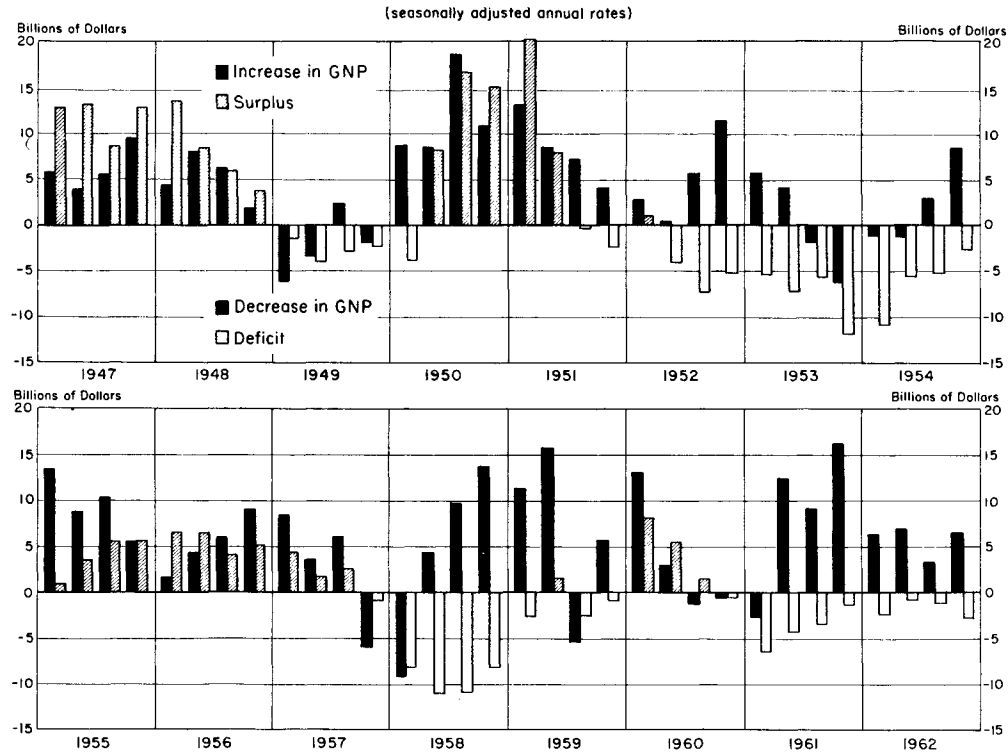
<sup>2</sup> 1947-48, 1950-II to 1951-II, and 1955-I to 1957-III.

<sup>3</sup> 1952-III to 1954-II, 1958-II to 1959-I, and 1961-II to 1962-IV.

<sup>4</sup> 1949, and 1953-III to 1954-II.

<sup>5</sup> Only two quarters in this case, 1960-III and IV.

**Chart 1: Change in the Gross National Product from the Preceding Quarter, Compared with the Position of the Federal Budget in the Current Quarter**



Source: Department of Commerce. The budget position is reported on the national-accounts basis.



It may be objected that there is a lag between the budget position and the response of the economy, hence that we should "lead" the former by a reasonable period. If we lead it by 6 months, the picture is not greatly altered. Of 51 quarters with rising GNP, 24 show budget surpluses in the second quarter preceding, 27 deficits. Of 13 with falling GNP, 7 show surpluses, 6 deficits.

For those preferring a more formal analysis, the coefficient of correlation between the budget position in the current quarter and the GNP change from the preceding quarter is +.390. In other words, there is a slight positive correlation between surpluses and rising GNP (or deficits and declining GNP). When we lead the budget position by 6 months, the correlation is  $-.04$ . This has no statistical significance.

#### *Possible explanations*

The absence of any significant correlation for the postwar period between the Federal budget position and economic trends raises the interesting question of why the alleged effect of the budget position has failed to register. There may be two reasons: (1) Its impact may be submerged by other factors; (2) it may not have the impact alleged.

If we were dealing with simple one-way causation—if economic movements were controlled exclusively by the Federal budget position—we would expect by conventional theory to find expansion associated with deficits and contraction with surpluses. But the causation is not one way. The budget position is itself influenced by the movement and level of economic activity. What we have is a complex interaction in which the influence of the budget may be submerged by more powerful forces, hence may not be separately identifiable.

It must be recognized that even sizable surpluses or deficits are small in relation to the GNP (\$10 billion is less than 2 percent, for example), and that even if their influence is in the theoretical direction it can be submerged for extended periods of time by countertrends in the economy. It can be argued for this reason that the absence of the expected statistical correlation for the postwar period is due to the smothering of the budget impact by such countertrends.

We regard this contention as exceedingly dubious. In our opinion, the key to the mystery lies elsewhere. The budget position has not had the impact attributed to it by the administration. With your indulgence, we should like to develop the point briefly.

### 3. THEORY OF FISCAL POLICY

It is sometimes assumed that Federal deficits are always and inherently stimulative to the economy and that surpluses are on the contrary always and inherently repressive. This is a gross oversimplification.

If we rightly understand the position of the administration, it rests on the assumption that an increase in the Federal deficit through tax reduction will yield a net addition to private spending. At first glance, this seems to follow inevitably from the fact that the beneficiaries of the reduction will have more after-tax income to spend. But there is another side of the shield. Unless the added deficit is

“monetized,” that is to say, unless it is financed by the creation of new money, it must be financed from private savings.

If it is so financed, it places the Treasury in competition with all other users of capital—corporations, unincorporated businesses, State and local governments, home mortgage borrowers, etc.—for these savings. This competition cuts down the amount of funds available to these users. If the added Federal deficit is substantial, the drain on the capital market is reflected in higher bond yields, higher mortgage loan rates, and lower credit availability than would otherwise obtain. Marginal credit, and marginal users of credit, are squeezed out in favor of the Treasury. Thus the increase in spending by the beneficiaries of the tax reduction may be partially or wholly offset by the decrease in private (and State and local) investment financed through the capital market.

#### *Variable effects*

Whether the offset is partial or complete depends on circumstances. During economic recessions, when the private demand for funds is declining and the capital market is sloppy, it is possible for the Treasury to increase its absorption of savings without a concurrent reduction of comparable amount in non-Federal investment. If this increased absorption stimulates the economy, it is even possible that there may be no net reduction at all. But when the Treasury absorbs savings in more normal markets, the offsetting curtailment of non-Federal investment is both more prompt and more complete. The stimulative effect is correspondingly diminished.

Here, certainly, is one reason for the failure of Federal deficits of the postwar period to show the stimulative magic assumed by the official theory. The Treasury has run deficits, not just during recession, but more than half of the time (35 quarters out of 64).<sup>6</sup> Since they have been financed largely out of savings, they have exerted a drag on private (and State and local) investment that has gone far to offset their stimulus.

#### *Present situation*

At the present time, the economy is not in recession, but has been expanding continuously for 2 years. It is, by various estimates, within 5 or 6 percent of its current potential and it may be closer than that. The capital market is in equilibrium. There is no hoard or pool of idle funds that the Treasury can absorb without detriment to other borrowers. Under these conditions, it is by no means certain that an added Federal deficit financed from savings would be significantly stimulative. In all probability, it would be substantially, if not largely, offset by the displacement of non-Federal investment.

Obviously, such displacement is precisely what the economy does not need. Thanks in part to a tax structure weighted against saving and investment, we already have a high-consumption, low-investment economy. For the decade of the fifties, total fixed investment in the United States was a smaller percentage of GNP than in 8 of 12 Western industrial countries. In terms of investment in productive equipment, we were at the bottom of a list of 10 such countries. Not sur-

<sup>6</sup> National accounts basis.

prisingly, our economic growth rate over the decade was second from the bottom.<sup>7</sup>

#### 4. FINANCING DEFICITS

These observations are not intended to exclude the possibility of an increase in the Federal deficit through tax reduction, but they do raise the question of how such an increase (if there is one) should be financed.

The administration has been rather vague on this question, in part, no doubt, because it involves Federal Reserve policy over which it has no direct control. In its 1963 report, the Council of Economic Advisers conveys the impression that it would welcome a considerable degree of monetization,<sup>8</sup> but recent statements of the Chairman of the Federal Reserve Board suggest extreme reluctance to do more than the unavoidable minimum.<sup>9</sup> The whole question is very much up in the air.

##### *The "inflation" angle*

There is a widespread belief that a deficit financed from savings is less "inflationary" than one financed by an increase of bank credit (one that is monetized). If this is so, it is only because it is less effective. It takes more of it to produce a given result. But if it is carried too far (assuming it is in fact expansionary), it becomes as inflationary as a monetized deficit carried too far. The main difference is in the appropriate dosage.

The notion that a monetized deficit is necessarily and inherently inflationary apart from circumstances and the extent of its use is a popular fallacy. Provided it does not expand the Nation's money supply beyond its legitimate requirements, it can be expansionary without being inflationary. Moreover, as we have just noted, it can achieve a given expansion with a fraction of the deficiteering required by the other approach.

The real question at present is whether the money supply can properly be enlarged by further monetization of the Federal deficit. We should like to address this question for a moment.

##### *Position of the money supply*

The Federal Reserve System has followed for years an extremely restrictive monetary policy.<sup>10</sup> Over the decade 1952-62, for example, the money supply (demand deposits and currency) has been permitted to grow at an average rate just over 1.5 percent a year (compounded). This compares with an average annual growth of 4.8 percent in the gross national product. It has been possible to have this GNP growth because of constantly rising money turnover rates, starting from the abnormally low level obtaining at the end of the war. This process of acceleration cannot go on forever. The ratio of money supply to GNP has already worked its way down to a very low level by historical standards, as can be seen from chart 2.

<sup>7</sup> "Capital Investment and Economic Progress in Leading Industrial Countries, 1950-60," *Capital Goods Review* No. 48 (January 1962).

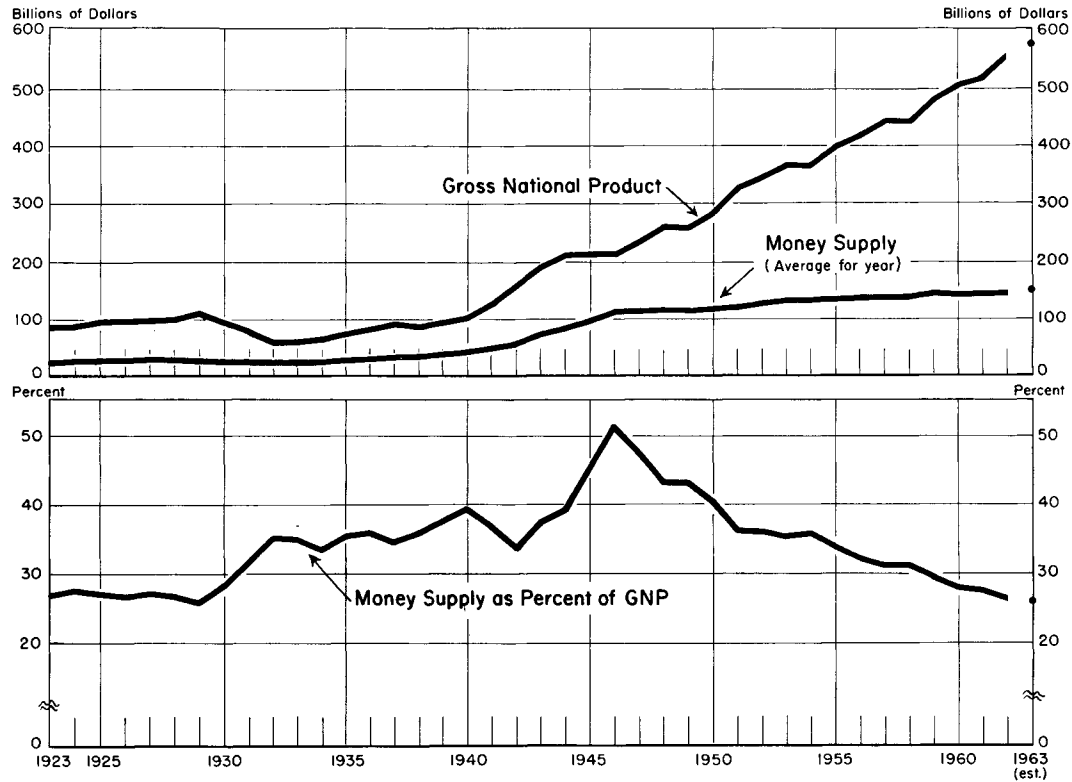
<sup>8</sup> Pp. 53-55.

<sup>9</sup> William McChesney Martin, statement to this committee, Feb. 1, 1963.

<sup>10</sup> We use this term to denote money-supply policy, as distinguished from credit policy. These are not the same, and do not always move in harmony.

While no one can say with assurance what the turnover potential of the money supply is these days (so many changes having occurred since earlier experience with current rates), we strongly suspect that the economy has for some time encountered resistance to further acceleration. This suspicion is strengthened by its behavior over the past 5 years. It has suffered less from specific maladjustments than from a kind of general debility. It has lacked energy. Not once in this interval has it achieved a level of aggregate demand sufficient for full prosperity. These symptoms are precisely what we would expect from an inadequate money supply. Here, in our opinion, is a more plausible explanation of the sluggishness of the system than an insufficient Federal deficit.

Chart 2: Gross National Product, Money Supply and Ratio of Money Supply to GNP



Sources: Department of Commerce and Federal Reserve System.

*Monetary growth requirements*

While we repeat that no one (including the Federal Reserve Board) can say for sure how much additional acceleration of money turnover is in the cards, it is interesting to see how much expansion of the money supply would be required if the rate were to level off where it now is. To get the GNP up to the \$600 billion a year level said to be its current potential would require an addition of \$10 billion. If the GNP were to grow thereafter only at the average rate of the fifties (4.8 percent annually in current dollars), it would require a yearly increase in the money supply of \$7 billion. This is more than it has grown over the past 4 years.

Even if turnover acceleration continues some time longer at a reduced rate, there will still be a need for more rapid monetary growth than we have been having. We believe that a properly controlled monetization of the Federal deficit is both desirable and safe.

## 5. OUTLINE OF POLICY

What we have had over the past few years is a fiscal policy at least intended to stimulate the economy, and a monetary policy calculated to restrain it.

Until recently, it was possible to attribute this restrictive policy to the constraints imposed by our gold and balance-of-payments position. But it is now clear, at least so far as the Chairman of the Federal Reserve Board is concerned, that it is justified on other grounds as well. Witness the following statement:

"My present feeling is that the domestic liquidity of our banks is now so high that still further monetary stimulus would do little if any good—and might do harm—even if we did not have to consider our payments situation at all [emphasis ours]. This means that if any additional Government action is needed in the financial field in order to give fresh expansive impulse to the economy, it would probably have to come from the fiscal side."<sup>11</sup>

If this is the final position of our monetary authorities, it is, of course, bootless to suggest even a modest monetization of the deficit. We are going to assume, however, that their cooperation would be forthcoming if Congress gave a strong lead, and our policy recommendations are pitched accordingly.

*General approach*

Since monetary policy has made very little contribution to economic expansion in recent years, the stimulative efforts of the Federal Government have been concentrated almost entirely on fiscal policy. The result has been a bad balance between the two—monetary policy underworked, fiscal policy overworked. It follows that the basic approach to our present problem should be the restoration of monetary policy to its proper place. Primary emphasis should be placed on monetary expansion. The object should be the monetization of enough of the Federal deficit to build the money supply at the rate desired.

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<sup>11</sup> William McChesney Martin, "Monetary Policy and International Payments," an address to the American Economic Association and the American Finance Association, Pittsburgh, Dec. 28, 1962. That at least one member of the Board takes some exception to this view is indicated by the recent testimony of George W. Mitchell before this committee (Feb. 1, 1963).

It is by no means certain that this will require an addition to the deficit already in prospect with the existing tax structure (some \$8 or \$9 billion for fiscal 1964). Conceivably it may be practicable, with the cooperation of the Federal Reserve System and the Treasury debt managers, to achieve the desired rate of monetary expansion without further enlarging this deficit. If, however, this is not considered practicable because of the restraints imposed by our balance-of-payments position, any enlargement of the deficit should be held to the minimum required for monetary purposes. This should be a fairly modest amount.

#### *Priorities in tax reduction*

Assuming an increase in the deficit is needed for monetary expansion, the question arises as to priorities in tax reduction. We believe first priority should be given to two long-overdue reforms, a reduction in the corporate rate and a scaledown of high-bracket personal rates. These reforms would not only eliminate two of the more indefensible survivals from wartime taxation; they would be a more potent economic stimulus, dollar for dollar, than tax relief primarily for the benefit of consumption.

Unlike tax relief for consumers, which increases their disposable income without affecting the appeal of the objects of expenditure, a reduction of the corporate rate has a dual effect: it increases the supply of funds and at the same time enhances the attractiveness of investment projects available for their use. By lowering the investment threshold, it enlarges the volume of eligible projects.

This point is discussed in an institute publication, "Effect of the Corporate Income Tax on Investment" (March 1959), from which we should like to quote briefly:

"The process of capital investment may be described as the incurring of capital charges in order to obtain an operating advantage, that is to say, a favorable change in the relation of revenue to operating costs. The corporate income tax falls on the earnings of equity investment. This means that to justify such investment a project must promise to yield a pretax return that will leave an attractive aftertax return when the tax is paid. Stated otherwise, it must promise not only an attractive aftertax return but the tax as well.

"The present corporate levy of 52 percent on taxable income is equivalent to a rate of 108 percent on the after-tax return required to justify investment. If that return is 10 percent, for example, the tax is 10.8 percent of investment, the combined rate being therefore 20.8 percent. What the tax does, in effect, is to raise the required pretax return to this rate. This alters the 'terms of trade' between capital charges and operating advantage to the detriment of the former.

"The increase in the required pretax return automatically excludes a whole range of investment projects that would be eligible in the absence of the tax, or at a lower tax rate. It limits eligibility, in other words, to projects of great urgency. The result is the deferment of both new business ventures and investments in the improvement of existing operations until their expected pretax return rises to the higher requirement.

"The main effect of such a high corporate investment threshold is to hold an umbrella over existing productive facilities. For it defers the introduction of new capacity competitive therewith. Old facil-

ities must become more decrepit and inefficient before they are replaceable. Their service lives are extended. The economy drags along in consequence with a productive mechanism of higher average age, and with more accumulated deterioration and obsolescence, than would obtain in the absence of the tax."

A reduction of the corporate rate by 5 points, from 52 to 47 percent, which we recommend as an interim objective, would make eligible for investment a whole range or tier of projects now excluded. Our calculations indicate many billions of dollars worth. Both from a long-range standpoint, and from the standpoint of near-term economic stimulation, this reform deserves top priority.

As for the scale-down of the high-bracket rates on personal income, little need be said. Those rates are generally recognized as indefensible. Such a scale-down, say to a top of 65 percent, would cost relatively little in revenue and would be strongly stimulative. Here, as with corporate rate reduction, the effect is twofold: the supply of disposable funds is enlarged, and the attractiveness of investment projects is simultaneously enhanced.

If these top-priority tax reductions fail to provide a sufficient increase in the Federal deficit for the purpose of monetary expansion, other reductions will of course be in order. As to these, in the event they are needed, we reserve our recommendations for the fiscal committees of Congress.

### *Conclusion*

We should like to make another point in closing. We have urged that corporate and top-bracket rate reduction be given priority if it is found necessary to enlarge the Federal deficit to achieve an appropriate rate of monetary expansion.

Actually, we go further. We believe that these two reforms are so urgent, and so long overdue, that they should be enacted even if an enlargement of the deficit is not deemed necessary. In that event, the loss of revenue—around \$3 billion a year—should be compensated either by a reduction of Federal expenditures, increases in other levies, or from new sources of revenue—such, for example, as a broadened excise tax system. The elimination of these wartime relics should not be longer delayed.

Finally, we should like to say a word on the importance of controlling the expenditure side of the Federal budget. No effort to relieve the economy of repressive taxation can get far if the budget continues to expand at its recent rate. This can only compound our fiscal difficulties over the long run. Restraint on outgo is absolutely basic.





## NATIONAL ASSOCIATION OF MANUFACTURERS

### THE TAX BARRIER TO ECONOMIC GROWTH

STATEMENT OF GEORGE G. HAGEDORN, DIRECTOR OF RESEARCH, NATIONAL ASSOCIATION OF MANUFACTURERS ON THE ECONOMIC REPORT OF THE PRESIDENT AND THE REPORT OF THE COUNCIL OF ECONOMIC ADVISERS FOR THE JOINT ECONOMIC COMMITTEE OF CONGRESS, FEBRUARY 15, 1963

I appreciate this opportunity of commenting, on behalf of the National Association of Manufacturers, on the President's Economic Report and on the Report of his Council of Economic Advisers. It is a source of gratification that these reports recognize forthrightly that the American economy is not growing as fast as it can grow and as it needs to grow. The ominous slowing down of the rate of economic recovery in 1962 and the persistence of a rate of unemployment which approaches 6 percent are factors none of us can afford to ignore. I am also in agreement that the Federal income tax system is one of the major barriers which have prevented us from attaining a satisfactory rate of growth and has repeatedly slowed down upward movements in economic activity well before they have reached full fruition.

Regretfully, however, I must say that the agreement ends there. The administration has incorrectly diagnosed the particular manner in which Federal taxes act as an impediment to economic growth and has misconceived the specific objectives which tax changes should serve. As a result, the tax program which the administration offers could have only limited success in the short run and no success at all in the long run. It would also have side effects which, in both the long and short run, would have a damaging impact on our economy.

The administration believes that the chief present barrier to further recovery and growth is an insufficiency of demand. It therefore recommends a package of tax changes whose central objective is to increase the purchasing power of consumers.

The National Association of Manufacturers believes, on the contrary, that the tax drag on the economy springs from the fact that taxes act as a barrier to the formation and effective use of capital. Our present tax system impedes both the accumulation of additional capital and the allocation of capital to the purposes in which it can be most useful. It produces these injurious results through its impact on the supply of investible funds and on the incentive for investing them in ways which would lead to dynamic growth. We therefore conclude that changes in the tax system should be primarily designed to deal directly with this problem of tax barriers to capital formation.

A tax program heavily oriented toward stimulating consumer purchasing power offers little hope of permanently raising the rate of economic growth. On the other hand, the quick effectuation of such a program would maximize the danger of renewed inflation and of deterioration in our international balance-of-payments position. A

program so oriented cannot, without abandoning its own central purpose of expanding total demand, ever lead us back to an era of balanced Federal budgets. By its own inner logic it discourages attempts to reduce or control Federal expenditures, as has been made plain by statements of administration representatives before your committee.

The type of tax program which this association advocates—i.e., one primarily directed toward increasing the availability of funds for private capital investment in a wide variety of projects and improving the incentives for such investment—is the best way of raising employment levels and improving the rate of long-term growth. It offers the prospect of restoring the Federal budget to balance within a reasonable length of time. It encourages control of Federal expenditures since its purpose is in no way frustrated by reductions in the demand for goods and services by the Federal Government. Such an approach poses no serious danger of inflation. By raising the levels of American productive efficiency it should contribute materially to improvement in our balance-of-payments position.

This is not to say that a reduction of the tax burden on consumers, allowing them to spend a larger part of their before-tax incomes on consumer goods and services, cannot and should not be part of a tax revision program. But this should be regarded as one of the benefits made possible by the greater economic growth resulting from a properly oriented tax revision, rather than the means by which such greater growth is achieved.

These conclusions are based on an analysis of the present state of the American economy and its recent trends, as well as on more basic considerations of what makes an economy grow in the long run.

#### OBJECTIVES OF THE ADMINISTRATION TAX PROGRAM

The Economic Report of the President, and other statements by the administration, present a variety of purposes which their tax proposals are intended to achieve. The ultimate objectives—with which no one can quarrel—are to raise the rate of economic growth, to provide incentives to investment both for expansion and greater efficiency, and to provide jobs for our growing labor force.

The means by which the administration expects its program of tax revision to reach these goals are also somewhat varied. Some attention is given to the need to strengthen business incentives and release more business capital. Recognition is given to the deterrent effects of high individual rates in the upper brackets. These rates, says the Council, “\* \* \* undoubtedly have a dampening effect on incentives to invest and take risks; and they impair the ability to accumulate investment funds.”<sup>1</sup> Cuts in taxes on business income “\* \* \* will strengthen investment incentives by increasing the after-tax profits that businessmen can expect to earn on new productive facilities.”<sup>2</sup> Such cuts will also: “\* \* \* add to the supply of internal funds, a large part of which is normally reinvested in the business \* \* \*.”<sup>2</sup>

Yet it is clear that the strengthening of incentives and the release of capital plays at best a secondary role in the administration’s analy-

<sup>1</sup> “Economic Report of the President,” together with Annual Report of the Council of Economic Advisers, January 1963, p. 45.

<sup>2</sup> *Ibid.*, p. 47.

sis of the kind of tax revisions that are needed. The emphasis is on the bolstering of consumer purchasing power as the central and overriding objective. In the President's message, for example, a discussion of incentives to investment is concluded with the statement: "Thus—and it is no contradiction—the most important single thing we can do to stimulate investment in today's economy is to raise consumption by major reduction of individual income tax rates."<sup>3</sup>

The specifics of the tax-revision program that the President has since proposed confirm the conclusion that improvement of incentives and of capital resources is given very little weight as compared with the objective of releasing additional consumer purchasing power. The steepness of progression in individual tax rates is of course a severe burden on incentives for investment and risk taking, and on the availability of private capital. Yet instead of designing the proposed tax revision to mitigate the severity of rate progression the administration has done the reverse. Taken as a whole the program gives greater reductions to the lower brackets of income than to the middle and higher brackets. Thus it intensifies the steepness of progression in the effective tax burden.

#### THE RECORD OF INVESTMENT AND PROFITS

Despite the economic sluggishness of the past 5 years the post-World War II period has been one of substantial economic growth. Although this growth pervaded most aspects of our economic activity, there have been two factors which have fallen well behind in the procession: business investment and corporate profits. This is true whether we make the comparison back to 1948 (the first postwar peak) or to 1957 (the beginning of the current period of chronic sluggishness), as shown in the following table (based on data in appendix C to the Economic Report):

	Percent increase	
	1948 to 1962	1957 to 1962
	<i>Percent</i>	<i>Percent</i>
Gross national product.....	113	25
Consumer income after taxes.....	102	24
Consumption expenditures.....	100	25
Government expenditures <sup>1</sup> .....	216	40
Business expenditures for plant and equipment.....	70	1
Corporate profits after tax.....	27	17

<sup>1</sup> Purchases of goods and services, transfers, interest, and subsidies—all levels of Government.

Clearly, consumer incomes and expenditures have kept up with the general economic growth and Government expenditures have run well ahead of it. Just as clearly, business investment and profits have lagged behind. This record on its face would cause us to doubt that either increased consumer purchasing power or Government expenditures holds the key to our growth problem.

To do them credit, the Council of Economic Advisers neither ignores nor glosses over this record of investment and profits trailing the rest of the economy. In fact the Council, in analyzing why the econ-

<sup>3</sup> *Ibid.*, p. XVII.

omy fell short of its expectations in 1962, reaches the following conclusion:<sup>4</sup>

"The error, then, was in the area of business investment, which fell about \$8 billion short of the level that had been expected for the year 1962. Indeed from the fourth quarter of 1961 to the fourth quarter of 1962, total business investment actually declined."

In the same paragraph the Council states rather plaintively that such a decline in investment "\* \* \* was unusual for the current stage of expansion."

The subpar performance of corporate profits during 1962 is also recognized in the Council's Report in a table accompanying the text (table 1, p. 14), although the text proper does not dwell upon it. Between the fourth quarter of 1961 and the third quarter of 1962, profits after taxes actually declined whereas the gross national product and the disposable income of consumers showed merely a slowing down in their rate of increase.

Yet the Council concludes that the failure of investment and of profits to grow satisfactorily in 1962 is support for its belief that what is needed is a stimulation of consumer demand.

Their argument in a nutshell is as follows: By 1962 businessmen had experienced "\* \* \* a long record of consistently, not merely temporarily, redundant capacity. Excess capacity meant lower profit margins. Further it meant that new investment was more likely to be risky and less likely to be profitable."<sup>5</sup> The existence of this redundant capacity means, according to the Council's reasoning, that comparatively little is to be gained from attempts to stimulate investment directly. Furthermore, the Council believes that the large liquid holdings of corporations and the fact that they have not in recent years used up their own internal sources of savings, indicates that lack of funds is not the barrier to higher levels of investment. By this reasoning the Council arrives at the conclusion that the most promising way to encourage business investment in plant and equipment is by raising the level of demand for the ultimate products the plant and equipment are intended to turn out—i.e., consumer goods. By raising the rate of capacity utilization, the Council argues, profit margins and incentives for new investment will both be improved.

Administration witnesses have argued at great length that, through the magic of the so-called "multiplier" a tax cut designed to raise consumer purchasing power will expand total demand by an amount several times as great as the amount of the tax cut. Their contention is that the additional incomes arising from the initial spending of the tax-cut dollars in turn generate further spending and further additions to income, and so ad infinitum.

Thus the administration spokesmen have turned an observed deficiency in investment and in profits into an argument for a tax program primarily oriented toward raising consumer purchasing power. The line of argument has a certain surface plausibility. Yet it is clear that in the long run no nation can make its people prosperous

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<sup>4</sup> "Economic Report of the President," together with Annual Report of the Council of Economic Advisers, January 1963, p. 15.

<sup>5</sup> Council Report, p. 17.

by providing them with more purchasing power. If it were that easy there would be no poor countries in the world. The administration argues, however, that our immediate problem is one of lack of purchasing power to keep existing facilities operating and thereby to stimulate investment in new facilities. Interpreted in this way, the validity of the argument depends on the contention that at present widespread excess capacity exists in the American economy. Without such excess capacity, mere increased demand cannot call forth an increase in output or employment. The magic multiplier then operates to raise prices rather than to expand production.

I do not believe that a realistic appraisal supports the premise that the American economy is suffering from excess capacity to any degree that is significant for investment prospects. On the contrary, there is a more general condition of restraints on growth arising from insufficiency of capacity to supply the particular kinds of demands that may be expected to increase with economic growth. The evidence for this view will be given later, but first it is necessary to examine the concepts of "capacity" and "capacity utilization."

#### THE MEANING OF "CAPACITY"

In mid-1962 your committee's Subcommittee on Economic Statistics held hearings and prepared a report on "Measures of Productive Capacity." These contained many useful contributions to better understanding of this complex subject.

Among the facts brought out in that investigation is the extreme crudeness of the existing statistical measures of capacity and rates of capacity utilization. Furthermore, such measures are very limited in their coverage since they deal only with manufacturing capacity and do not cover other sectors of the economy which may be expanding faster than manufacturing. Finally, various measures of capacity and rates of utilization show wide discrepancies among themselves.

To say these things is not to disparage the competence of those who have worked in this field, but to recognize the inherent complexities of the subject. The fact remains that the available statistics on capacity and its rate of use are a shaky guide in questions of national economic policy.

The distinction between the "engineering" concept of capacity and the "economic" concept, as brought out in the subcommittee's report, is a highly significant one. The engineering approach attempts to measure the physical limits imposed on output by the available stock of equipment and plant. The economic approach recognizes that, before this physical limit is reached, a rate of operations may be attained at which costs rise so steeply that it is not profitable to use existing facilities more intensively. When this latter point is passed there is a strong tendency for industry to build new capacity—provided of course that the necessary capital can be found. For that reason the concept of economic capacity, rather than engineering capacity, is the significant one in dealing with the issue of whether, currently, excess capacity is the chief factor restraining further investment.

But there is an even broader problem which arises in appraising the condition of the country in respect to its economic capacity. That is the question of how we shall combine measures of capacity utilization in various fields in order to guide us in reaching such an overall appraisal. A low rate of capacity utilization in one field does not in any realistic sense offset a high rate of capacity utilization in another. Hence, there may be little point in averaging them together.

Economic growth inevitably means economic change, since the various sectors of the economy never grow at uniform rates. A dynamic economy is one that is changing in shape as well as in size.

In most periods, we find some industries operating at or close to their full economic capacity while others are operating well below capacity. The significance of this state of affairs depends on the relative prospects for growth of the two categories of industries. Where the tides of growth are leading to increased demand for the products that are already being produced at capacity levels, the excess capacity for producing other goods and services is irrelevant.

It may also be noted that similar observations apply to the supply of liquid funds in the hands of corporations. Statistics on nationwide totals of such funds are relatively meaningless. Unless the funds are available for the particular kinds of new opportunities that are arising in an economy striving to grow in new directions, they cannot be a means of supporting investment for growth.

#### CAPACITY UTILIZATION—THE STATISTICAL EVIDENCE

The question to which we are seeking the answer is this: Is the slowing down of economic growth observed in 1962 generally the result of (a) the insufficiency of capital resources for investment which would expand output and jobs, or (b) the inadequacy of demand to keep our existing capacity occupied, which thus dampens the incentive to further expansion?

The general considerations which have been discussed up to this point are intended to clarify rather than to answer this question. To answer it we turn to the economic record of what actually happened in 1961 and 1962. There are two statistical tests that may be applied: the profits test and the price test.

*The profits test.*—In an economy operating generally well below the capacity (realistically measured) of its efficient physical facilities we may expect increases in output to result in more-than-proportional increases in profit. With the growth in output overhead costs can be spread over a larger volume of sales. Each successive additional dollar of sales carries a larger component of profit. On the other hand, where an economy is pressing against the ceiling of capacity (i.e., capacity to produce, at competitive costs, the particular products that are wanted) we may expect increases in output to be accompanied by little or no increase in profit. Inefficient high cost facilities must be drawn into service, or the facilities already in use must be operated beyond their most profitable rate.

What actually happened to output and profits in 1961 and 1962 is indicated in the following table (quarterly figures at annual rates, as reported in appendix C of the Economic Report) :

[Dollars in billions]

	Gross national product	Corporate profits	
		Before taxes	After taxes
1961—I.....	\$500.8	\$39.8	\$20.3
II.....	513.1	44.8	22.9
III.....	522.3	48.3	23.7
IV.....	538.6	51.4	26.3
1962—I.....	545.0	50.1	25.6
II.....	552.0	50.9	26.1
III.....	555.3	51.1	26.1
IV.....	562.0		
	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>
I 1961 to IV 1961.....	+7.5	+29.1	+29.6
IV 1961 to III 1962.....	+3.1	-.6	-.8

The first quarter of 1961 was a cyclical low point. During the first phase of the recovery, lasting through the fourth quarter of 1961, total profits rose about four times as fast as total output. This suggests that 1961 was a year in which efficient unused capacity was being drawn into operation thus giving a substantial lift to profits.

After the fourth quarter of 1961 output continued to grow, although at a somewhat slower rate. But this further growth of output produced no further growth in profits. This indicates that output was expanded only by drawing in relatively costly and inefficient facilities which yielded no increase in profits. The fact that substantial idle facilities remained in some industries is of no relevance if, as seems to have been the case, expansion took place in directions which pressed against available capacity to produce at competitive costs.

*The price test.*—If the slowing down of economic growth in 1962, as compared with 1961, was due to a slackening of demand we should expect to find less upward pressure on prices in 1962 than in 1961. If, however, the factor holding down the economy was a capacity ceiling, we should expect to find that the slower growth in output in 1962 was accompanied by increased pressure on prices.

Price increases have been moderate in the past few years, as compared with the earlier postwar period. They have not been entirely absent, however. The broadest possible price index—the implicit price deflator for gross national product—shows a persistent rise of well over 1 percent a year since 1957.



The following table, derived from appendix C of the Economic Report, shows the course of this implicit price index over the past 2 years (1954=100) :

1961—I	115.4
II	115.6
III	116.0
IV	116.2
1962—I	116.6
II	117.2
III	117.7
IV	118.1
Percent increase at annual rate :	
I 1961 to IV 1961	0.9
IV 1961 to IV 1962	1.6

The rate of price increase was greater in 1962 than in 1961. This does not suggest that the slowing of growth in 1962 was due to a slackening of demand pressures. But it is exactly the result we should expect if expanding demand was meeting capacity bottlenecks in 1962.

To summarize: Both the profits test and the price test lead to the same conclusion. The discouraging performance of our economy in 1962 was not a symptom of insufficiency of demand. It was rather the outcome of the inability of the economy to generate sufficient capital and offer adequate incentives, for expansion of our productive capabilities.

Apparently a turning point was reached in about the fourth quarter of 1961. The subsequent behavior of profits and prices disprove the contention that we were running into a barrier of insufficient consumer purchasing power. The barrier was the tax burden on the private economy which deprived it of the capital needed for further expansion.

Our conclusion may seem to fly in the face of common observation since the unused capacity in some of our basic industries is highly visible. The answer is twofold: First, the general lift which can be given to the economy by releasing capital for expansion in other fields will help to draw much of this unused capacity into operation. Second, some of this visible unused capacity may turn out to be of merely historical interest, since it is either too inefficient to be used or it is capacity for types of production which are no longer required in the new directions our economy is taking.

#### THE INCENTIVE TO INVESTMENT

For investment to occur there must not only be funds available for the purpose, there must also be the incentive of a reasonable prospective profit to be earned on the new investment.

The administration maintains, in essence, that the necessary incentive can be created simply by expanding the general level of demand and that this will in itself raise the investment to satisfactory levels. But this contention is belied by the record of profits since the fourth quarter of 1961 as already cited. Despite the steady rise in total output since that time, at a rate of about 3 percent a year, profits after taxes have not increased at all. Mere increase in demand for final products without any increase in profit is not going to create incentive for the investment we need for growth.

One of the factors reducing both present and prospective profits is the high level of labor costs. There has been some easing in the rate of increase in unit labor costs in more recent years. However, this is

hardly cause for very much satisfaction since it was achieved largely as the result of a substantial overhang of unemployment in the labor market. It raises the question of whether, if we do succeed in improving economic conditions and thereby reducing unemployment, we will not thereby intensify the upward pressure on labor costs which squeezes profits and thus suppresses growth.

The source of the upward pressure on labor costs, which can apparently be held in check by labor-market forces only when unemployment is at a level of about 6 percent, is the exceptional power of labor unions. If we are to escape from a vicious circle in which all efforts to achieve higher growth simply lead us back to an unemployment rate of 6 percent, the monopoly power of labor unions must be dealt with as such. Although the question of taxes is now at the center of the stage, the growth-suppressing power of labor unions to raise costs is a problem to which Congress must also seek a solution.

Meanwhile, tax revisions can be used as a means of improving incentives for business operations and business expansion. An important objective of tax changes should be to raise the prospective after-tax incomes of corporations, unincorporated enterprises and individuals. This will strongly increase the incentives for using the financial resources of business which are presently available, or which will become available, for the new investments which will expand output and create new jobs.

#### THE IMPORTANCE OF CAPITAL FORMATION

Regardless of the exigencies of our immediate economic situation, it is undeniable that long-run economic growth is dependent on achievement of the maximum rate of increase in the Nation's potential for producing goods and services. As many nations have learned to their sorrow, mere expansion of monetary purchasing power cannot create national prosperity and high standards of living. Only a set of conditions which permits a high level in the production of real goods and services can do that.

Many factors are of course involved in the growth of productive potential: the fund of technological know-how, the skill, training, and morale of the labor force, as well as the accumulation of capital. However, the leading student of the subject, Prof. Simon Kuznets, has arrived at the following conclusion after an exhaustive study of past trends in capital accumulation:<sup>6</sup>

“\* \* \* Granted that, without the accumulated body of knowledge and a healthy and educated labor force, such stock of capital is useless. Yet, if knowledge does exist and human labor is available to apply it, effective use of those resources requires material capital goods. Major additions to our technology—the mechanization of spinning or weaving, the introduction of coal and coke for smelting iron and making steel, the invention of the stationary steam engine and its use for transportation, the discovery of electric power and its production in giant hydroelectric plants, and the brilliant promises of power and automation from applications of atomic energy—each has called for large inputs of resources into construction and equipment.

<sup>6</sup> “Capital in the American Economy,” by Simon Kuznets, Princeton University Press, 1961, p. 391.

*One persistent bottleneck in the use of knowledge in economic production has been the scarcity of the resources for the production of capital goods needed for the application of new knowledge \* \* \*."*  
[Emphasis added.]

We have previously argued that a tax revision program strongly oriented toward freeing resources for capital formation is the most effective way of meeting the economic difficulties of the immediate present. Professor Kuznets' findings demonstrate that it is also the most effective means for promoting long-term economic growth.

A tax program which emphasizes the quick expansion of consumer purchasing power would very quickly run into the bottleneck of insufficient capital resources. After all, even according to the administration's calculations, the gap between current output and current productive potential is only some 7 or 8 percent. Does the administration anticipate that, some time in the near future, it will have to reverse its tax action for raising consumer purchasing power in favor of a program to provide more funds for capital formation? If not, won't the added consumer purchasing power simply waste itself in a futile demand for goods and services exceeding our productive potential? The highly touted multiplier will then turn out to be merely a device for hastening the inflationary results of such a condition.

### *Conclusion*

The tax barrier to economic growth is not the only serious economic problem facing the Nation. It has been emphasized in this commentary both in response to a similar emphasis in the President's Economic Report and because of a conviction that prompt action in the tax area is the most immediate requirement for a resumption of national progress.

For reasons which have been given, tax revision should not be approached with the objective of raising consumer purchasing power. This is a self-defeating program leading to economic trouble, rather than to economic progress. Additional real after-tax purchasing power for consumers is a reward we can earn through removing the tax barrier to growth but it is not the means by which we can reach that end.

Instead, the central objective of tax revision should be the release of capital and of incentives for using it. It should be mobile capital which is available for a wide variety of purposes. Therefore, reduction of individual tax rates on middle and upper incomes, as well as reduction of the corporate rate, must play a large part. We must seize the opportunity to moderate the murderous steepness of progressive tax-rate increases through the middle and upper brackets.

Since the problem is a large one the tax reduction must be substantial in magnitude. It should, therefore, be spread over a series of years. The anticipatory effect of a prescheduled program of substantial tax reduction, of the right kind, should produce an immediate improvement in the American economy's muscle tone.

The guiding philosophy must be one which encourages simultaneous control on the expenditure side of the Federal budget. The purchasing power approach, by its own logic and by the statements of its advocates, encourages the view that the very purpose of tax reduction would be thwarted by concomitant expenditure reduction.

## NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

NEW YORK, N.Y., *February 14, 1963.*

HON. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee, Congress of the United States,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: This is in response to your letter of January 23 inviting comments on the materials and recommendations included in the 1963 Economic Report of the President.

The President's report and the appended report of the Council of Economic Advisers are sound analytical, and especially well written, documents. We find ourselves in substantial agreement with the economic outlook projected in the reports. Our views on the 1963 economy were formulated late last autumn and we have seen no reason to change these views in light of recent developments.

The underlying strength of the economy has convinced many earlier recession-minded economists to change their views. Moderate economic expansion, which characterized the economy in the fourth quarter of 1962 and early 1963 may be expected to continue through the remainder of the year. The rate of business expansion, however, will not be sufficient to reduce unemployment to levels consistent with employment goals of the Employment Act. Moreover, as the Council points out, the difficult task of reconciling international balance-of-payments problems with domestic economic needs will continue as a major problem for Federal policymakers.

The Council's report on expected financial developments in 1963 is less exhaustive than its projections for business in general. Our views are that in the economic climate anticipated, relative interest rate stability in short- and long-term financial markets may be expected to continue through most of the year. Demands on capital markets will continue large but fortunately also will the flow of saving. The only major increase in capital market demands is likely to come from the Federal Government sector reflecting the expected large budget deficits in fiscal 1963 and 1964. In this respect we applaud the position of Chairman Martin of the Federal Reserve urging that Federal deficits be financed to the maximum extent feasible through bona fide long-term savings rather than through the creation of bank credit.

In this regard, we believe it desirable for the Treasury to be unshackled from the requirement of paying no more than 4 $\frac{1}{4}$  percent interest on new securities of more than 5 years' maturity. While rising interest rates are not in prospect for 1963, occasional upward thrusts during the year could hamper Treasury debt management operations.

Another matter which we continue to urge, in connection with the formation of national economic policy, is official recognition of the essential role of saving in stimulating and financing the Nation's economic growth. The crucial role of saving in the economic growth

process has been borne out increasingly by scholarly research. One recent study, conducted by the highly regarded National Bureau of Economic Research, concluded that historically the main limitation on capital formation in the United States has been an inadequate volume of saving. This conclusion is supported by the experience of advanced foreign nations where rapid economic growth has been associated with high rates of saving.

It is gratifying to note, therefore, that the importance of saving in our national economic policy was recognized in the President's 1963 Economic Report. In urging his new program of tax reduction and reform, the President indicated that, together with these tax measures, the maintenance of "monetary and credit conditions favorable to the flow of savings into long-term investment in the productive strength of the country" is desirable.

With respect to the President's tax program itself, there is no doubt that enactment of tax reduction provisions could provide strong stimulus to the economy, perhaps without inflationary effects for a while. We are not yet convinced, however, that such strong medicine is necessary in 1963 in view of rising Federal expenditures for defense and related activities. Perhaps it would be better to delay tax reduction temporarily as the economy continues to expand, in the meantime concentrating attention on controlling Federal expenditures. The huge Federal deficit now in prospect could become difficult to manage unless the Treasury is given greater freedom.

The administration's reform proposals, including the recommended limitation on deductions by individual taxpayers of mortgage interest, property taxes, and other expenditures to the amount exceeding 5 percent of adjusted gross income, also would have an impact on the economy. In view of the complex nature of the proposed revisions, we are not prepared to comment at this time on their net effect on specific sectors or the overall economy.

May we say in connection with the President's other recommendations that the savings bank industry continues to support Cabinet status for housing and "truth in lending." Moreover, we are on record as supporting the President's Executive order on desegregation in housing, excepting only that we continue to urge a broadening of this order to include conventionally financed as well as FHA and VA financed housing. Broad housing legislation, finally, in the areas of urban renewal and rehabilitation, as well as in widening the market for private housing, will continue to receive our industry's support.

The only major legislation in which we have a strong interest is the proposal to authorize Federal charters for mutual savings banks. The advantages of Federal chartering from the standpoint of the public interest have been recognized by the Commission on Money and Credit, private research and industry groups, and individual savings and loan leaders, who have endorsed the idea. We are hopeful that the President's Committee on Financial Institutions, under the chairmanship of Walter W. Heller, will agree that a Federal system of mutual savings banks will further national economic policy of accelerating economic growth on a sustainable basis with relative price stability. As you know, there have already been press reports that the Heller committee has endorsed the principle of Federal charters for mutual savings banks.

With the 100th anniversary of dual chartering for commercial banks approaching, it is appropriate that the Federal mutual savings bank bill, introduced with bipartisan support early in this session, is expected soon to be the subject of congressional hearings. In these hearings, evidence of the vitality and importance of mutual savings banking will be presented, and the benefits to the Nation of an expanded savings bank system substantiated.

Attached to this letter are materials summarizing the importance of Federal charters to savings banks and to the Nation. It is respectfully requested that these materials—a letter to Mr. Heller of October 9, 1962, and a leaflet on broad benefits of Federal charters—be inserted in the printed hearings as appendixes to this letter. Because several of the substantive arguments supporting Federal charters are included in the attached materials, and because detailed economic evidence will be presented at congressional hearings, we have not burdened this letter with further statements on Federal charter benefits.

Thank you for the opportunity to comment on the President's Economic Report. We hope this letter will prove useful to the Joint Economic Committee in preparing its own report in the coming weeks.

Sincerely yours,

GROVER W. ENSLEY,  
*Executive Vice President.*



## NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

NEW YORK, N.Y., *October 9, 1962.*

DR. WALTER W. HELLER,  
*Chairman, Committee on Financial Institutions,  
Executive Office of the President,  
Washington, D.C.*

DEAR DR. HELLER: This letter is in response to the White House release of August 21 inviting written suggestions or comments from interested groups on the study being conducted by the interdepartmental Committee on Financial Institutions. It follows up earlier correspondence with Gardner Ackley in which it was urged that the Committee endorse the recommendation of the Commission on Money and Credit favoring Federal charters for mutual savings banks.

As you know, the Federal charter bill was initially introduced in the Congress on July 1, 1960. On October 2 and 3, 1962, amended bills were reintroduced in the Senate and House respectively, both on a bipartisan basis.<sup>1</sup> Several copies of the Multer bill are attached. Copies of his introductory statement together with that of Senator Sparkman will be sent to you shortly. Under separate cover I am sending you also a copy of our monograph prepared for the Commission entitled "Money and Credit, Mutual Savings Banking: Basic Characteristics and Role in the National Economy." I will make specific reference to portions of this monograph at a later point.

You are probably aware that, following initial introduction of Federal charter legislation over 2 years ago, the Housing and Home Finance Agency and Veterans' Administration studied and endorsed the bill while the Federal Reserve commended it for careful consideration. The Federal Home Loan Bank Board, which originally opposed the bill, has now, under Chairman McMurray, informally endorsed it. It is evident, therefore, that major Federal agencies are favorably inclined toward Federal charters for mutual savings banks.

It is not my purpose here to present detailed arguments, economic and otherwise, in support of the proposal for a Federal mutual savings bank system. A comprehensive brief, including detailed statistical data, will be submitted in connection with congressional hearings on the Federal charter bill, expected to begin in February 1963. Moreover, substantial evidence of the advantages of Federal chartering has already been presented in our monograph. See especially pages 253-266. In this letter, therefore, I would like only to summarize the basic case.

Legislation authorizing the establishment of a Federal mutual savings bank system should be supported on at least three broad grounds: (1) National economic goals of accelerating economic growth, achiev-

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<sup>1</sup> S. 3776 (Sparkman, Democrat, Alabama, and Bush, Republican, Connecticut); H.R. 13318 (Multer, Democrat, New York); H.R. 13319 (Barrett, Democrat, Pennsylvania); H.R. 13347 (Carey, Democrat, New York); H.R. 13320 (Fino, Republican, New York); H.R. 13321 (Halpern, Republican, New York); H.R. 13322 (Rains, Democrat, Alabama).



ing maximum employment, and maintaining relative price stability, will be furthered; (2) equality of competitive opportunity, now denied savings banks, will be provided; and (3) a sound vehicle for broadening the investment powers of other savings institutions, now narrowly circumscribed, will be made available. Let me expand somewhat on these three broad areas.

#### FURTHERING NATIONAL ECONOMIC GOALS

The geographic extension of mutual savings banking, practical only through Federal charters, will support two basic economic objectives: (1) An increased flow of saving, more evenly distributed throughout the nation; and (2) an increased availability of mortgage and other long-term credit with a consequent reduction in costs of borrowing and in regional mortgage yield spreads. There is general agreement that these objectives are essential to the longrun accomplishment of accelerated economic growth with relative price stability. On occasion, it is true, short-run considerations tend to obscure the objectives of longer-run goals. The fact, for example, that we have been for some months now in a sidewise economic movement scarcely means that our longer-run need for increased saving to finance capital formation has diminished. Professor Wallich of Yale put it well, I believe, when he said in a recent article, that:

"We can no longer afford to discourage saving—it is needed to finance growth. Even though in the present state of the economy, there seem to be more savers than investors, that is largely a question of the business cycle and should not determine longrun tax policy."

I am sure you are also familiar with the findings of Simon Kuznets in his monumental National Bureau study, *Capital in the American Economy*, and with the recent experience of foreign nations, both pointing to the crucial role of savings in economic growth. Kuznets concluded that the essential restraint on capital formation in the United States has been an inadequate supply of savings rather than inadequate demand of capital. Foreign nations that experienced more rapid growth than the United States in the 1950's also had higher ratios of personal savings to disposable income and devoted larger proportions of total output to capital formation. The recent report by Prof. Warren Hunsberger of Johns Hopkins on the Japanese economy indicated that the key to that nation's phenomenal rate of growth has been the ability " \* \* \* to create the needed capital through domestic savings \* \* \* ."

If we agree that a high rate of saving and reduced costs of mortgage and other credit are essential to our long-range economics goals, it remains for us to demonstrate that geographic extension of savings banking through Federal charters will contribute to these objectives. As noted earlier, evidence on this point has been included in our monograph, and a comprehensive economic brief will be presented in connection with forthcoming congressional hearings. Let me at this point only summarize some pertinent findings from the recent study of Chicago banking by Professors Schweiger and McGee of the University of Chicago:

1. The ratio of savings in local institutions to personal income is higher in mutual savings bank areas than in nonmutual savings bank areas at comparable levels of per capita income.

2. In leading savings bank areas actual personal savings were larger than expected relative to prevailing income levels (on the basis of regression analysis of the savings/income relationship) while in major nonsavings bank areas the reverse was true.

3. Restricted entry into financial markets has led to insufficient savings facilities, inefficient allocation of resources, and a restricted supply of credit available only at high costs to borrowers.

On the basis of their findings, Schweiger and McGee concluded that maximizing competition among financial institutions, and reducing restrictions on freedom of entry into thrift markets, would substantially increase the volume of local savings. In this framework, they specifically recommended the amendment of Illinois banking laws to permit the establishment of mutual savings banks.

#### EQUALITY OF COMPETITIVE OPPORTUNITY

As a practical matter, it is now quite difficult to implement the Schweiger-McGee recommendation or, for that matter, to serve the needs of numerous private citizens throughout the Nation, who have expressed serious interest in the establishment of savings bank facilities. Recent efforts to have savings bank legislation adopted on a State-by-State basis have been frustrated by the weight of entrenched local competitive opposition. Only in Alaska was the enactment of such legislation successful, and this required a 2-year effort. Incidentally, the unusually large volume of deposits attracted by the Alaska Mutual Savings Bank in less than 1 year, accompanied by continued rapid growth of previously existing savings institutions in Anchorage, is indicative of how a new vital institution can increase the flow of savings in a community.

If extension of savings banking beyond the present 18 States is desirable on economic grounds, therefore, it can best be achieved through Federal charter legislation. Such legislation would provide for savings banking the advantages of a dual banking system long available to commercial banks, savings and loan associations, and credit unions. As the 100th anniversary of dual banking approaches, and commercial bank groups everywhere proclaim its merits, it is anomalous that savings banks alone among major deposit-type institutions are not a part of the dual banking system.

The result is that savings banks operate at a competitive disadvantage, with severe restrictions on freedom of entry into the financial markets, and without the benefits of the system of checks and balances between Federal and State supervisory authorities. Not only have financial institutions thrived under dual chartering but also the supervisory systems themselves. In the face of the current reappraisal of State-Federal supervisory relationships, it is well to remember that some States did not make provision for supervised savings and loan associations and credit unions until Federal charters for such institutions had been authorized. Authorization of Federal charters for mutual savings banks will redress the current imbalance between savings banks and other financial institutions, without weakening the State supervisory systems.

## BROADENED INVESTMENT POWERS FOR OTHER SAVINGS INSTITUTIONS

There has been increasing support for the view that investment powers of savings and loan associations are too narrowly prescribed. The advantages of such broadened powers have been recognized not only by students of finance—including the Commission on Money and Credit—but also by spokesmen for the savings and loan industry. Present members of the Federal Home Loan Bank Board, moreover, in direct contrast to their predecessors, have recently been urging the broadening of savings and loan investment outlets.

Flexible lending and investing powers have long been advocated by savings bank leaders. In our monograph (see pp. 265-266), it was suggested that, in periods when demands for home mortgage credit fall short of the available supply of funds, the financial fabric of our economy, and of savings and loan associations in particular, would be strengthened if these institutions had broader investment outlets. The lack of alternative uses for funds, on such occasions, causes some savings and loan managers to “reach” for mortgage loans by stretching appraisal values, accepting marginal borrowers, liberalizing credit terms unduly, and by otherwise reducing the quality of credit. We pointed out that it is basically unsound for a huge financial industry to be locked into one sector of the capital market and into one type of credit instrument. No other main type of financial intermediary is so limited in its operations.

Broadened powers for savings institutions can be achieved soundly and most expeditiously through the Federal charter bill, which provides for conversion of savings and loan associations to Federal mutual savings banks. The establishment of appropriate safeguards and standards for conversion would effectively limit the broadening of powers to those savings and loan associations willing and able to qualify as banking institutions. Otherwise, to authorize a sweeping expansion of financial powers for an entire industry, restricted mainly to the highly specialized function of home mortgage finance, would be to permit de facto a radical change in basic orientation and objectives—indeed it would redefine the very basis of savings and loan existence—yet without requiring appropriate organizational and structural changes. An increasing number of savings and loan leaders support this basic position.

For all of the reasons summarized in this letter, and on the basis of the more detailed documentation cited in our monograph and in the study of Chicago Banking, the Committee on Financial Institutions should endorse the recommendation of the Commission on Money and Credit in favor of Federal charters for mutual savings banks.

I hope that such endorsement will be strong enough, moreover, as to encourage the active support of the President in favor of legislation necessary to implement the committee’s recommendation.

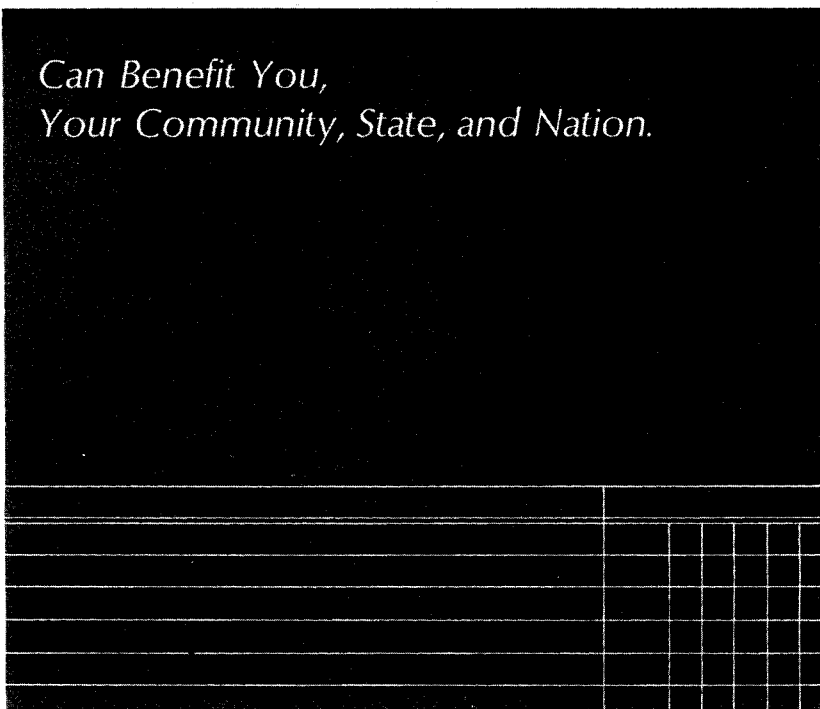
Thank you for the opportunity to express my views on this important question. I shall look forward to the committee’s final report in November.

Sincerely yours,

GROVER W. ENSLEY,  
*Executive Vice President.*

*How*  
FEDERAL MUTUAL SAVINGS BANKS

*Can Benefit You,  
Your Community, State, and Nation.*





**Legislation** now before Congress, introduced under bipartisan sponsorship, would extend these benefits to all 50 states. Briefly, the legislation provides for the establishment of Federal mutual savings banks: **Chartered and supervised** by the Federal Home Loan Bank Board; **Insured** by an existing agency of the Federal Government; **Authorized** to offer a broad range of depositor services; and **Granted** broad and flexible investment authority, with primary emphasis on home mortgage lending.

The proposed legislation also permits state-chartered mutual savings banks and state and Federally-chartered mutual savings and loan associations to convert voluntarily into Federal mutual savings banks. Through conversion, savings and loan associations would gain the broader investment and other powers they now seek.

There are 512 state-chartered mutual savings banks now operating in 18 of the 50 states and in the Virgin Islands.

MUTUAL SAVINGS BANKS — first organized in 1816 — are **dedicated** to promoting thrift and are operated solely for the benefit of their depositors. They channel the savings entrusted to them into housing and other long-term capital needs of their communities and states.

MUTUAL SAVINGS BANKS **provide** their communities with convenient facilities where the savings of individuals are readily available and earn maximum returns consistent with safety . . . They have a record of safety and stability unsurpassed in the financial annals of the nation.

MUTUAL SAVINGS BANKS **are the model** for a system of Federal mutual savings banks that will serve these same purposes, provide the same services, and spread the benefits of personal savings, home financing, and capital formation to **all** areas of the nation.

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## THE MUTUAL SAVINGS BANK RECORD

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on the savings side

Personal savings tend to be greater in areas where mutual savings banks exist than in comparable areas served only by other types of financial institutions.

A study by a research team at the University of Chicago shows that the ratio of savings to personal income in local institutions is higher in communities with mutual savings banks than in those where per capita personal income and other factors are the same but where there are no mutual savings banks.

Of the 10 states with the highest increase in savings relative to personal income in the last decade, five are states in which mutual savings banks are a major force in the savings market.

In areas where mutual savings banks exist and vigorously promote thrift, savers derive the benefit of a favorable rate of interest resulting from a free and competitive environment for savings.

At the start of 1963, the nation's 512 mutual savings banks were serving the owners of more than 22 million savings accounts. Deposits totaled more than \$41 billion, were earning interest at an average annual rate of 4 per cent, and were protected by the banks' reserves as well as by government insurance.

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## THE MUTUAL SAVINGS BANK RECORD

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on the investment side

The 512 mutual savings banks channel the bulk of their more than \$46 billion of assets into home mortgages and capital markets, thus contributing significantly to meeting the nation's long-term credit needs.

Savings banks now have \$32 billion invested in mortgage loans.

Since 1952 mutual savings banks have channeled a larger volume of savings into Federally-underwritten mortgages than any other type of lender. They are the largest holders of VA loans and the second largest holders of FHA loans.

Where there are mutual savings banks, mortgage loans tend to be more readily available at lower costs to borrowers than in the non-mutual savings bank areas.

Even in the rapidly-growing Pacific Coast States, mortgage interest rates in periods of large demands and tight money have tended to be lower in the State of Washington, where there are mutual savings banks, than in California, where they do not exist.

Savings banks, after meeting the credit needs of their communities, also invest in out-of-state mortgage loans. These loans now total over \$8 billion in the 32 non-savings bank states.

Moreover, savings banks have \$12 billion invested in the securities of private businesses, of municipalities and states, and the Federal Government.



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## BENEFITS OF FEDERAL MUTUAL

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### SAVINGS BANKS

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**To You:** Mutual savings banks, conveniently located throughout the 50 states, will provide you with a wider choice among savings facilities and access to local mortgage lending institutions.

**To Your Community:** More savings in local institutions will mean more funds for new homes, urban rehabilitation and renewal, new schools, highways, and other community improvements. In addition, farm and local business enterprises will have access to more credit for modernizing and expanding their operations.

**To the 50 States:** The addition of savings banks to the states' financial system will generate increased capital for the economic expansion of the states . . . The existence of Federally-chartered savings banks will help state legislators and bank supervisors maintain and strengthen the vitality of state-chartered banking services, and, in the 32 non-savings bank states, encourage them to develop state-chartered savings banks.

**To the Nation:** In a recent study by the National Bureau of Economic Research, it was concluded that an inadequate supply of savings rather than an inadequate demand for capital over the long term has been the primary restraint on the nation's economic expansion . . . The establishment of Federal mutual savings banks will encourage the higher rates of personal savings essential to higher rates of capital formation with which to accelerate the nation's economic growth.

At present, savings banks are the only deposit-type institution denied access to the demonstrated benefits of the dual banking system. Entry of savings banking into new areas is consistent with a basic premise of the nation's private enterprise system — freedom to enter markets throughout the economy, ensuring maximum competition.

Conversion of mutual savings and loan associations into Federal mutual savings banks with flexible investment powers will permit them to adjust to financial and business changes and still continue to promote thrift despite fluctuations in mortgage demands.

## SUPPORT FOR THE FEDERAL MUTUAL SAVINGS BANK BILL

**Federal chartering of mutual savings banks has the support of Federal Government agencies . . . independent research groups . . . Democratic and Republican members of Congressional Committees . . . an increasing number of individual savings and loan leaders who see in the conversion provisions of the bill an opportunity to gain broader investment and other powers . . . and many commercial bankers who appreciate how savings banks complement and supplement their own institutions in serving the public.**

**The Commission on Money and Credit in its 1961 report on the adequacy of the nation's banking structure stated: "At present commercial banks and savings and loan associations may obtain federal charters. Since only 17\* states now provide for the establishment of savings banks, it is not possible to establish savings banks in two-thirds of our states. Federal charters for savings banks would permit operation in any state, and this would stimulate competition and enterprise among financial institutions, improve the banking facilities in some communities, and perhaps encourage greater conventional mortgage lending activity in all areas.**

**"The Commission recommends that federal charters be made available for mutual savings banks."**

\* Since the Report was issued a new state — Alaska — provides for the chartering of savings banks. One was established there in 1961, and is helping to increase the state's personal savings and to meet its home financing needs.



## THE NATIONAL GRANGE

STATEMENT OF THE NATIONAL GRANGE BEFORE THE JOINT ECONOMIC COMMITTEE OF THE CONGRESS CONSIDERING THE ECONOMIC REPORT OF THE PRESIDENT, PRESENTED BY L. ALTON DENSLow, ASSOCIATE LEGAL COUNSEL, FEBRUARY 15, 1963

The Grange deeply appreciates the invitation of this Committee to submit its views with respect to the materials and recommendations contained in the 1963 Economic Report of the President.

At its 96th annual session held in Fort Wayne, Ind., last November, the National Grange expressed its grave concern with the high levels of taxes and urged that a determined effort be made to achieve reductions. On the other hand, however, it has been our uniform position over the years that taxes should not be reduced while the budget is out of balance. Although we recognize the validity of the proposition that there are expenditures which are economically justifiable, even though they must be made from borrowed funds, we question the wisdom of any action which would reduce tax revenues below the level of budgeted expenditures.

At our last appearance before the Committee we urged that vigorous action be taken to remove the barriers to our agricultural exports which were being erected by the countries of the European Economic Community. Since then the Congress has provided ample authority to the President to deal with this problem by passage of the Trade Expansion Act of 1962, and we note with great satisfaction the President's statement of intent to use that authority "to maximum advantage to the end that our agricultural and industrial products have more liberal access to other markets—particularly those of the European Economic Community."

With respect to transportation, Grange policy continues to emphasize (a) support of lower freight rates, (b) preservation and strengthening of agricultural exemptions, (c) preservation of competition, even within an established policy of reasonable governmental regulation, and (d) opposition to unfair trade practices by which one mode of transport may destroy another through unfair (noncompensatory) competition.

Concerning wage and hour legislation, the Grange is opposed to any changes which would discriminate against or adversely affect farmers. It is fundamental to recognize that agriculture is subject to a cost-price squeeze which does not affect other segments of our economy. This has been the primary reason for the continuation of the agricultural exemption over the years.

The Grange agrees that education is a national problem and that because of the mobility of our people and the interdependence of every element of our economy, an inadequate school system in any one State adversely affects the entire Nation. We believe that the Federal Government should provide money needed to improve educational opportunities in these areas of lower wealth, but that the control of its use must remain in the hands of local and State authorities.

The longstanding record of the Grange in community service is well known. The mobility of the farm population and ties between farmers and other businessmen show the stake that is involved in developing whole trade areas as well as local communities. We have welcomed the rural areas development effort as a new opportunity for the Grange to join with others in developing and utilizing our local resources, including manpower. Such enabling legislation requires local initiative to obtain results and the close cooperation of many groups—farmers, industrial leaders, and private and public organizations. Success in community and area development and in the efficient utilization and training of available human resources requires a clear identification of problems, evaluation of different means of solving them, and an active program which will command the broadest possible support by all interested groups.

(The following letters were received from 2 of the organizations that were unable to submit statements:)

### CONSUMERS UNION

AMHERST, MASS., *February 20, 1963.*

Senator PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
Congress of the United States,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: I am very sorry that we were unable to comply with your request for a statement on the Economic Report of the President as we have been short handed in the last couple of months. We are, however, most interested and in the future would be happy to comply.

Sincerely,

COLSTON E. WARNE, *President.*

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### LIFE INSURANCE ASSOCIATION OF AMERICA

NEW YORK, N.Y., *February 18, 1963.*

Hon. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
Congress of the United States,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: When I received your letter of January 23 inviting me to comment on the materials and recommendations contained in the 1963 Economic Report of the President, I had intended to work up a statement by the deadline of February 15 which you indicated. Unfortunately, however, pressures of other duties and some illness have prevented me from working up such a statement. I regret this very much because I appreciated the opportunity. I hope that you will keep me on your list for comment on the report next year.

Sincerely yours,

JAMES J. O'LEARY,  
*Vice President and Director of Economic Research.*

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