BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 3, 1959

To Chairman Martin

From Jerome W. Shay

Subject: Hearings before Joint Economic Committee on President's Economic Report

JWS

In connection with your appearance before the Joint Economic Committee on February 6, it may be helpful to outline below principal points that have been raised at the current hearings through February 2:

On January 28, when Budget Director Stans testified, Senator Douglas opened the hearing with a statement that, in his view, the President's Economic Report is "concerned more about inflation than about unemployment or the virtual stagnation of the level of production"; that the "recession is still with us"; that "we are not at maximum levels of employment and production because our policies have been geared too much to holding down prices"; and that "public policy must embrace more than price stability." The Republican members present (Congressmen Curtis, Kilburn, and Widnall) objected to this statement as a prejudging of the hearings, while the Democrats present (Senator O'Mahoney and Congressmen Patman and Reuss) defended the statement. (A copy of the Stans' prepared testimony is attached.)

Congressman Patman referred to the present $8 billion of interest per year on the national debt and asked Stans if any agency of the Government was making any effort at debt or interest reduction. In reply to Stans' answer that the matter was one for Secretary Anderson, Patman said that "the Treasury is captive of the Federal Reserve System which the President regards as an independent fourth branch of the Government" and that, therefore, "the Treasury is virtually helpless." Patman went on to say that "nothing is done to reduce the debt because a big debt is profitable to the banking system." During Patman's questioning, Stans said he would prefer a tax increase to deficit; he agreed that the national debt stands in the way of national progress and that some tax collections should be applied to debt reduction; and he also agreed that the Federal Reserve can set interest rates. Patman's concluding observation was that, since our interest rates are so much higher than "the 2-1/2 per cent rate prevailing in the USSR," it is impossible for us to compete successfully with Russia.

During the Stans' testimony, Congressman Reuss indicated that he would have preferred a $79 billion budget, the additional $2 billion to be raised by plugging tax loopholes, and to be used towards relief of depressed areas, defense and increasing the Development Loan Fund.

Senator O'Mahoney seems to feel that unless more funds are available for Government development of our water resources, we cannot expect to keep ahead of the USSR. While this apparently sectional approach was not particularly representative, other questioning of Stans also suggested that the President's budget failed in some respects to provide for adequate expenditures for "deserving" projects, e.g., relief of depressed areas and national defense.

During the hearing on January 30, the matter last referred to was discussed in answer to Congressman Widnall's question, which was -- "What should be the priority of Federal spending if we are faced with a deficit, as we probably are?" The panel of economists testifying that day included Richard Musgrave, William Fellner, Walter Heller, Benjamin Ratchford, Paul Samuelson, and Herbert Stein. The Widnall question was characterized by Senator Douglas as "the most important question for these hearings." National defense was given first priority by a majority of the panelists, with foreign aid and aid to education tying for second priority.

In this connection, Congressman Bolling has regularly asked "How much growth can be expected to result from the President's recommended growth measures included in his Economic Report at page 67?" Almost without exception, the various panelists who have thus far testified have shown very lukewarm enthusiasm for the President's list.

In answer to questioning by Congressman Curtis, the panelists on January 30 seemed generally agreed that the President's Economic Report should not have suggested the possibility of a tax cut.

Most of the panelists seemed to doubt that "Federal economic policies during 1958 carried serious danger of inflation in 1959." The question to that effect was asked by Congressman Bolling. The ensuing discussion seemed to indicate that sentiment of the panelists was pretty well divided on whether taxes should be increased. Ratchford, Samuelson, and Stein seemed to agree that any increase in expenses (whether to solve unemployment or any other problem) not offset by tax increases would be a serious inflationary threat. The others seemed to see the transcendant problem as national defense and growth, rather than inflation which, they felt, could be dealt with when a threat of inflation became much clearer.

Congressman Patman again criticized the extent of commercial bank holdings of Government securities and past reductions of reserve requirements which enabled them, he said, to buy such securities and create money at no cost to them. In this connection, he renewed his proposal to have the Federal Reserve Banks, rather than the commercial banks, buy all Government securities not absorbed by non-bank investors, and to "immobilize" the resulting increase in reserves by increasing reserve requirements. To this, he would add a program by the Fed to peg Government securities at 2-1/2 per cent. This was quickly characterized by Paul Samuelson as a "highly inflationary" scheme.

The session of the hearings on February 2, poorly attended by Committee members, involved another panel. Perhaps the predominating tone was set by Robert Eisner, an economist at Northwestern University, who said that, "The decision to accept unemployment, whether in the view that it is necessary to prevent prices from rising or for any other reason, is a decision to accept a lower rate of growth." Both he and Daniel Hamberg, economist at the University of Maryland, seemed to agree with a suggestion of Congressman Bolling that monetary policy cannot stimulate growth and monetary policy as an anti-inflationary tool can restrain growth and have highly discriminatory effects. At this session of the hearings particularly, the goal of dollar stability seems to run a very poor second to increased rates of growth.

Attachment

cc: Mr. Young