NEWS RELEASE

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D. C. 20429

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FOR RELEASE TO P. M. PAPERS, SATURDAY, JUNE 13, 1964 PR-52-64(6-11-64)

The lack of a short-term tax tool is a major piece of unfinished business for the nation, Joseph W. Barr, Chairman of the Federal Deposit Insurance Corporation, suggested today.

Addressing the annual meeting of the District of Columbia Bankers Association at The Homestead, Hot Springs, Virginia, Mr. Barr urged support of a thesis enunciated by Secretary of the Treasury Douglas Dillon in a recent address, in which Mr. Dillon outlined the advantages such an approach could have as a counter-cyclical tool.

Mr. Barr pointed out that in 1962 the Kennedy Administration sent to Congress a recommendation for a standby tax reduction authority. "At the time we found that this concept was simply too novel for the Congress even to consider," he said.

Now, he pointed out, thinking has possibly changed slightly, especially in light of the proven effects of the Revenue Acts of 1962 and 1964. The Congress, he said, is "probably much more certain that tax policy is an effective economic weapon."

"I believe that the 1962-1964 experience also convinced the Congress and the country that under a Congressional system any change in over-all tax policy takes not months but years," Mr. Barr said.

(MORE)

He cited the "relatively wide and relatively frequest swings in monetary policy" during the period 1951-1960, when monetary policy was relied on heavily as a counter-cyclical tool, and added:

"Frankly, I have always sympathized with the commercial banking system in periods of wide and frequent swings of monetary policy. Decisions for the individual banker cannot be easy when shifts of policy are freqnent and drastic."

He added "it is for this reason that I recommend to you a close scrutiny of the short-run tax proposal. It would be premature for me or for you to come to any hard or fast conclusions at this time. However, I believe it is appropriate for all of us to study this problem closely and to weigh the impact of such legislation not only on the economy as a whole but upon the operations of the commercial banking industry. I have a hunch that such a bill could bring increased stability to our banking system and help mitigate some of the problems that stem from complete reliance on monetary policy as a counter-cyclical tool."

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FOR RELEASE TO 10 A.M. PAPERS
SATURDAY, JUNE 13, 1964

STANDBY TAX AUTHORITY AS IT RELATES TO STABLIITY IN THE COMMERCIAL BANKING SYSTEM

Address of

JOSEPH W. BARR, CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D. C.

at the

ANNUAL CONVENTION

of the

DISTRICT OF COLUMBIA BANKERS ASSOCIATION

at

The Homestead

Hot Springs, Virginia

Saturday, June 13, 1964

10 A. M.

STANDBY TAX AUTHORITY AS IT RELATES TO STABILITY IN THE COMMERCIAL BANKING SYSTEM

On Saturday, June 6th, the Honorable Douglas Dillon, Secretary of the Treasury, delivered an address at the Harvard Business School which I consider to be must reading for anyone in the financial community or anyone in this government who is charged with responsibility in this area. I will not attempt to cover all the subjects discussed by Secretary Dillon, but I do want to call to your attention the following three paragraphs of his remarks:

"While the prime purpose of our overall tax program is--and always has been--the long-range stimulation of our economy to permanently higher levels, the timing of the program has been important in sustaining the present expansion, and deliberately so. We must not, however, let this question of timing obscure the underlying objectives of the tax program. The fact that the Revenue Act of 1964 is having some beneficial counter-cyclical effects should not be taken to mean that we have succeeded in developing a new and effective counter-cyclical tool.

"There remain, in my opinion, great obstacles to the use of tax policy for purely counter-cyclical purposes. The chief of these obstacles is the fact that, within our constitutional system, a long lag typically intervenes between a request for a change in tax rates and legislative approval. Unless and until some method is worked out--acceptable to the Congress and consistent with its prerogatives--whereby tax rates can be varied without undue delay, the purely counter-cyclical function of tax policy will remain outside our arsenal of economic tools.

"This does not mean that cyclical changes in tax policy would not be useful. Nor, fortunately, does it mean that tax policy is entirely impotent in moderating cyclical fluctuations today. By promoting sustained growth and a stronger economy, tax policy can be and, as it has been developed over the past three and one-half years, now is an important counter force both to recessions and to inadequate growth. But we clearly have a major piece of unfinished business to resolve before we can claim that tax policy is fully equipped to do for us the job that any modern economy requires of it."

On May 8, 1962 the Administration did send to Congress a recommendation which would give to the President Standby tax reduction authority.

Such authority would permit the President to reduce the fixed statutory rates by up to 5 percentage points for a period of six months with the possibility of extending the reduction for another six months. But in no event could the period of uninterrupted tax reduction exceed one year without specific affirmative Congressional action. A plan of tax reduction would take effect 31 days after submission by the President, but only if in the course of this period Congress did not disapprove the plan by concurrent resolution. Thus the proposed legislation attempted to combine assurance of Congressional control with provision for the flexibility of action needed to achieve the objectives of maximum employment and output, economic stability, and growth.

At the time we found that this concept was simply too novel for the Congress even to consider. They objected that there was no proof that tax policy was a useful counter-cyclical tool; they objected that this approach would enable the President to cut taxes and put the responsibility on the Congress for raising taxes and they objected that this approach would violate the constitutional responsibility of the Congress to control tax policy.

From my particular vantage point it appears that there may be some change in thinking occuring in the country. The Congress seems to be taking justifiable pride in the economic climate that they have created with the enactment of the Revenue Acts of 1962 and 1964. They are probably much more certain that tax policy is an effective economic weapon.

I believe that the 1962 - 1964 experience also convinced the Congress and the country that under a Congressional system any change in over-all tax policy takes not months but years. From my experience, I would say that this lengthly deliberation is appropriate. The consequences of tax policy carry so many ramifications and spread in so many directions that it is not always easy for a small group of men to decide quickly on the best course of action. In this respect, I believe that our Congressional system is superior to the Parliamentary systems that prevail in most countries.

However, it is equally apparent that a Parliamentary system can move much more quickly to correct short run economic dislocations. The Government, under such a system, makes its proposals which are either enacted in a period of days or weeks or the Government falls.

From all this experience I would imagine that there would develop rather wide spread acceptance of Secretary Dillon's statement that the lack of a short-term tax tool is a major piece of unfinished business for this nation.

The implications of the Heller approach to short-run tax policy have deep significance to the commercial banking industry, and I would strongly advise you and your colleagues to consider and to debate this subject carefully. At first blush it appears to me that the adoption of such a tax could be a significantly stabilizing factor in bank operations and decisions.

During the 10-year period from 1951 to 1960, inclusive, when the government was relying heavily on monetary policy as a counter-cyclical tool there were relatively wide and relatively frequent swings in monetary policy. Average monthly interest rates on 3-month Treasury bills ranged from 0.7 percent to 4.6 percent, and on long-term United States Government bonds from 2 4 percent to 4.4 percent. Average monthly free reserves of Federal Reserve member banks ranged from plus $836 million to minus $875 million. The annual rate of growth in the money supply, measured by quarterly averages compared with the same quarter of the preceding year, varied from 5.4 percent to minus 2.0 percent. During the past three years, there has been more stability in all of these measures. Bill rates have ranged from 2.3 percent to 3.6 percent, and long-term Government bonds from 3.7 percent to 4.2 percent. Member bank free reserves have varied from $555 million to $91 million, and the annual rate of growth in the money supply from 1.4 to 4.1 percent.

This comparative record underscores Secretary Dillon's statement that our balance of payments problems forced the nation, in the past 3 years, to rely more heavily on fiscal policy than on monetary policy.

Frankly, I have always sympathized with the commercial banking systems in periods of wide and frequent swings of monetary policy. Decisions for the individual banker cannot be easy when shifts of policy are frequent and drastic.

It is for this reason that I recommend to you a close scrutiny of the short-run tax proposal. It would be premature for me or for you to come to any hard or fast conclusion at this time. However, I believe it is appropriate for all of us to study this problem closely and to weigh the impact of such legislation not only on the economy as a whole but upon the operations of the commercial banking industry. I have a hunch that such a bill could bring increased stability to our banking system and help mitigate some of the problems that stem from complete reliance on monetary policy as a counter-cyclical tool.