

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS BEFORE THE JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES EIGHTY-FIFTH CONGRESS FIRST SESSION PURSUANT TO **Sec. 5 (a) of Public Law 304** (79th Congress)

JANUARY 28, 29, 30, 31, FEBRUARY 1, 4, 5, AND 6, 1957

Printed for the use of the Joint Economic Committee



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

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JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, JANUARY 28, 1957

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

(This hearing was held in executive session of the committee, but is made a part of the printed record by mutual consent.)

The committee met at 10 a. m., pursuant to call, in the District Committee Room of the Capitol, in executive session, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman (presiding), Bolling, Mills, Talle, Curtis, and Kilburn and Senator Watkins.

Present also: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Chairman PATMAN. The committee will come to order.

On January 23, the President transmitted his Economic Report to the Congress, and it was referred to this committee for study as provided by the act of 1946. Senate Joint Resolution 2, passed by the Congress in the opening days of this session, authorized the President to transmit the report this year, 3 days after the statutory deadline of January 20.

The Joint Economic Committee is to advise the Congress with respect to the main recommendations contained in the President's report, on or before March 1.

As chairman of the committee I know I speak for all members of the committee in hoping that we again this year can transmit a constructive report to the Congress before that deadline.

At its organization meeting of January 22, the Committee unanimously approved the procedure for hearings which will be followed during the next 8 days. Without objection, I will insert in the record at this point the schedule of hearings agreed upon, and which I released on January 25.

(Information referred to follows:)

[For release Friday a. m., January 25, 1957]

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

CHAIRMAN PATMAN ANNOUNCES HEARINGS ON THE PRESIDENT'S ECONOMIC REPORT

Representative Wright Patman (Democrat, Texas), chairman of the Joint Economic Committee, has announced plans of the joint committee to hold 8 days of hearings, commencing January 28, on the President's Economic Report which was transmitted to Congress on Wednesday (January 23).

Under the Employment Act of 1946, the President's Economic Report is referred to the Joint Economic Committee, which is to review it and " * * * file a report with the Senate and the House of Representatives containing its findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report * * *."

At its organization meeting on January 22, the committee unanimously approved the procedure for hearings set forth in the attached schedule. A 2-page summary of the hearings is shown first. This is followed by a detailed list of witnesses, topics and questions. All of the hearings will be held in the old Supreme Court Chamber, Senate wing of the Capitol, starting at 10 a. m. each day.

JOINT ECONOMIC COMMITTEE

WRIGHT PATMAN, Representative, Texas, *Chairman*

JOHN SPARKMAN, Senator, Alabama, *Vice Chairman*

HOUSE OF REPRESENTATIVES

RICHARD BOLLING, Missouri
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 THOMAS B. CURTIS, Missouri
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SENATE

PAUL H. DOUGLAS, Illinois
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 ARTHUR V. WATKINS, Utah
 BARRY GOLDWATER, Arizona

GROVER W. ENSLEY, *Executive Director*

JOHN W. LEHMAN, *Clerk*

HEARINGS ON THE PRESIDENT'S 1957 ECONOMIC REPORT¹

SUMMARY

January 28 (Monday)—(executive session) : Council of Economic Advisers :

Raymond J. Saulnier, Chairman.

Joseph S. Davis, member.

Paul W. McCracken, member.

January 29 (Tuesday)—The Federal Budget :

Percival F. Brundage, Director, Bureau of the Budget.

January 30 (Wednesday) : Panel: Economic Outlook for the Coming Year :

Labor Force, Hours, Productivity, and Potential Output :

Ewan Clague, Commissioner, Bureau of Labor Statistics, Department of Labor.

Government Demand for Goods and Services :

Louis J. Paradiso, Assistant Director and Chief Statistician, Office of Business Economics, Department of Commerce.

Business Demand :

Martin Gainsbrugh, Chief Economist, National Industrial Conference Board.

Consumer Demand :

George Katona, program director, survey research center, University of Michigan.

Agricultural Outlook :

Oris V. Wells, Administrator, Agricultural Marketing Service, Department of Agriculture.

January 31 (Thursday)—Panel: Price Changes and Policy Implications :

Recent Price Changes.

Factors in Price Changes.

Policy Implications of Price Changes and Prospects.

Leon H. Keyserling, consulting economist.

Jules Backman, professor, school of commerce, accounts and finance, New York University.

Otis Brubaker, research director, United Steelworkers of America.

Bradford Smith, economist, United States Steel Corp.

¹ Hearings will be held in the old Supreme Court Chamber, Senate wing, United States Capitol. All sessions are open to the public except on January 28.

January 31, etc.—Continued

George Hitchings, manager, economic analysis department, Ford Motor Co.

Nat Weinberg, director, research department, United Auto Workers.

Karl Fox, professor, department of economics and sociology, Iowa State College of Agriculture and Mechanical Arts.

Albert Rees, professor, economics department, University of Chicago.

February 1 (Friday)—Panel: Fiscal and Monetary Policy for the Coming Year: Effectiveness and Relationship of Fiscal and Monetary Policy:

Alfred Neal, President, Committee for Economic Development.

Seymour E. Harris, chairman and professor, department of economics, Harvard University.

Impact of Federal Fiscal and Monetary Policies on State and Local Governments:

Walter Heller, professor, school of business administration, University of Minnesota.

Benjamin U. Ratchford, professor, department of economics, Duke University.

Recommended Fiscal and Monetary Policy for 1957:

Louis Shere, professor, department of economics, University of Indiana.

Lester V. Chandler, professor, department of economics and sociology, Princeton University.

February 4 (Monday)—Fiscal and Monetary Policy for the Coming Year:

George M. Humphrey, Secretary of the Treasury.

February 5 (Tuesday)—Fiscal and Monetary Policy for the Coming Year:

William McC. Martin, Jr., Chairman, Federal Reserve Board.

February 6 (Wednesday)—Invited Panel: General Views and Recommendations of Economic Interest and Research Groups:²**Agriculture:**

Charles B. Shuman, president, American Farm Bureau Federation.

Herschel D. Newsom, master, the National Grange.

James G. Patton, president, the National Farmers Union.

Business:

John S. Coleman, president, United States Chamber of Commerce.

Ernest S. Swigert, president, National Association of Manufacturers.

Frazar B. Wilde, Chairman, Research and Policy Committee, Committee for Economic Development.

Labor:

George Meany, president, American Federation of Labor and Congress of Industrial Organizations.

John L. Lewis, president, United Mine Workers of America.

G. E. Leighty, chairman, Railway Labor Executives Association.

Don Mahon, executive secretary, National Independent Union Council.

General:

Ralph Watkins, chairman of the board of trustees, Federal Statistics Users' Conference.

HEARINGS ON THE PRESIDENT'S 1957 ECONOMIC REPORT³**DETAIL****DATES, WITNESSES, TOPICS, AND QUESTIONS**

January 28 (Monday)—Council of Economic Advisers (executive session): Raymond J. Saulnier, Chairman, accompanied by Joseph S. Davis and Paul W. McCracken, members.

1. What are the levels of employment, production, and purchasing power needed in 1957 to carry out the objectives of the Employment Act?

2. What are the current and foreseeable trends in employment, production, and purchasing power?

² Written statements of other groups will be received.

³ Hearings will be held in the old Supreme Court Chamber, Senate wing, United States Capitol. All sessions are open to the public except on January 28.

January 28, etc.—Continued

3. What assumptions with respect to prices, national income, personal income, corporate profits, and the like, underlie the President's Economic Report?

4. Review the effects of present Federal economic programs on employment, production, and purchasing power.

5. How will the recommendations set forth in the President's Economic Report contribute to achieving the objectives of the Employment Act?

January 29 (Tuesday)—The Federal Budget:

Percival F. Brundage, Director, Bureau of the Budget.

1. What are the major changes in expenditures and revenues contemplated in the President's budget for fiscal year 1958?

2. What assumptions with respect to prices, national income, personal income, corporate profits, and the like, underlie the President's budget?

3. What commitments extending beyond fiscal year 1958 are contemplated by the budget?

4. How will these changes in the budget affect the economy in the year and years ahead?

5. Elaborate on the provisions in the budget for improving the Federal statistical program during the coming year. How far will these improvements take us toward the goal of an integrated Federal statistical system?

**January 30 (Wednesday)—Panel: Economic Outlook for the Coming Year
Labor Force, Hours, Productivity, and Potential Output:**

Ewan Clague, Commissioner, Bureau of Labor Statistics, Department of Labor.

1. Compare actual changes in the labor force, hours of work, productivity, and output during 1956 with long-run trends.

2. How would these long-run trends work out in 1957?

3. What is the present outlook for prices—consumer, wholesale, construction, etc. in 1957? Are these indices good measures of inflation?

Government Demand for Goods and Services:

Louis J. Paradiso, Assistant Director and Chief Statistician, Office of Business Economics, Department of Commerce.

1. Translate the budget estimates into expenditures for goods and services and incomes from national product for calendar 1957, comparable with past periods as published by the Department of Commerce.

2. What are the likely trends in receipts and expenditures of State and local governments in 1956-57 in terms of the national income and product accounts?

3. What is the present outlook for prices, as reflected in the value of total national product in 1957?

Business Demand:

Martin Gainsbrugh, Chief Economist, National Industrial Conference Board.

1. On the basis of surveys, how much investment are businessmen planning for 1957? How would this compare with 1956 in terms of the national product categories in dollar values and in real values?

2. What is the consensus concerning spending in 1957 for residential construction? For inventories? For net private foreign investment?

3. What is the outlook for financing this investment from internal and external sources?

Consumer Demand:

George Katona, program director, survey research center, University of Michigan.

1. What evidence is available as to consumer plans and expectations for 1957? What will likely be the rate of personal savings? What do consumers anticipate with respect to price movements?

2. Translate these expectations into estimates of consumer spending in 1957.

Agricultural Outlook:

Oris V. Wells, Administrator, Agricultural Marketing Service, Department of Agriculture.

1. What is the outlook for farm production, price, and income in 1957?

2. How will this affect the farmer's spending on new construction and farm machinery?

January 31 (Thursday)—Panel: Price Changes and Policy Implications:
Recent Price Changes:

1. What significance do you attach to recent price developments? What is the import of the differences in movements during recent years of the index of wholesale prices, consumer prices, construction, producers' equipment, and of the implicit deflator for gross national product?

2. To what extent do retail prices now reflect the changes that have taken place in 1956 at the raw material and manufacturing levels? Do recent changes in wholesale prices foreshadow further rises in retail prices in 1957? If so, by how much?

3. What implications for wage changes in 1957 are contained in present labor contracts and in trends in prices?

4. Can you differentiate between price movements in "competitive" areas and in the so-called administered price areas; between relatively big and relatively small business; in industries showing relatively high profits and in industries with relatively low profits; in industries with increasing demand and in industries with declining demand?

Factor in Price Changes:

1. What are the most significant factors responsible for recent price changes?

2. To what extent do you believe these will continue to exert an upward influence on prices? For how long?

Policy Implications of Price Changes and Prospects:

1. Are fiscal and monetary policies sufficiently stringent to prevent general price increases consistent with maintaining present low levels of unemployment? Can fiscal and monetary policy stem inflationary trends which result from cost-price pressures?

2. What changes in other economic policies—private as well as public—would increase the effectiveness of restraints on inflationary price increases?

Leon H. Keyserling, consulting economist.

Jules Bachman, professor, school of commerce, accounts and finance, New York University.

Otis Brubaker, research director, United Steelworkers of America.

Bradford Smith, economist, United States Steel Corp.

George Hitchings, manager, economic analysis department, Ford Motor Co.

Nat Weinberg, director, research department, United Auto Workers.

Karl Fox, professor, department of economics and sociology, Iowa State College of Agriculture and Mechanical Arts.

Albert Rees, professor, economics department, University of Chicago.

February 1 (Friday)—Panel: Fiscal and Monetary Policy for the Coming Year:
Effectiveness and Relationship of Fiscal and Monetary Policy:

Alfred Neal, president, Committee for Economic Development.

Seymour E. Harris, chairman and professor, department of economics, Harvard University.

1. Are we currently relying too heavily on monetary policy in lieu of fiscal policy for restraining inflationary pressures? What standards would you suggest for determining the relative emphasis which should be placed on use of monetary policy and of fiscal policy for stabilization purposes?

2. Are fiscal and monetary policy working together or at cross purposes with respect to economic stabilization?

3. Are fiscal and monetary policies sufficiently stringent to prevent general price increases consistent with maintaining present low levels of unemployment? Can fiscal and monetary policy stem inflationary trends which result from cost-price pressures?

Impact of Federal Fiscal and Monetary Policies on State and Local Governments:

Walter Heller, professor, school of business administration, University of Minnesota.

Benjamin U. Ratchford, professor, department of economics, Duke University.

February 1, etc.—Continued

1. Have recent monetary policy developments significantly affected the volume of State and local government construction programs?

2. What are the problems of improving the relative financial position of State and local governments during periods of inflationary strain? Can these problems be solved at the State and local level or do they call for Federal action?

3. Evaluate the financial resources of State and local governments for meeting their long-range responsibilities. In general terms, what type of long-range adjustments in Federal, State, and local government revenue systems may be called for by currently projected demands for public services?

Recommended Fiscal and Monetary Policy of 1957:

Louis Shere, professor, department of economic, University of Indiana.

Lester V. Chandler, professor, department of economics and sociology, Princeton University.

1. What recommendations for general or structural revisions in fiscal and monetary policy would you make at this time?

2. Should the scope of general credit controls be broadened to include financial intermediaries other than commercial banks which are members of the Federal Reserve System?

3. What devices would you suggest to direct a larger proportion of the available credit supply to certain purposes with a high social priority, e. g., school construction, while retaining general credit restraint?

February 4 (Monday)—Fiscal and Monetary Policy for the Coming Year, Continued.

George M. Humphrey, Secretary of the Treasury.

1. Do you have any recommendations for general or structural revisions in tax policy at this time? Do you have any long-range recommendations for tax revision for promoting steady economic growth?

2. Could we have improved upon the division of labor between tax policy and monetary policy as instruments of restraint during the past year?

3. If inflationary pressures abate during the year, would you recommend priority be given to fiscal or to monetary easing?

4. What do you foresee as the Treasury's principal debt management problems in the year ahead, assuming the continuation of tight money?

February 5 (Tuesday)—Fiscal and Monetary Policy for the Coming Year, Continued:

William McC. Martin, Jr., Chairman, Federal Reserve Board.

1. What information do you have about the impact of so-called general credit controls upon small business as compared with big business? Upon State and local governments as compared with nongovernmental credit users?

2. Are present statutory provisions governing reserve requirements satisfactory and desirable?

3. Is the breadth of direct control (now limited to member banks) sufficient for the workings of general monetary controls, or should the direct influence of central bank operations be extended to cover other financial intermediaries, such as insurance companies, savings and loan associations, installment credit institutions, nonmember banks, etc.?

4. Is there any acceptable way of restraining the demand for loans without raising the interest rates?

5. Have you any general suggestions for revision of the present institutional arrangements in the field of money and banking, which would facilitate the use of general credit controls for economic stabilization?

February 6 (Wednesday)—Invited Panel: General Views and Recommendations of Economic Interest and Research Groups: *

* Written statements of other groups will be received.

February 6, etc.—Continued

Agriculture:

- American Farm Bureau Federation, Charles B. Shuman, president, 2300 Merchandise Mart, Chicago 54, Ill.
- The National Grange, Herschel D. Newsom, master, 744 Jackson Place, NW., Washington 6, D. C.
- The National Farmers Union, James G. Patton, president, 1404 New York Avenue, NW., Washington 5, D. C.

Business:

- Chamber of Commerce of the United States of America, John S. Coleman, president, 1615 H Street, NW., Washington 6, D. C.
- National Association of Manufacturers, Ernest S. Swigert, president, 2 East 48th Street, New York 17, N. Y.
- Committee for Economic Development, Frazar B. Wilde, chairman, research and policy committee, 1729 H Street, NW., Washington, D. C.

Labor:

- American Federation of Labor and Congress of Industrial Organizations, George Meany, president, 815 16th Street, NW., Washington 6, D. C.
- Railway Labor Executive Association, G. E. Leighty, chairman, 1001 Connecticut Avenue, NW., Washington 6, D. C.
- United Mine Workers of America, John L. Lewis, president, 900 15th Street, NW., Washington 5, D. C.
- National Independent Union Council, Don Mahon, executive secretary, Warner Building, Washington 4, D. C.

General:

- Federal Statistics Users' Conference, Ralph J. Watkins, chairman, board of trustees, 1741 K Street, NW., Washington, D. C.

Chairman PATMAN. This morning in executive session the committee will hear from the Council of Economic Advisers. At this point, I would like to insert in the record an exchange of correspondence between the Chairman of the Council of Economic Advisers and myself last December with respect to the manner in which this particular hearing will be held. (See p. 46.)

I am happy to say the proposed compromise was unanimously agreed to by the Joint Economic Committee at its organization meeting on January 22.

The agreement is as follows: This meeting will be in executive session with a transcript taken of those parts of the meeting which the Council feels will not jeopardize its position. At any point in the hearing when the Council feels it is entering into an area where it wishes to "roll up its sleeves," it will be given permission to go off the record with no stenographic notes made. Upon completion of this portion, it will go back onto the record. The Council will be given the privilege of editing the transcript and of providing additional elaborations or deletions. This edited transcript will then be made a part of the printed hearings for the benefit of the committee members, the Congress, and the general public.

I know that all present today hope that this procedure will work well. I am sure that it will.

Our first witness this morning is Raymond J. Saulnier, Chairman of the Council of Economic Advisers.

Dr. Saulnier, will you introduce your two colleague Council members and proceed with any introductory remarks that you may care to make preliminary to questions from the committee.

STATEMENTS OF DR. RAYMOND J. SAULNIER, CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS; JOSEPH S. DAVIS, MEMBER OF THE COUNCIL; AND PAUL W. McCracken, MEMBER OF THE COUNCIL

Dr. SAULNIER. Thank you, Mr. Chairman.

I have with me this morning my two colleagues on the Council of Economic Advisers, Dr. Joseph S. Davis, and Dr. Paul McCracken.

I want to say at the outset that I appreciate very much the courtesy you have shown the Council in arranging for the procedures under which we are here this morning, and under which we are to discuss with you the major findings of the Economic Report.

Chairman PATMAN. For the Chair, I will state that we are pleased with your attitude, and we are glad to know that you are working with us.

Dr. SAULNIER. Thank you, Mr. Chairman.

Chairman PATMAN. It is a very fine and cooperative way.

Dr. SAULNIER. We recognize your interest in an objective discussion of these questions, and we want to do everything we can to advance a better understanding of our Nation's economic problems.

I have no prepared statement, Mr. Chairman, and I would be glad to proceed at once with any questions that you want to put before me or my associates on the Council. I should like to feel, Mr. Chairman, that I may, from time to time, refer to my colleagues any questions that are beyond my competence.

Chairman PATMAN. I would like to ask you 1 or 2 questions, and then I will yield to Mr. Bolling who must go to another committee meeting.

The discussion of the tight credit policy on pages 42 and 44 acknowledges that the effects have been highly uneven, with small business and the home-building industry being adversely affected. Moreover, it is conceded that moderate restraints are not sufficient to deal with the recent price pressures, while stronger restraints would injure innocent bystanders, and risk the possibility of a recession.

What, then, are the benefits of a policy of general credit control?

Dr. SAULNIER. Mr. Chairman, this is an aspect of economic policy that is of very special interest to me. I have no quarrel, really, with the policy that has been followed—one which since late 1954 has been moving toward greater tightness. But certain aspects of that policy seems to me to have been undesirable. Now, two, in particular, have been mentioned directly. One is the effect on housing, on home building and home purchase; the other is the effect on small business.

It was already becoming evident in late 1955 that small-business concerns were having rather special difficulty in satisfying their credit needs. We saw this in a rather rapid pickup in the volume of applications for credit to the SBA.

Another aspect of that interested us. Without changing their credit standards at all, SBA was finding that an increasing proportion of its applications qualified for loan assistance. This meant that the average quality of the risks that were coming to SBA was improving. What this suggested to me was that, increasingly, small-business concerns—not concerns in trouble, but concerns of pretty good quality—

were finding it difficult to meet their credit needs through the private banking system.

One of the first things we did, therefore, was to propose a supplementary appropriation for SBA.

Chairman PATMAN. It was \$20 million.

Dr. SAULNIER. That is right.

Chairman PATMAN. That is the part that I could not understand. If you were disturbed at all, \$20 million for the whole United States would not mean too much.

Dr. SAULNIER. Well, we made a proposal for a sum which in our judgment would enable the SBA to take care of the flow of applications that was coming to it at the time.

Chairman PATMAN. If you do not mind, let me ask a question there. The objection of the tight money policy was to restrain house building because it was inflationary, was it not?

Dr. SAULNIER. That was one of the objects.

Chairman PATMAN. It was the principal object, I would assume.

Dr. SAULNIER. I would not say, Congressman Patman, that it was the principal object.

Chairman PATMAN. It was a major objective?

Dr. SAULNIER. It was one of the objectives.

Chairman PATMAN. Now, that being true, you had 2 ways to do it; 1 is to use the interest rate which would affect everybody, and the other was to use powers that you had to increase the downpayment and shorten the term of payment which would have restrained home building effectively, which I assume you will admit? Why did you not use the latter instead of the former?

Dr. SAULNIER. We did use the latter, as you know.

Chairman PATMAN. Only to a very limited extent; was it not?

Dr. SAULNIER. We used it to the extent that we thought, judging the situation as best we could, was needed. We added 2 percent to the downpayment requirements for both FHA and VA loans. We shortened the maximum permissible maturity from 30 to 25 years.

I think it is, if I may say so, not correct to interpret the general monetary policy as having been designed exclusively to cut back home building. That was not the case.

Chairman PATMAN. It may not have been so designed, but it was one of the ends you had in mind, because in home building there would be increased competition for scarce materials and labor and, for that reason, it would be inflationary.

Dr. SAULNIER. This was, Congressman Patman, I believe, one of the considerations they had in mind; but only one. Let me reiterate that if the problem put on me had been "How should we restrain home building?" and if I understood that that was the only problem, I would never propose general monetary restraints.

Chairman PATMAN. I am glad to hear you say that.

Dr. SAULNIER. I would do it through the selective devices available to the Federal Government.

Chairman PATMAN. That is what I was getting to.

Dr. SAULNIER. In connection with its mortgage guaranty and insurance programs.

Chairman PATMAN. I will yield to Congressman Bolling, as he has to go to another meeting.

Representative BOLLING. I regret very much that I do have to leave, and if I was going to stay I would question along somewhat different lines.

On this particular subject, one of the other areas that has disturbed me in regard to the effect of a tighter money policy has been the impact that this policy has had on municipalities, school boards, and other problems. It raises, again, a question which has been in my mind ever since I have had the privilege of participating in the Patman subcommittee deliberations on general credit control and debt management some years ago. That is the question as to whether or not very serious consideration needs to be given to achieving a more flexible instrument than the instruments available to us presently. I approach that question with no preconceptions, and I have no notion as to what the more flexible instrument might be or could be or should be.

When I see that the interest rate on tax-exempt municipals is somewhere around 5 percent that may be a little high, but it is in that general area—and I translate this back into what it means to a school district trying to float bonds, I am concured.

Dr. SAULNIER. You mean by a more flexible instrument, a more selective instrument, or general credit restraint?

Representative BOLLING. Yes.

Dr. SAULNIER. I must confess, Congressman Bolling, that my instinctive preference is for the general controls. I prefer them because they seem to me to hold a promise, at least, of getting the job done, and of holding back the pressures and demands that make for price increases and inflation, with a minimum of intervention into the daily lives of people and the daily business of concerns. I prefer that as a method of control.

Now, I recognize that it does not work evenly, and it does not work perfectly. To an extent, we have to step in and try to ease the pressure here and ease the pressure there in order to make it work better.

In the specific case you have in mind, in the financing of municipalities, of school districts, and so on, there are, after all, certain things which these communities and these jurisdictions can do for themselves. Some of them are still operating with limitations on interest rate, and limitations on debt amount, which tend to impair their ability to finance their own operations. Some modification of these limitations would help.

But I should like to say with all candor that at a time like this there is no real escape from a higher level of interest rates than we have been accustomed to when our economy was less fully employed, and when the demand for funds was less than it is now.

Representative BOLLING. Of course, this gets a little out of the field of economics, but what disturbs me is that we hear on the one hand quite an outcry that our school system is in one sense degenerating, which I think is accurate, and then on the other hand the best we can come up with in the economic field, perhaps for very valid reasons, is a situation which tends to further that degeneration. I think it is not unreasonable for the average prudent school board to be a little

bit disturbed about the prospects of its being able to manage the kind of interest rate that it would have to pay, even if it made the local tax changes required to be able to pay it.

It seems to me that this is that cloudy area where we run into the question of social objectives versus sound economics.

Dr. SAULNIER. I think one of the things which a high interest rate and a generally tight money market is going to do is to cause the postponement of some projects. I trust that they will be the projects with the lowest priority in the communities, and I expect they will be.

Secondly, higher money costs will encourage people to plan their projects on a little simpler and less expensive basis. At a time like this, it strikes me that that is probably good economics.

Representative BOLLING. I have no objection to that, but the thing that disturbs me is that in every study that I have seen we are short a great number of schoolrooms. How much of this is the responsibility of extravagance in the past is a question.

Dr. SAULNIER. That is true, Congressman, although we must not overlook the fact that expenditures in this area are very high, and are rising, and were higher in 1956 than in 1955. And 1955 was substantially above 1954. It is not that we are not spending money for schools. Indeed, we are spending money faster than we have for many, many years. I think we are making real progress.

I hope that under the school bill—which I trust will be passed this year—we can expedite that.

Representative BOLLING. That raises another question that may seem a little fanciful, but I do not think it is. I suspect that the pressure for the school bill will be greater as a result of tight money than it would have been without it—an interesting economic twist.

I apologize for having to leave.

Chairman PATMAN. I just want to enlarge on his question briefly, and then I will yield to the other members of the committee.

Your recommendation is that the school district change their constitutional or local barriers and permit the interest rate to rise?

Dr. SAULNIER. I would say, Congressman Patman, that where a local school district or other jurisdiction has an interest-rate limitation that is impairing its ability to raise funds at competitive rates in the market, there is an adjustment called for, and promptly.

Chairman PATMAN. Does it not seem to you almost against conscience for people to have to pay 5 percent on tax-exempt securities? That means a person with a million dollars can buy a million dollars' worth of Memphis, Tenn., bonds paying $4\frac{3}{4}$ percent and go to Florida or any place they want to, and then from here on out they can collect nearly \$4,000 a month and, having no taxable income, pay no taxes.

Dr. SAULNIER. Tax exemption, of bond investment, Congressman Patman, is a feature of our tax laws for which I have never had any enthusiasm.

Chairman PATMAN. I think that is a rather mild statement. I think we ought to be for them or against them.

Congressman Curtis.

Representative CURTIS. I would like to pick up on that one thing. I appreciate the opportunity to inquire because I have to leave pretty promptly. I just had an unusual situation occur and so I have to leave.

On that point of the tax exemption of these municipalities, I think, in the recommendations on page 49 at the top, there is a proposed amendment to the Internal Revenue Code to extend the conduit principle. It points up a very important fact that the municipals are not tax exempt to one of the main markets for this kind of security. That is your investment trust, where you can have a spread in your portfolio. It is true that a very rich individual who can spread his portfolio over a number of municipals can get the tax exemption, but it is not available to your investment trusts and others, which are one of the main markets. That is one reason, I suspect, if this amendment were to go through, and I am interested in talking to Representative Mills about it, you could get a bigger market and actually lower the interest rates.

But I want to pick up one thing. The very thing I wanted to bring out was really in the nature of a comment and then to have your comment. It was right along these lines.

I have felt for some time that our committee or some committee should make an objective study of the effects of inflation. In our tax study 2 years ago, I made a statement in some supplementary views that I felt a good bit of our troubles in our tax laws arose from the effects of inflation. I want to particularly point out the effect that it has had on local governments, school boards, and sewer districts, and so forth, who are dependent upon real-estate property taxation, which, in turn, is based upon an assessment of real estate. If you get into the mechanics of assessing real estate, you find that of course the assessment has occurred over a period of years, and most of the assessed property was put on the books in the thirties, before inflation.

You attempt to correct the situation by increasing the rate, and you hit unduly the new property that has gone on the books since inflation. It has presented an almost impossible situation politically and practically to every county, every school district, in the United States.

I think there lies one of the basic situations that has caused this difficulty that our school boards are involved in, and that our local taxing authorities find themselves in.

That is one aspect of the results of inflation in the past.

It seems to me with our concern for inflation in the future it might have been well to have spelled out some of the economic results of inflation.

Another area that I think should be pointed up is corporate investment. What the companies are trying to do is replace the machinery and the equipment or utility, such as the telephone poles that they have. The effect inflation has brought to them is terrific. They have set up their depreciation accounts based upon a cost in the 1930 dollar, and have to replace it with the 1956 dollar. That lies at the base of a great deal of this capital investment difficulty that is spelled out in here, as I see it.

I was a little disappointed, and this is not adverse criticism because probably this report is not the place to put it, but I would have thought it was. Somewhere we ought to spell out, or the economists ought to

spell out, if they will, the real damage that inflation has caused in the past so that we, the people and the Congress, will realize the real dangers of inflation for the future. As I say, I threw that out as my comment for your comment.

Dr. SAULNIER. I think it would be entirely appropriate for the Economic Report to expand in some detail on the dislocations that are brought about in our economy when our price level moves from one level to a very much higher level. It has not been done in any detail in this Economic Report or in any of the preceding ones. It seems to me a perfectly appropriate subject for attention.

We could discuss the dislocations caused by inflation, of which you have given two good illustrations.

Representative CURTIS. I wanted to emphasize that point. There was one other point that I would like to call attention to.

Chairman PATMAN. May I interrupt you briefly?

Do you not think it is just as important in pointing out the evils of inflation to point out the evils of depression?

Representative CURTIS. Those are a little more apparent, I think. I think we have seen it. Inflation is an insidious thing, and it is something that occurs gradually and no one exactly sees how it operates.

Chairman PATMAN. In the depressions I have gone through, I have seen it.

Representative CURTIS. The people have seen depression because they were out of work. In this thing, our pensioners know that they cannot buy as much, but they do not quite understand why they cannot.

The second thing I wanted to mention is that throughout this report, just as other economic reports, there has been a presumption which I wish did not exist. It is that tax take is the same thing as the tax rate. In other words, the recommendations are that the tax rates should remain the same in order that the revenue can come in. I believe that any tax has a point of diminishing return, and I think that in many instances, and this is my own reasoning, we have gone beyond that point of diminishing return. I think a good example was the excess-profits tax, where I am satisfied the elimination of that tax, which was mainly a tax on growth businesses and small businesses, actually produced more revenue to the Government through the regular corporate tax.

I just wish it were not always presumed that just preserving a particular tax rate is going to preserve your revenue.

I want to go on to illustrate that. For example, I am convinced that probably from a psychological standpoint, if we reduced the corporate tax of 52 percent to 49 percent, just so that the private enterprise was getting 51 cents out of the dollar, and the Government only 49 percent, some of these rather extravagant and I would say, uneconomic expenditures of corporations would not be made. If that theory is at all right, we would increase our tax take by reducing the tax rate. I think it is worth exploring. We would probably have a bigger tax take at 49 percent than we would get at 52 percent.

But the main point I want to make is that I wish we would not assume that the tax rate is the thing that is going to give us the greater tax take.

Finally, on this same subject, I notice there is no recommendation in regard to this device we had in the law, the stock dividend credit. Yet the purpose the Ways and Means Committee had at the time that was put in the law was trying to relieve a tax on a certain type of corporate investment device. That is equity capital as opposed to bank borrowings and as opposed to corporate bonds.

It is a difficult thing to prove, and I doubt if you really can prove it economically, but there is no question of the fact that if we were able to switch \$1 billion of investment from bonds to stock, we would get a better tax take, even allowing for the dividend credit. The tax on equity earnings is subject to the 52 percent corporate tax, while the interest paid on bonds and bank borrowings is deductible from the 52 percent tax.

Then there is the other feature on corporate investment of retained earnings. We have also seen here, in the Economic Report in spite of the fact that corporations earned less, the amount of dividends to the people was more. In our subcommittee hearings on the economic effect of our tax structure we received some advice from some of our witnesses that there would be a psychology with a tax dividend credit to encourage management to declare dividends instead of holding the earnings for reinvestment.

Again, if that is done, and if that was the cause-and-effect relationship, which is difficult to say, we would gain in tax take because the corporation pays the 52-percent tax all right, but no individual pays the individual tax on retained earnings. But if the corporations declare its earnings as a dividend, then it becomes subject to the individual tax, too.

But in this area where so much emphasis has been placed in this Economic Report on our need for capital investment, I regretted that more attention was not paid to that. Also, I regretted that there were no recommendations in the area whether or not the Congress might with the executive suggestion explore further whether we can release investment capital, so that we can lower the interest rates. It is the shortage of investment capital, as the report points out, that lies at the base of the increase in the interest rates. It is market demand.

Now, having made that speech, in effect, I would appreciate any comments.

Dr. SAULNIER. I just have two comments. First, in my own thinking about tax matters I do not assume that a tax rate reduction will produce a proportionate reduction in revenues. On the contrary, it is quite conceivable that a reduction in the tax burden, by stimulating greater economic activity, may in the end produce a higher tax take, as you put it. I think we all understand it is very difficult to make a judgment on these things. It is difficult to anticipate what the specific effect will be. Furthermore, I think one gets an expansive effect from tax reduction only if you make a pretty good-sized tax reduction. A nibbling away at the tax rates would probably, over a short run, have little tendency to increase the tax take.

With your comments on the dividend credit and the possibility that some measures might be taken that would expand the use of equity funds in the capital markets at this time, I have a good deal of sympa-

thy. I think you will probably agree, however, that the effect would be more to substitute one type of financing for another. That is, it possibly would not create new savings. Primarily, I think, the effect would be to channel investment funds more along the equity route than along the debt route, which in my judgment would be a good thing.

Representative CURTIS. Would you not say that the source of funds of equity capital is pretty much different from your source of bank borrowing, and even bonds? You have a different market.

Dr. SAULNIER. Certainly.

Representative CURTIS. So that the shortage seems to be in bank borrowings, as much as anything. Am I right in that presumption? There seems to be the squeeze, it seems to me.

Dr. SAULNIER. That is certainly where the squeeze is most evident. That is right, sir.

Representative CURTIS. Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Mills.

Representative MILLS. Mr. Chairman, for a moment I want to pursue the question that Mr. Curtis propounded.

Is it not true that the level of employment would largely determine the effect upon the economy of a tax reduction? If you have full employment and have a tax reduction on either business or individuals, is it not true that you may well bring about a condition of greater demand for resources and therefore increasing prices rather than an increase in production?

I am assuming that under a condition of full employment, your resources might be pretty generally utilized at that point, so that through tax reduction you would not bring into existence any greater amount of productive facilities. There just would not be the additional facilities to meet the increased demand from the tax reduction. It does not always follow, that is what I am saying. I think that might as well follow as any other development.

Would you think that I am right on that point?

Dr. SAULNIER. Certainly in appraising the probable effects on our economy of a reduction in tax rates, we have to take account of the level of employment and production. When that level is as high as it is now, we have to take account of the likelihood of the tax reduction increasing the demand for resources, and pushing our economy into the inflationary zone.

Another aspect that one would want to take into account, and I think Congressman Curtis has this in mind, is the possibility that savings would be increased by some form of tax reduction. Savings would be made that would not otherwise be made, and those additional savings would help in our fight against inflation.

Representative MILLS. But they would not necessarily contribute to increased production, if you reached that level in your cycle of complete, full employment.

Dr. SAULNIER. What I have in mind is just this: If you were to make by dividend credit, for example, the investment in equities much more attractive for me, I might on the basis of that decide to forego some consumption to a greater degree and make funds available for investment that would not otherwise have been available, and enable us to finance a larger volume of investment activity without recourse to inflationary methods.

That is entirely hypothetical.

Representative CURTIS. Would you yield there?

If the money went into plant expansion or new machinery, you would increase productivity. At least that is a possibility. I am not saying it would happen, but I say if that did happen then you would be assisting production.

Representative MILLS. It would be a possibility, but it is always hard for me to visualize a situation wherein you increase production at a time when you have no employees available for that increased activity.

Representative CURTIS. An improved machine will do it.

Representative MILLS. That is technological development.

REPRESENTATIVE CURTIS. That is where you need your money.

Representative MILLS. Certainly I would not disagree with your thought that there would be a conversion in type of investment from borrowing to equity capital, but I did not intend to get into that.

I wanted to ask Dr. Saulnier a question about what levels of production and what levels of employment, and what levels of purchasing power are needed in 1957 to carry out the objectives of the Employment Act.

DR. SAULNIER. Mr. Mills, the Economic Report does not specify levels in quantitative terms. We have attempted in the report to describe the levels that prevail at this time. We have done that in terms of employment and of production, and of purchasing power, and income, and disbursements, and consumption expenditures.

We have then stated that in our judgment there is ground for confidence that these levels, these high levels of employment and production, will be extended into the months ahead.

Representative MILLS. You mean by that further raised?

DR. SAULNIER. Further raised, yes, or raised in a manner, at least, that would give us as good a record in the months ahead in terms of employment, unemployment, and production as we have now.

Of course, our economy will be larger. That is larger in terms of our labor force. But how much larger it is really impossible for us to say with any precision.

We have not, therefore, attempted to specify the level of employment or the level of production in quantitative terms which we would either expect to prevail so many months ahead, or in our judgment is needed so many months ahead.

Representative MILLS. My point is this: Did the budget message or the material used in the budget message which apparently reflects, as I read it, the attainment of sufficient levels of production, employment, and purchasing power to carry out the objectives of the Employment Act, not come from the President's economic advisers?

DR. SAULNIER. I would not say that it came directly from the Council of Economic Advisers; no.

Representative MILLS. I did not see anything in the economic report, in other words, that would verify the budget estimates.

DR. SAULNIER. That is correct. Just let me state, Mr. Mills, that the Treasury, the Bureau of the Budget, and the Council of Economic Advisers have, in my experience down here, worked very closely with one another in working out bases for estimating the probable revenues in the fiscal period ahead.

That is done on the basis of estimates of the economic situation.

Now, we do this independently. These are matters about which the professional estimators will have differences of opinion. They make estimates that vary over a range. Sometimes the range is rather wide.

The estimates that we have independently made vary little from the estimates that the Treasury has made. And those variations are quite well within the range of estimating error. I have no quarrel with the estimates that underly the Budget Bureau's revenue estimates.

Representative MILLS. I am trying to understand, Mr. Saulnier, if I can, what the underlying basis of these estimates for fiscal 1958 are. Now, the Secretary of the Treasury transmitted to Senator Douglas by letter dated January 16 a basis for his revenue estimates based upon calendar years 1956 and 1957. Personal income in calendar year 1956 is estimated at \$325½ billion. In calendar year 1957, it is \$340 billion or almost \$15 billion additional. Corporate profits for the calendar year 1956 are \$43 billion, and for the calendar year 1957, \$44 billion.

Now, those changes could result from more than two things, but certainly two things. You could have more personal income in 1957 than in 1956 because more people were employed at better jobs, or you could have that increase reflecting increased wages and with respect to corporations increased unit profits rather than profits based upon an increased number of units of production.

If I understand the situation, the budget message itself must deem that one or the other of those two situations will come into existence, or exist during calendar year 1957. That is, either that we will have more inflation or else there will be more people employed in better jobs in 1957.

Do you have any information that would be of help to me in getting me on which of the two tracks I should be on to properly understand and evaluate the budget message and the economic report?

I wanted to throw this one additional thought in that is disturbing to me. As the President said in his economic message, he trusted that the leaders of labor and of business would use voluntary restraints as they go forward into the months ahead. It indicated to me that he wanted them to exercise those restraints for the purpose of holding down inflationary trends in the months ahead.

That throws me, then, into believing that he anticipates, or the budget message anticipates that these increases can come through increased employment of people in better positions.

Dr. SAULNIER. I think that is a correct inference.

Representative MILLS. That is the actual correct inference?

Dr. SAULNIER. That is the correct inference, yes.

Representative MILLS. Does the economic message, then, carry out that thinking with respect to the question I asked originally?

Dr. SAULNIER. The economic message, while it does not do it in quantitative terms, contemplates an expansion of the economy in 1957 over 1956, which would justify these higher estimates of personal income and of corporate profits, without price effect.

Now, of course if we are unsuccessful in holding the line on prices and have rising prices with the present levels of employment and of income, that will, of course, yield a higher volume of tax revenues. We would hope that that would not happen.

Representative MILLS. Now certainly the Secretary meant to convey the thought that you have when he wrote his letter, because he says in this letter "We do not assume any change in prices from the present."

Now, is this projection into calendar year 1957 sufficient to carry out the objectives of the Employment Act?

Dr. SAULNIER. In my judgment, it is.

Representative MILLS. In other words, those estimates are based upon what you would deem to be the desirable growth which you foresee occurring in calendar year 1957, to maintain the objectives of the Employment Act?

Dr. SAULNIER. As well as we can foresee them.

I would like to say, Mr. Mills, that at this time it is exceedingly difficult, and perhaps more difficult than usual, to estimate the amount of growth in our labor force that can be anticipated over the next calendar year.

This is a short period of time, and it is difficult always to make estimates for such a short period. But we have just gone through a period in which labor-force participation has been very high. Young people have been coming into the labor force in large numbers. Women have been coming into the labor force at unusually high rates. This has increased the volume of people wanting and seeking work. Whether that will continue at quite the same rate for another year is, I think, a very real question.

Representative MILLS. I want to ask you the \$64 question: What are your views with respect to the relationship of the objectives of the Employment Act and economic stability? Are they reconcilable? Can you have both, economic stability and the objectives of the Employment Act being carried out at the same time?

Dr. SAULNIER. Let me answer that question this way, Mr. Mills: I am an enthusiast for the objectives of the Employment Act.

Representative MILLS. Permit me to interrupt long enough to say that I am, too.

Dr. SAULNIER. I would like to call attention to the fact that the Employment Act is silent on price stability. I have over a long number of years interested myself in this question of just how specific one should be in laying down the rules for economic stabilization policy, primarily in connection with the Federal Reserve Act.

I have, myself, by and large, been on the side of a pretty vague kind, or pretty general, let me put it that way, general kind of a mandate. It has been asked from time to time whether the Employment Act ought to be amended to incorporate a price stability dimension.

Representative KILBURN. What do you understand to be the objectives of the Employment Act, just in two sentences?

Dr. SAULNIER. The objectives of the Employment Act, sir, are that the Federal Government should use its full resources to promote high levels of employment and production and purchasing power, and that it should do this within the framework of a private enterprise system.

Representative KILBURN. Thank you.

Dr. SAULNIER. As I say, it has been asked whether the act might be amended to include a price stability criterion or price stability objective.

As I would try myself to administer my responsibilities under the Employment Act, to have price stability in the act, specifically stated in the act, would not make any difference. I regard price stability as a major objective of economic stabilization policy. All I can say, Mr. Mills, is that I would strive to achieve both high employment and price stability. We have put it in the economic report a dozen or more times as "prosperity with price stability." I hope we can attain this objective.

Let me say that over the last few years we have done, I think, more than just moderately well. We have had high employment, and we have had high production, and we have made perfectly enormous improvements in our productive plant. We have sustained a very, very heavy Federal budget with a very large component in that Federal budget of defense expenditures. With all of this, we have had price increases—and these have come mainly in the last 12 months—of something less than 3 percent.

Now, that 3 percent I wish had never happened. I hope that we can move into a period of greater price stability. I am an optimist about being able to reconcile these objectives.

Representative MILLS. Certainly the administration spokesmen ought to be taken at their word, and I am perfectly willing to do that. The last thing that would be desired would be very much inflation. But in the zeal that we all have to carry out the objectives of the Employment Act, I am beginning to wonder just a little bit if those objectives can be carried out without some moderate amount of inflation.

Chairman PATMAN. May I interrupt you to suggest that I hope you make a distinction between a necessary expansion and inflation? I am afraid that oftentimes people fail to make that clear.

Representative MILLS. Normal growth should be distinguished from inflation, which would mean growth as a result of increases in price and not necessarily in numbers of units. I am glad that you point that out.

Now, Mr. Chairman, I would like to include this letter in the record.

Chairman PATMAN. Without objection, it is so ordered.

(Letter and attachment referred to follows:)

THE SECRETARY OF THE TREASURY,
Washington, January 16, 1957.

HON. PAUL H. DOUGLAS,
Chairman, Joint Economic Committee,
United States Senate,
Washington, D. C.

DEAR SENATOR DOUGLAS: In accordance with your request of January 7 for the assumptions underlying the 1958 budget estimates, I enclose a table showing the assumed figures for personal income and corporate profits for the calendar years 1956 and 1957. We do not assume any change in prices from the present.

Sincerely yours,

(Signed) G. M. HUMPHREY,
Secretary of the Treasury.

BASIS OF REVENUE ESTIMATES

Calendar year income levels assumed in the revenue estimates for fiscal 1957 and fiscal 1958 are as follows:

[In billions]

	Calendar year 1956	Calendar year 1957
Personal income.....	\$325.5	\$340.0
Corporate profits.....	43.0	44.0

Chairman PATMAN. I would like at this point to bring out one additional thing. In your report on page 50 you state:

If a vigorous rate of economic growth is to be realized without recourse to inflationary finance, the supply of savings must be sufficiently high to meet the heavy demands for funds for private, State, and local undertakings. The Federal Government is releasing funds for such purposes by a budgetary surplus and reduction in its debt.

Now, you believe, do you not, Mr. Saulnier, that if we operate on a balanced budget and have a surplus, as we pay on the national debt and reduce it, it is perfectly all right to increase private debt?

Dr. SAULNIER. You say "perfectly all right."

Chairman PATMAN. Without any danger of inflation. I am looking at it strictly from an inflationary standpoint.

In other words, we have a debt now aggregating about \$700 billion; \$275 billion of that is the national debt. Now, if we paid \$5 billion down on that debt and reduced our aggregate to \$695 billion thereby, do you not think that we could safely increase the private \$5 billion without any danger of inflation?

Dr. SAULNIER. We could safely increase private investment by that amount. Whether it would have to be in the form of debt or not is another matter. Thus, if I own a Government bond, let us say \$10,000, and the Government pays that bond off and I find myself with \$10,000 in cash, I can spend it on consumption or I can invest it in more debt securities, or I might buy equities. So the reduction of national debt may make it possible to have an expansion in equity investment. I personally would prefer that.

Chairman PATMAN. I am looking at it solely from the standpoint of creating money. Now, if we reduce the national debt, as we reduce it, it is perfectly all right for commercial banks to increase their deposits, we will say, by making loans because as the national debt goes down, private debt can go up. That is, generally correct; is it not?

Dr. SAULNIER. If the Federal Government pays off some debt that was held by the banking system—you see in my earlier example they were paying off some debt held by me and that is a different thing—then the banking system can increase its credit to individuals and to business concerns or to State and local governments without there having been an increase in the money supply. That is correct, sir.

Chairman PATMAN. Do you not think it is time, now, for us to have a definite program for reducing the national debt?

Dr. SAULNIER. I have advocated for many years the use of every resource possible to reduce the national debt.

Chairman PATMAN. Now, Mr. Humphrey keeps saying that if we do not reduce Government expenditures, we will have a severe de-

pression. He must mean that if we have deficit financing, it will probably result in a depression. He could not mean that expenditures themselves will cause a depression if the budget is balanced.

You would not say that we are in any danger of a depression as long as we have a balanced budget; would you?

Dr. SAULNIER. I would prefer to let Secretary Humphrey expand on that for himself.

Chairman PATMAN. Disassociating the question from my remarks about Secretary Humphrey, do you see any danger of any depression as long as we have a balanced budget? Is it not only when we have an unbalanced budget that we are in a dangerous position as far as depression is concerned?

Dr. SAULNIER. In the present situation, Congressman Patman, I would not say that the present level of Federal expenditures and the prospective budgetary surplus for our Federal budget is in and of itself a factor likely to produce depression conditions in this country in the immediate run.

Chairman PATMAN. Would you answer be the same if our budget were \$10 billion more, if the prospective receipts would cover it?

Dr. SAULNIER. My answer would be the same, but I would be unhappy over the fact that the Federal Government was for any reason absorbing that much larger part of the resources of the country. That is for reasons which, important as they are to our national security, are not in the immediate situation making goods and services available to satisfy consumer wants.

Chairman PATMAN. I am only asking you that to get your answer as to what effect on inflation it would have. I am not advocating it or suggesting that we should have it. I am just asking you what the effect would be as long as we had a balanced budget.

Dr. SAULNIER. In the present situation, Congressman Patman, a balanced budget is an anti-inflationary element in our program.

Chairman PATMAN. Certainly, and I am all for it.

Representative KILBURN. Could I clarify that? I do not understand why you say it would not affect inflation. Suppose instead of \$10 billion, it was \$100 billion that the Government was going to spend, even though they get it back in taxes and balance the budget. That \$100 billion goes into the bloodstream of this country, and could cause inflation, in my opinion.

Representative MILLS. If you will yield to me at that point, I do not desire to presume to be able to read the mind of the Secretary of the Treasury, but I think that I have had sufficient conversations with him to reach a conclusion, perhaps, as to what he had in the back of his mind when he said that these expenditures could bring about a depression.

I think what he is thinking about is the effect upon public confidence of continued Government spending at a high level, either bringing about overconfidence or underconfidence that could set off the chain reaction resulting in deflation and depression.

I intend to ask him if that is not his thinking when he comes to the committee.

Chairman PATMAN. Do you want to answer Mr. Kilburn's question?

Dr. SAULNIER. Would you be good enough to rephrase it for me?

Representative KILBURN. As I understood Mr. Patman's statement, it was that even though the Government increased its spending by \$10

million, if the taxes received also rose so that the budget was balanced there would be no inflationary effect.

Chairman PATMAN. That is right.

Representative KILBURN. I should think to the contrary that when you have \$10 billion being spent by somebody, in this case the Government, going into the economy of this country, it is bound to be inflationary.

Dr. SAULNIER. Let me put it this way. We are assuming in this case that we are going to increase our tax take by \$10 billion. We are taking \$10 billion away from the people and reducing their consuming power. Then we are making that \$10 billion available for the production of goods and services important to the Federal Government, and in this case let us assume that they are defense goods. The net effect of this on our economy is that we have a reduced output of consumer goods and larger production of defense goods.

More of our resources, in other words, are going into the production of military goods, and less into the production of consumption goods.

Representative KILBURN. I am new to this Committee, but I should think that the difference in that case would be that the \$10 billion is being spent, regardless of whether it was defense or not. If it was being saved, it would help prevent inflation, but as long as it is being spent it helps inflation.

Chairman PATMAN. And velocity enters into the problem, too. I am not quite satisfied with the answer to my question about the national debt. If I understand the capitalistic system, a system which I am highly in favor of, it is a system based on debt. In other words, we must have debt in order to have money. In order to have debt, we must have a good commercial banking system. I think we have the best in the world and I want it to continue that way. I believe in both the capitalistic system and the private commercial banking system, and I believe in a bank making good profits because it cannot serve the people to the maximum extent unless it is a profit-making enterprise. But, it being true that our money is based on debt, as we pay off that debt, whether it is national debt or private debt, it cancels that much money. That is correct; is it not?

Dr. SAULNIER. If the debt is held by the banking system.

Chairman PATMAN. Regardless of who holds it, if you pay off \$5 billion of the national debt, you have reduced the money supply \$5 billion over the Nation.

Dr. SAULNIER. Only if the debt was held by the banks and not if it was held by an individual. If the Federal Government comes to you and takes \$1,000 away from you and then comes over to me with that \$1,000 and says, "We would like to have you give us the bond that you have in your pocket for \$1,000 and we will give you this \$1,000 which formerly was Congressman Patman's money," I give up the bond and I take the money that formerly was yours. The transaction has been completed. You are the taxpayer and I am the investor. I am now in liquid funds. There has been no change in the money supply.

Chairman PATMAN. If I borrowed the money from a commercial bank, that would still be the same thing; would it not? That would not enter into the transaction?

Dr. SAULNIER. Now, this is getting a little more complicated. If we can somehow trace this into the banking system, we can find, I am sure, some means by which we can produce a reduction in the

money supply. But it must eventually be traced there in order to produce that result.

Chairman PATMAN. I recognize that only in the banking system where the fractional reserve system is used does this operate to create money when loans are made, and to destroy money when loans are paid.

Dr. SAULNIER. That is right.

Chairman PATMAN. Mr. Talle.

Representative TALLE. As has been pointed out, the purpose of the committee is to make a continuing study of employment, production, and purchasing power. Employment suggests jobs and wages, and production suggests plant and output and purchasing power suggests real wages and consumer behavior. How good are our statistics in those three fields?

Dr. SAULNIER. Well, you have asked me a question, Congressman Talle, on matters on which I am far from expert. Employment statistics present a difficult technical problem from the purely statistical viewpoint. I am no expert on that. As you may know, my own field of work has been primarily in finance. But I will say that our employment statistics are pretty good. They are really outstandingly good as measured by the employment statistics of many other countries of the world. Our production statistics are pretty good, too, although if you get a real technician answering your question he would inundate you in no time with reservations and qualifications about the various indexes that we have of industrial production. But, by and large, they are tolerably good.

I must confess that I have never been quite clear what the Employment Act refers to when it refers to "purchasing power," but you can interpret that as meaning the amount of funds becoming available to individuals for expenditure. That is personal income. Or you can interpret it perhaps as the amount of money which individuals are expending. On both of those, we have pretty good statistics, and in recent years, the last 10 or 15 years, we have made very striking improvements in them.

But I would be making unjustified claims if I claimed to be an expert on any one of these specific fields of statistics.

Representative TALLE. The term "real wages" means purchasing power; does it not?

Dr. SAULNIER. Real wages represent to us our measure of what the individual is able to buy in goods and services with the wage payment he receives.

Representative TALLE. That leads me to my next question.

There seems to be an increasing tendency to include escalator clauses not only in labor contracts but in some other contracts, too. There is evidence of this in France, in Germany, in Great Britain and in some other countries. People who draw pensions would like to have escalator clauses to ensure that their pensions will have constant purchasing power. Does that complicate your calculations?

Dr. SAULNIER. Well, I am not sure what you mean by "complicating the calculations." These are devices by which we get automatic adjustments of income payments to individuals in line with changes in some specified index of prices. To a certain extent they do not complicate the problem, but rather they make quite obvious and explicit some of the implications of a price rise. Thus one reads that the

consumer price index goes up by point something or other in the last month, and that this automatically means a wage increase of 1 cent or 2 cents or 3 cents an hour for X number of workers.

That becomes quite explicit and well understood.

But that is a different matter, of course, from the judgment we might make as to whether this is good for our economy or not.

Representative TALLE. Take, for instance, this situation: It is not unusual for employees whether on the job or retired to want more income. An illustration would be social security benefits. Now, it is a tedious process, probably, to come to Washington to ask Members of Congress to supply something more by specific laws. It would be far easier to get it by using escalator clauses. They are automatic and tied to cost-of-living indexes. From the recipients' point of view these clauses may seem rather desirable, but I am wondering what effect they have on calculations, if they became general. Suppose everyone's income were tied to a purchasing power index.

Dr. SAULNIER. I must say that I have many misgivings about the escalator clause.

Representative TALLE. I do, too.

Dr. SAULNIER. One of my misgivings is that at the present time we have some people on an escalator while others are still puffing up the stairs.

Representative TALLE. And that is unfair. Certainly a lot of people feel it is unfair. If some have it, why should not all? You could wind up with everybody having it, and I wonder how you would proceed under a general escalator situation?

Dr. SAULNIER. I doubt that as a practical matter we could get our economy thoroughly escalated. But even assuming for the moment that we could, I must say that the prospect of such an economy just moving up its collective escalator frightens me. I would much prefer a world in which we have to make our adjustments piece by piece, and in which our economic policy can be directed to maintaining a stable price level within a full employment context.

Representative TALLE. I have been and am very much interested in improving economic statistics. There is nothing romantic about that, but I think it is a bit of drudgery that needs to be done.

I believe firmly it is something that the world needs.

Dr. SAULNIER. We in the Council have been very appreciative of the work that this committee has done in working toward improvements in our statistics. We appreciate that very much and we want to be just as helpful as we can in connection with it. There are a good many areas in which we need far better statistical information than we have now.

Representative TALLE. I would think, for instance, in the field of production that it would be very important to have reliable economic statistics because if, as is claimed, wages are paid on the basis of productivity, you must have reliable data as to productivity or you will not know whether you are paying proper wages or not.

Dr. SAULNIER. That is correct, sir.

Representative TALLE. That is all, Mr. Chairman.

Chairman PATMAN. Before yielding to you, I would like to make one observation.

Senator WATKINS. Go ahead. I have not been here long enough to get oriented up to this point.

Chairman PATMAN. We were talking about the national debt and a balanced budget, and I suggested that we should not pay off the national debt too fast because it would be deflationary. I also made the point that if we paid off some of the national debt, we could, I thought, increase other debts in proportion and it would not be inflationary. Mr. Saulnier suggested if the Government took \$1,000 away from me in taxes and then took that \$1,000 and gave it to him in payment of a bond, it would not be deflationary because the money would still be in circulation. Of course I agree with him.

But, if it were paid to a commercial bank that has the power to expand through the fractional reserve system, it would be deflationary because it would extinguish that much of a debt. Let us take that \$1,000 debt, Mr. Saulnier, that I paid the taxes and the Treasury pays to you for the bond. If you owe that money or if you borrowed the money to buy bonds like many people do and you immediately paid the bank the \$1,000, it would have the same effect; would it not?

Dr. SAULNIER. That is right. If I had been holding that bond with a \$1,000 secured loan from a commercial bank and I retired that loan when my bond was retired, it would have the same effect. It would have the same effect as if the bond had been held directly by the commercial banks.

Chairman PATMAN. Would you like to ask any questions, Senator Watkins?

Senator WATKINS. Not at this time; no, sir.

Chairman PATMAN. Mr. Kilburn, have you any questions?

Representative KILBURN. As I said, I am new to this committee, Mr. Saulnier, and I wanted to try to get clear in my mind a couple of basic things that are confusing me a little.

Do you think that we are in an inflationary period and do we want to stop this inflation?

Dr. SAULNIER. Well, Congressman Kilburn, when an economy is operating as close to the ceiling of capacity as ours is, and when confidence on the part of business concerns and of individuals is as high as it is now, and when you have as large a backlog of demands for community improvements as we have now, there is a more or less persisting danger that the economy will pass into the inflationary zone.

Representative KILBURN. As I understand it, the cost-of-living index has gone up 3 percent in the past 12 months.

Dr. SAULNIER. That is right.

Representative KILBURN. Is that not inflation?

Dr. SAULNIER. We ordinarily define inflation as an increase in the price level. There is no question, therefore, but what we must record this as having been a year of moderate inflation.

Representative KILBURN. So that the value of the dollar has gone down?

Dr. SAULNIER. That is correct, sir.

Representative KILBURN. And that is inflation, in any book, I think.

Dr. SAULNIER. You are correct, sir.

But let me say, Congressman, that if you take the price increase of 2.9 you will find that it is made up of increases of a number of different kinds. Let us take rent as an example.

We have many communities in New York—I do not know how many—in which rent control still exists. Why do we have that rent

control? We have it because during World War II and during the Korean conflict period there was a great pressure or demand for housing space, tending to push rents up. These laws were put into effect to hold rents at what was regarded as a proper level. Now, some of them are still there.

If they had not been there, rents would have gone up long ago. The fact that these laws are on the books has suppressed that movement. Now, little by little, these laws are being terminated, little by little those rents are rising.

Now, what does a rent increase that occurs in 1956 or 1957 as a result of the termination of a rent-control law really mean as regards the pressures of inflation in 1956 or 1957? It seems to me that what it means is that you are getting a belated, a late, or deferred manifestation of some inflationary developments which occurred in an earlier period.

Representative KILBURN. I can understand that. That is just the same as when your prices went up after price control.

Dr. SAULNIER. That is right, and we have to bear these things in mind when we interpret the price history of recent months.

Representative KILBURN. One thing that has confused me a little is our respected chairman's statement that I read, in which he stated we have to do something about interest rates so that we will not have a recession. It seems to me that the problem now is inflation.

Chairman PATMAN. Would you consider an increase in interest rates inflationary?

Representative KILBURN. I would answer that this way. It seems to me, and that was going to be the point of my next question to the witness, that the increase in interest rates is the law of supply and demand operating.

Chairman PATMAN. That does not answer the question, though.

Representative KILBURN. Let us get the answer to this, first.

Dr. SAULNIER. That is correct, and I think that while it is true that an increase in interest rates is an increase in the cost of doing business for a concern and may be reflected in a higher price for whatever it is the business concern is producing, the higher interest cost is an anti-inflationary measure in the sense that it tends to restrain demands for credit. Let me add this one sentence. By restraining credit, it helps avoid the price increases that we call inflation.

Chairman PATMAN. Do you believe that the interest rate restrains borrowers to any great extent?

Dr. SAULNIER. Yes; I think it does. I think it is having that effect on a good many borrowers.

Chairman PATMAN. I want to ask you one more question. How much of this 2.9-percent increase in the past year is due to increased interest rates?

Dr. SAULNIER. You would have to take several steps to the right-hand side of the decimal point, in my judgment, before you could get the cost allocable to higher interest. Part of it is agricultural prices, and part of it is increases in rents, and part of it is increases in the cost of personal services. In these, I think, Mr. Chairman, the interest cost has been a very minor item.

Representative KILBURN. It seems to me that anything that discourages borrowing, like higher interest rates, stops inflation. That would be my guess.

Now, the next question that I would like to ask you is this: With interest rates going up due to the law of supply and demand, then is it not true that about the only thing that the Government or the Congress can do in such a situation is to make the loans themselves just like they did in the veterans loans. They made more and more money available for veterans housing directly from the Government because the banks would not loan the veterans mortgage money because the interest rate was not in the market range.

As soon as they made a loan of 100 cents on the dollar, the best they could get for it was 90 cents on the dollar. Consequently, they did not want to make the loan. So then Congress and the Federal Government stepped in and created or allowed the Veterans' Administration to make direct loans. If we let the law of supply and demand operate in money rates, then the only way to overcome it is to have the Government loan it directly.

DR. SAULNIER. It is certainly true that in a situation of this kind, where important classes of borrowers are finding it not only more costly to borrow but in some cases are finding it impossible to borrow, there is a great temptation to come to the Federal Government and say, "Won't you lend the money to us directly?"

I must say in all candor to you, Congressman Kilburn, and to Chairman Patman and members of this committee, that while I have subscribed to the steps that were taken, modest steps they were, to assist small business through SBA and to assist the mortgage market through the Federal National Mortgage Association, I have sought all along to keep those measures at a minimum level and to avoid taking the route of direct Federal lending as a means of avoiding the pressures that a tight money policy imposes on our economy.

Representative TALLE. If we do that, do we not run into the same thing that we have run into with the escalator clause? If one group can get it directly from the Government, why not everybody, and we have socialized credit.

DR. SAULNIER. We do not solve the inflationary problem this way.

Representative KILBURN. When you say the "tight money policy," is not the tight money policy the result of the law of supply and demand?

DR. SAULNIER. You are absolutely right, and I am glad that you have commented on what was really a misstatement of mine. When I said that this is the result of the tight money policy, I really should have said, that this is the result of an economic situation in which the demand for funds is running ahead of the available supply.

Representative KILBURN. There is nothing that the Federal Reserve can do or this committee can do or Congress can do to stop high interest rates caused by the law of supply and demand, is that right?

DR. SAULNIER. That is right. Nothing in my judgment that would be appropriate.

Representative KILBURN. I would presume, Mr. Chairman, that one of this committee's objectives is to halt inflation.

Chairman PATMAN. We are not for inflation. We are against it.

Representative KILBURN. Our alternative basically is to either let the law of supply and demand operate—

Chairman PATMAN. But the Federal Reserve makes the law of supply and demand. I think Mr. Saulnier agreed with me when he said that they could not properly do anything more because he intimated that the evils would overbalance the good.

Representative KILBURN. You mean to say in your opinion that the Federal Reserve by lowering their rediscount rate could lower the demand for money?

Chairman PATMAN. Yes, and the Open Market Committee would be the most feasible way to do it. You see, they are meeting today, the Open Market Committee is meeting today, for all practical purposes to do just that.

Representative KILBURN. With all due respect, you and I have a very basic difference here. I think the Federal Reserve policies on rediscount rates follow the money market.

Chairman PATMAN. I know your sincere and honest views but I cannot agree. We just have a difference of opinion on it.

Representative KILBURN. There is no use pursuing that part of it, but I wanted to get straight in my mind that the purpose of this committee or one of the purposes of this committee is to try their best to be helpful in stopping inflation. Does the Council of Economic Advisers feel that we have either to let the law of supply and demand work in money rates or the Government has to make the loans?

Dr. SAULNIER. My own feeling, as I say, is that we have to resist the temptation to try to evade the operation of these money market forces by direct Government lending.

Representative KILBURN. Of course if the Government did go into the loaning business even more than they are now, and are there not about 18 different agencies now making loans—

Dr. SAULNIER. I regard myself as something of an authority on this subject. The last time I tried to make a listing of them, it took so many pages that it must have added up to more than that.

Representative KILBURN. They are in the money lending business?

Dr. SAULNIER. That is correct, sir.

Representative KILBURN. If this practice continued to grow would it not be inflationary?

Dr. SAULNIER. It could be.

Representative TALLE. Have we not overlooked one point? We have been talking about demand and the rising rate, but if the rates are higher people are encouraged to save, and there is more saving which results in larger supply of loanable funds.

Dr. SAULNIER. That is correct. That is the classical formula for bringing a lack of balance under control.

Representative TALLE. John Stuart Mill stressed "The savable fund and the effective rate of accumulation."

Dr. SAULNIER. As I say, this is the classical means for bringing into balance the demand for funds on the one hand, and the supply of funds on the other. A rising interest rate will both tend to reduce the level of demand, and increase the level of savings supply.

Representative MILLS. I wanted to get back to the point I was pursuing earlier. My curiosity to ask the question stems from language in the Economic Report on page 44, and I wanted to read a few lines in the second paragraph. The sentence begins:

When production, sales, and employment are high, wage and price increases in important industries create upward pressures on costs and prices generally. To depend exclusively on monetary and fiscal restraint as a means of containing the upward movement of prices would raise serious obstacles to the maintenance of economic growth and stability. In the face of a continuous upward pressure on costs and prices, moderate restraints would not be sufficient; yet stronger restraints would bear with undue severity on sectors of the economy having little if

any responsibility for the movement toward a higher cost-price level and would court the risk of being excessively restrictive for the economy generally.

These are not acceptable alternatives to stable and balanced economic growth. The American economy possesses the potentials for expansion and improvement. If these potentials are supported by proper fiscal and monetary policies on the part of Government, and by appropriate private policies, our economy can achieve and maintain high levels of production, employment, and income with stable prices.

It was because of that language that I asked the question whether or not the objectives of the Employment Act and our overall objective of a stable economy are always consistent. We have had now for the last few months, as you have pointed out, some increases that of course have been reflected in this increase in the indicators of production.

We have pretty well carried out the objectives during that period of time of the Employment Act. Now, I am always curious when I am talking to economists to get their opinion as to whether or not these objectives could have been carried out when maintaining complete stability in the overall price level.

Dr. SAULNIER. The price index you are thinking of is the consumer price index?

Representative MILLS. Yes, which has gone up only about 4 to 5 percent in the period of the last 4 years.

Dr. SAULNIER. It is perfectly conceivable, Congressman Mills, that with a different behavior of farm prices in this period, we might have had roughly the same levels of overall employment and of production and income with less price increases than we have had. It is perfectly possible.

Now, if in past years we had had less of a buildup of carryover stocks in agriculture and had had less of a decline in farm prices, and if we had had a more stable farm price index in the last 3 or 4 years, and continuing through 1956, the consumer price index would have looked appreciably different. That would not in itself have affected the ability of our economy to attain high levels of employment and production.

It is perfectly conceivable, also, that if it were not for the great inflationary forces that were at work in our economy during the two war periods, we would have avoided these deferred price changes of which I was speaking earlier.

We would have had less inflation of prices in 1956 than we did have. Yet this would not have impaired appreciably our ability to achieve high levels of employment and production. In other words, the price increases of 1956 were not essential to high employment and production.

Representative MILLS. I am still thinking in terms of the relationship of these objectives to the budget which has been suggested and the justification for the Congress going along with the budget on the assumptions which are made with respect to the budget.

Now, the President refers in this language that I have quoted to the so-called cost-price push. Let us see whether or not this cost-price push can occur without an accommodating expansion in aggregate demand which, of course, is money.

Dr. SAULNIER. Can it occur without an accommodating demand; is that your question?

Representative MILLS. Yes.

Dr. SAULNIER. A change either in the money supply or in the rate of turnover of money and thus in aggregate demand, is implied if you have a fairly general increase in prices resulting from a wage-cost push.

Representative MILLS. Is it not important that we know whether it comes from a more rapid turnover or a more accommodating supply of money?

Dr. SAULNIER. It is important, analytically, to know whether it comes from one or the other. In 1956 it came primarily from the more rapid turnover of our money supply.

Representative MILLS. Is it contemplated that there will be an even more rapid turnover in 1957? Is that the basis that is used?

Dr. SAULNIER. I would doubt it and I would doubt it for this reason: The more rapid turnover of money in 1956 was due in part, I think, to a drawing down of cash balances by corporations and to a more rapid turnover by the corporations of their cash funds.

Now, there is kind of a saturation point here, I think. A business concern can increase the volume of its business on a given dollar volume of cash and perhaps go to a still higher level, but there is a question as to how far that can go. There must come a point at which a further increase or further decrease in its liquidity position is not practicable.

I think we must be closer to that point now than we were at the beginning of 1956. Let me put it this way: The prospect for a more rapid turnover of money in 1957 is relatively slight.

Representative MILLS. Does this present budget that we are working on actually hold out the possibility of an increase in prices from a continuation of this "cost-price push," as a matter of fact? Does it not create more pressures in that direction? Does it not mean, therefore, that we must have more restraint in our Federal Government fiscal and monetary policies to accommodate that expenditure by the Government?

Dr. SAULNIER. In the present situation, Congressman Mills, I would prefer a larger budgetary surplus than is contemplated.

Representative MILLS. Actually, what I am disturbed about is whether or not the Congress is safe in assuming such growth as you have indicated is the basis for assumptions with respect to the budget for purposes of making expenditures by Government for months ahead.

Now, in order to justify these expenditures and for the Government to remain on a balanced budget, it is absolutely essential that 1 of 2 things occur that we talked about a few minutes ago: Either it is more inflation or an actual increase in production and personal income based upon more employment in better jobs.

Then we must, if we justify the appropriation of the funds contemplated in this budget with the expectation of doing that and ending with a balanced budget which would not adversely affect our economic stability, come to the conclusion that this growth will occur.

Normally we do not make our appropriations depend upon assumptions about changes in levels of economic activity. But this time we are being asked to assume this increased growth which we all want and which we all say is necessary in order to end up with a balanced budget after making these appropriations.

Senator WATKINS. As a practical matter, do we not make our appropriations largely on the pressures that are put on us?

Representative MILLS. I fear, Senator, that one of the great pressures we have is the fact that it is in the budget.

Senator WATKINS. There was probably a pressure to put it in the budget, too.

Representative MILLS. I am concerned with what one of your very eminent Members of the Senate said with respect to this budget. He said that in his opinion it reflected a contemplation of more inflation. You have said that the budget is not predicated upon inflation. I am glad to hear that it is not in your thinking predicated upon inflation.

What I am fearful of is that we will create the situation through appropriation of the funds involved in this budget, to make it impossible to avoid additional inflation except if we utilize even greater restraint in Government fiscal and monetary policy. I do not see where we can obtain the additional restraint in fiscal policy that we might need to utilize after making the appropriation.

Representative CURTIS. Would you yield for a clarification there? You said Dr. Saulnier had said that this was not predicated upon inflation. Did you mean by that that the budget is going through as is, or was there a comment on that? Was there a comment to the effect that the budget as is would not create inflation?

Representative MILLS. No. What I had tried to develop earlier with Dr. Saulnier was whether or not this budget and economic message and these things that are coming to the Congress are predicated upon more inflation or continuation of inflation. Or whether or not they are predicated upon increases in income and productivity at fixed prices. He said it is the latter that they are predicated upon.

Dr. SAULNIER. I might say in that connection, Mr. Mills, that it is my understanding that the estimates of revenue for a fiscal period ahead have in the past, as well as in this budget, been based on some assumptions as to the growth of the economy.

The estimates which we have for revenues for fiscal 1958 do predicate a growth in the economy at a normal long-term rate. But to make an assumption on growth is not an innovation in budget-making.

Representative MILLS. It may well be that some allowance has been made with respect to Government estimates, in estimating them at least, for some growth. However, we found it to be the situation normally when we have been in a rising economy that the Treasury has underestimated revenues far more often than it has overestimated revenues. We do have that situation.

But here we have this decided jump between calendar 1956 and calendar 1957 with respect to personal income on which the revenues in part are based, of \$325½ billion in 1956 to \$340 billion in 1957. That is a \$14½ billion increase.

Now, do we have some criteria to go by in terms of the historical record that would indicate that the recommendations contained in the budget and the overall economic situation justify our assumption that a balanced budget will be attained?

Dr. SAULNIER. Our own calculations of what would be involved in terms of increased production, employment, and income, if we expand in 1957 at about a normal historical rate, correspond roughly with what has been estimated by the Treasury.

Representative MILLS. Now, let me get it down to figures. Do you mean to say then, that if we have in the calendar 1957 an increase in our overall national production of 3 or 3½ percent, which is I understand about the normal increase or normal growth, that increase will reflect this addition in personal income?

Dr. SAULNIER. That is right.

Representative MILLS. So then we do get down to this point, that the budget receipts are predicated upon a growth in overall gross national product of around 3 or 3½ percent?

Dr. SAULNIER. It would be in that neighborhood, that is right. That is, a growth that would be consistent with the objective of the Employment Act to maintain a level of employment that will provide jobs for those who can be expected to come into the labor force in 1957.

Representative MILLS. What are the factors that presently exist, Doctor, that give rise to the conclusion for these purposes that this rate of growth will occur in our overall national product in 1957?

Dr. SAULNIER. Well, I can run down the major sectors of our economy. As to capital expenditures and business, I think there is no expectation that they would increase in 1957 at as rapid a rate as they increased in 1956 but a further increase is anticipated. There are, as you know, some areas of capital investment, notably public utilities, where the rate of growth is anticipated to be quite high.

Secondly, we can take State and local units. It is, I think, not unreasonable to anticipate that the overall volume of activity in that segment of our economy will increase in 1957 over 1956. As you know, expenditures there have been stepping up fairly regularly and persistently over some period of time.

The consumer is always the mystery man in this drama. It is impossible to tell precisely what is going to happen there.

Representative MILLS. Judging from recent situations with respect to the consumer, I think it would cause us to feel that his confidence has not diminished to any extent.

Dr. SAULNIER. That is correct.

Representative MILLS. I think that you are pretty safe in assuming a continuation of consumer confidence underlying a pretty high level of consumer demand.

Representative TALLE. Would you yield to me for just a moment? Turning back to local expenditures which you just mentioned, most of the State legislatures are meeting this month and no doubt a good share of their work will be to pass laws that have to do with meeting local obligations in order to share in Federal funds under various Federal-State matching plans.

Dr. SAULNIER. As I said earlier, I trust that some of their activities will be directed toward facilitating the raising of funds independently of the Federal Government.

Representative TALLE. I share your hope, sir.

Representative MILLS. There are two points that I am concerned about, Doctor, not as an economist of course, because I am not, but as I had looked to the future and tried to determine whether we can have this rate of growth in 1957. There are two questions always in my mind.

One is in respect to what inventory policies will prevail in 1957 and the other, because I have realized that much of our growth in 1956 was based upon enlarged shipments overseas, what our situation in 1957

may be with respect to imports, particularly in the light of the developments that are now plaguing us in the Middle East.

Do we have any information upon which we can safely predict for the future with respect to inventory policies and positions?

Dr. SAULNIER. Well, inventory accumulations were fairly high in 1956 and I think it is reasonable to expect further accumulations in 1957.

Representative MILLS. What was the rate of accumulation last year?

Dr. SAULNIER. It was somewhere in the neighborhood of \$3.5 billion in 1956. That is, the addition to the dollar volume of inventories of all sorts in our economy.

Representative MILLS. Is it essential now, in order to carry out these objectives and these predictions, that inventory accumulations in 1957 only be \$3½ billion, or must they not be at a greater rate than that?

Dr. SAULNIER. I don't recall the figures precisely, but I feel quite certain that I am correct in saying that inventory accumulations in 1957 at a lower rate than prevailed in 1956 are not inconsistent with these budgetary assumptions.

Representative CURTIS. Could I ask one question just for clarification? In your inventory figures, you said it runs the gamut and that includes raw materials as well as finished products.

Dr. SAULNIER. That is right.

Representative MILLS. What about the possibilities of exporting goods overseas for 1957 compared to 1956?

Dr. SAULNIER. What we call net foreign investment was a fairly substantial element in the economic expansion of 1956. I believe it was under \$2 billion, but it is an important factor because it was a substantial increase over the previous year.

Now, this represented two major factors—the very rapid rate of economic expansion abroad, and the rather sharp revival of private foreign investment. As you know, in many cases when there is private investment abroad this means that the funds invested are spent in this country to buy equipment of one sort or another, which does involve an increase in exports.

Senator WATKINS. How do you determine the investment abroad? How do you find out how much private investment there is? It seems to me if it is a private affair, there would not be any public figures on it.

Dr. SAULNIER. I am afraid that someone more expert than I is going to have to give you the details of making these estimates of foreign investment. There is, as you may know, a special unit in the Department of Commerce that puts together regularly our balance of payments figures, and makes estimates on private investment abroad.

While I would be glad to supply you with a technical memorandum on that subject, I think I would probably confuse you more than help you if I tried personally to give you the information.

Senator WATKINS. I just wanted to be informed.

Representative MILLS. I had in mind more the export of goods produced in the United States than the export of dollar investment abroad. I was thinking in terms of the remarkable increase that occurred this year in the exportation of American made and grown

goods, particularly farm products overseas. In order for us to continue even at the present rate of production here in the United States, I would think we would almost have to maintain those levels of export.

If we are going to grow, a part of that growth must be reflected, as I see it, in increased shipments overseas. With the disturbances that presently exist, I have been thinking that it would be very difficult for us to enjoy in 1957 the same rate of export that we enjoyed in 1956.

I wondered if those things were considered and to what extent they affected the determinations that were made here for purposes of this economic report and the budget.

Senator WATKINS. Will you yield to me at that point? Would you not expect that the present rate would continue, particularly with the stimulation given to the export of oil and petroleum products?

Representative MILLS. I would hope that our overall exports might be greater than they were in 1956 but I had some degree of caution in my own mind with respect to them being as great, even with this exportation of oil.

Senator WATKINS. This will be caused not by economic causes, but by international affairs that have no relation to economics.

Representative MILLS. The difficulty as I pointed out in our exportation of as much, if that is the case, in 1957 as in 1956 would certainly be due to these disturbances over there. But they would directly affect our economic conditions here with respect to this anticipated growth.

Senator WATKINS. I would agree with you on that. It seems to me that no matter how well we plan at home, we are governed almost entirely by whatever happens in the foreign field.

We can plan and we can lay out our plans as to what we want to do and we can set out our economic program and all of a sudden something happens over there and knocks it into a cocked hat.

Representative CURTIS. You mentioned the bulk of the farm products in there. The countries abroad are claiming that we achieved that figure through a sort of force-out and they allege that we are dumping.

Representative MILLS. You ran into it on that subcommittee that you are on.

Representative CURTIS. I was a congressional adviser to our delegation over there at GATT and that was on the tongues of most of the representatives of the GATT countries. With that kind of pressure from them and these allegations, I think that we are going to run into increased difficulties in being able to dispose of as much surplus agricultural products.

Representative MILLS. I am glad to know that you have the same concern I do about that.

Representative CURTIS. I do.

Representative MILLS. I was somewhat surprised as I read the Economic Report that there is not any information in it, as I read it, on this point.

Dr. SAULNIER. Do you mean on surplus sales?

Representative MILLS. No, on the relationship of our exports to this growth that we are contemplating.

Dr. SAULNIER. The Economic Report merely states on page 46, at the top of the page, "While the factors influencing our markets

abroad are complex and diverse, foreign trade and investment on balance appear likely to remain high.”

Representative MILLS. I read that but that still does not mean to me that it will remain as high as it was in 1956 or it could still be high and not be as high as it was in 1956. If it is only as high as it was in 1955 we will have to look somewhere else than to export of goods to find the basis for the increase in overall activity here at home.

Dr. SAULNIER. We have identified this as one of the areas of uncertainty in the economic picture.

Representative MILLS. Is it just an uncertain area or is it an area of weakness as we approach 1957?

Dr. SAULNIER. I think it is better described as an area of uncertainty than an area of weakness. I think we must also bear in mind that, important as this is, not only for our economic life and for the prosperity of the rest of the world, it is far from being a major item in the aggregate economic accounts of our country.

We could have a very substantial decline in net foreign investment—say 30, 40, or 50 percent—and dollarwise it would involve something in the neighborhood of half a billion dollars.

Representative MILLS. Perhaps I am wrong in this, Doctor, in the assumptions that I make with respect to what must exist for this rate of $3\frac{1}{2}$ percent of growth to occur. It seems to me that we must have, in order for that rate of growth to occur in the 12 months' period, very, very favorable economic conditions along most lines of activity.

You cannot have very many reversals of what took place in 1956 without losing that rate of growth. In order to have a rate of growth of $3\frac{1}{2}$ percent in other words, you must have some degree of growth all along the line in these factors contributing to the whole.

Now, you have considered all of them as you have reached these conclusions and I am merely, because of the lack of anything really specific in here on that, raising the point as to what effect and influence you anticipate from that failure of one activity on the overall?

Dr. SAULNIER. To get this result, you have to have pluses in some areas of the economy and if you have minuses in other areas, your growth, where growth does occur, must be greater than the average or the aggregate in order to carry its extra burden.

Representative MILLS. You could have a complete cessation of exports if you compensated for that loss in increased military growth or in some other growth, perhaps?

Dr. SAULNIER. That is correct.

Representative MILLS. You are talking about foreign investments?

Dr. SAULNIER. I am talking about our net foreign investment figure.

Representative MILLS. I am talking more about our export of goods rather than the dollars now.

Dr. SAULNIER. This encompasses that.

Representative MILLS. I know, but our exports of goods far exceeded \$1,400 million in 1956.

Dr. SAULNIER. That is correct, and they are offset in our national accounts by our imports.

Representative MILLS. We have a surplus still of exports over imports; is that right?

Dr. SAULNIER. Yes, which we make up for with our investments.

Representative MILLS. We partly make up for it with our investments abroad.

Dr. SAULNIER. Yes; partly.

Representative CURTIS. On this same point I just wanted to develop a few things that were mentioned because I had a question along this line. I had one with regard to this foreign investment.

Actually, in the long run, is that the kind of thing that helps balance any dollar gaps? It is perfectly true that the immediate process of investment is involved and it will bring in money, but as that capital investment in turn earns over the long range, it will work the other way. Am I right about that?

Dr. SAULNIER. It does work the other way, as income has to be repaid to the investor in this country. Ultimately one would hope the investment itself would be returned. But, of course, the ability of foreign countries to make those income payments implies prosperity on their part and economic expansion, and one would expect the demand abroad for funds to grow.

Representative CURTIS. On this point of how much we can anticipate next year, using the combination of foreign trade and investment, this is based upon the discussions of the subcommittee I am on, of foreign trade, with the governmental officials and business people in the Western European countries. Many of these countries are relaxing the barriers that they have against our investing in their countries because now they are anxious to encourage it.

So it would look like foreign investment will be maintained, if not increased, because a great deal of it has been going to Western Europe.

Now, on that I was going to ask the same question that Senator Watkins asked about the accuracy of our estimates of capital investment abroad, and in particular whether or not we included in it the plowing back of earnings in the investment that we already have.

I was amazed in talking with our movie industry in Britain to find that they have earned so much money on their original investment, and because taking those earnings out of Britain would have caused Britain considerable economic strain, they agreed to just reinvest. They put in around 50 or 60 million dollars and went into some areas over there that they never intended to.

There is a lot of that kind of reinvestment going on and I do not know how our Department of Commerce would catch those figures. Maybe they could, but I am curious to know if we do know the extent to which our figures on our foreign investments are reliable.

Dr. SAULNIER. I would not be able to say how satisfactory the estimating methods are, but I am sure that an effort is being made to encompass the degree of reinvestment of earnings in these estimates. I can say only that I am confident that a good job is being done—as good as is practicable at this time. There are excellent people working on it.

Representative CURTIS. We have another thing that pertains to that. Western Germany now is in a creditor position and it is apparently investing money over here. I understand France is, too. I know of no way of measuring the amount of flow of foreign investments.

Dr. SAULNIER. I think the net is the other way. There will always be some individuals abroad who will have the resources available for investment and will find the United States an attractive place in which to place their funds.

Representative CURTIS. I asked the French people if they had any way of estimating how much French capital might be coming into the United States for investment. They indicated that they could not tell very well. There were supposed to be restrictions on it, but they rather frankly admitted that these negotiations were handled through the Swiss and they had no way of measuring it.

Dr. SAULNIER. You inspire me to make a special effort to find out how these estimates are made.

Representative MILLS. Doctor, I have just 1 or 2 other thoughts. I had recently been told, and I notice that it is somewhat expressed here in the President's economic message, that the drive is being made by some foreign countries to obtain treaties with the United States that will recognize the going rate of tax in the foreign countries rather than the actual amount of tax paid by the business in the foreign country.

They say it is necessary that we recognize the going rate of tax if we do not nullify tax concessions which these foreign countries may make for purposes of obtaining outside capital.

I can understand their point of view. But since the matter is referred to in the economic message, has full consideration been given to the possible consequences here at home, to the effect on the use of resources here under such a program if it should become widespread and be included in several treaties with several countries?

Are we putting ourselves then in the position in which we may lose the use of facilities and resources that would otherwise be available to us and are we thereby in the long run diminishing the possibility of economic growth here at home in keeping with the purposes of the Employment Act?

Dr. SAULNIER. Another alternative that you should include in that list is the possibility that this would help us to substitute private investment for public investment abroad.

Representative MILLS. It may do that; but the point I am getting at is this: Would it in any way jeopardize the accomplishment in the long run of the objectives of the Employment Act here at home to pursue a program which grants this concession to foreign investment of American capital and resources? Is it worthy of consideration?

Dr. SAULNIER. It is an economic problem. If the attractiveness of foreign investment increases, and such tax treaties would increase the attractiveness of foreign investment by giving effect to the tax privileges accorded investment abroad, it would tend to draw investment funds from our own economy.

Other things being equal, it would make the balance between the supply of available funds for investment here and the demand for them a little less favorable. Other things being equal—and we have to make that assumption in order to reason about this at all—it would tend to cause investment costs and interest rates to be a trifle higher in the domestic market.

Representative MILLS. Is there occasion then, to have us hold up a flag of caution to the adoption of such a program and its widespread utilization?

Dr. SAULNIER. Being as uncertain as I am about the immediate impact of such treaties, and being as keen an advocate as I am for measures that would increase the flow of our funds abroad for pur-

poses of economic development, I would hesitate to say that we ought to hold back on tax treaties at this time.

Representative MILLS. Even though it means supplanting the signals of the market place with concessions and subsidies?

Dr. SAULNIER. Even though it might mean at this time a little heavier demand for investment funds in our market than prevails currently.

Representative MILLS. I had one other thought. I am a little bit concerned about language which the President uses in his economic message:

Reliance for stability in economic growth cannot be placed exclusively on the fiscal and monetary policies of Government.

A little further down he says:

Of particular importance in a prosperous economy is the responsibility of leaders of business and labor to reach agreements on wages and other labor benefits that are consistent with productivity prospects and the maintenance of a stable dollar.

Now, that causes me to feel that there must be some method in mind whereby these leaders will be asked to assume this responsibility. I wonder if you could describe the mechanism that you envision by which these leaders of business and labor can assume this responsibility.

Dr. SAULNIER. I would just like to make two comments on that, Mr. Mills. First, there was no intention in the economic message of the President to take the position that the full burden "could not" be placed on monetary and fiscal controls. The economic message merely says that we court certain risks "if" we place the full burden on monetary and fiscal controls.

Representative MILLS. I read that a little earlier.

Dr. SAULNIER. I think that is rather an important point. It is rather an important interpretation or understanding of the language to have in mind.

Representative MILLS. Then this language should be understood to mean "shall not" rather than cannot.

Dr. SAULNIER. And that it could not do it without producing certain other results which one would regard as undesirable.

Representative MILLS. In other words, it is better not to rely exclusively upon fiscal and monetary policies of Government. It is better, according to this report, for us to rely to some extent upon that, and at the same time for us to obtain recognition of the responsibility of leaders of business and labor that they have a chore to perform in this connection if we are to remain economically stable.

Now, what I am getting at is this: I think if that is the procedure that we are following, we must sometime or other obtain recognition of that responsibility from them during the year 1957. Now, first of all, what is the mechanism that is contemplated for getting the picture over to them and then, secondly, the mechanism by which the leaders of business and labor can assume this responsibility?

Dr. SAULNIER. I think the first and fundamental requirement is that we understand the problem and get a broad public understanding of it. It is my hope that the economic messages—this economic message and also that portion of the state of the Union message that deals with this—will help to communicate to the public generally the nature of these responsibilities.

Representative MILLS. Frankly, can we expect them to assume the responsibility that we say is theirs and which we desire them to assume, unless we ourselves in Government set an example that the assumption of their responsibility would require them to follow?

Dr. SAULNIER. I think the example that Government sets is enormously important.

Representative MILLS. Then does it come to this, that if we expect them to do what we want them to do this year, we must steer away from increases in salaries of Government employees during the year 1957? The President's Economic Report does not say that there should be any, but there is a drive underway already.

Dr. SAULNIER. That is correct, sir.

Representative MILLS. It is quite a strong drive, I think, for about \$800 per employee.

Now, does this suggest that if we want business and labor to assume responsibility for holding back on price and wage increases, we must do the same in the Government? Is that the case?

Dr. SAULNIER. That is correct.

Representative MILLS. So that in order for us to expect the maximum out of them, we will have to do the maximum here to keep them from having such increases occur during the year 1957?

Dr. SAULNIER. That is right.

Representative MILLS. Does this recommendation mean that in wage negotiations in the steel industry, for example, agreements should be based on the productivity prospects for the steel industry or for the economy as a whole?

Dr. SAULNIER. Well, that is a hard question.

Representative MILLS. If it is agreeable to the other members of the committee, and particularly to the members of the President's Economic Council, I would like to submit to them some questions which they may answer and return for the record.

Use your own judgment as to what you would say and what you should not answer, if you want to do that.

Dr. SAULNIER. We would be glad to do that.

Representative MILLS. I have no desire to do anything more than just to have the information.

Representative CURTIS. Are they along these lines?

Representative MILLS. These are the questions submitted to all members of the committee.

Dr. SAULNIER. We would be glad to do that, Mr. Chairman, but I would only ask that, in making such requests, you will bear in mind that the Council has many duties to perform. One of the very heavy ones that we have to perform is the preparation of the Economic Report.

We have been hard at work on the preparation of the Economic Report since the 1st of November. Three long months have gone by and the Council has devoted just about its full resources to this task. I hope that we will not now be called upon to write another Economic Report.

Representative MILLS. I would not have any such thought in mind.

Dr. SAULNIER. Might I say that, in making that request, I have just this in mind, and I feel very strongly about this: I am an enthusiast about the Employment Act and about the possibilities of service that the President can get from the Council of Economic Advisers. I feel

very definitely that the service that we can render to the President and to the Government and to the public in this matter is very much affected by the kind of homework that we inherit. We can sit down and turn ourselves into just a guild of writers, but I think we would be less useful than if we can turn ourselves to the practical day-to-day problems of Government.

Representative CURTIS. What you are saying in effect, is that this series of questions, if answered fully, would be almost another economic report. I am inclined to agree with you.

Representative MILLS. I doubt that they would. Have you seen the questions?

Dr. SAULNIER. I have not seen the questions.

Representative MILLS. We could sit here and go through those questions for the remainder of the day if it was the will of the committee, but I thought that it could be just as productive, if the questions were susceptible of answers for them to be submitted for the record rather than keeping these gentlemen here later.

I know all of us have other things to do.

Representative CURTIS. I have not gone through all of these questions but I have seen some of them. They certainly are questions that require lengthy and statistical answers.

Dr. SAULNIER. This presents a very real problem for the Council of Economic Advisers. Frankly, I would rather come up here and spend 2 or 3 days talking with you gentlemen about them, than to prepare written responses. I am quite frank about that. I would be glad to come up here and talk for 2, 3, or 4 days.

Representative MILLS. I will certainly withdraw my request if it means that much of a burden to you.

Dr. SAULNIER. I have done a good deal of writing in my day on finance and economic stabilization, and it comes hard to me. When the Council of Economic Advisers prepares a document of this kind, it has to be done with very great care and I can foresee weeks and weeks of work in that document.

Representative MILLS. Let me, then, put the questions in the record at this point and just go ahead and get your answers to this one question if it is possible.

(The questions referred to by Representative Mills are as follows:)

SOME QUESTIONS POSED BY THE JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

Prepared by the Staff of the Joint Economic Committee

I. PROBLEMS OF ECONOMIC STABILIZATION

The President, in his letter of transmittal, states: "Reliance for stability in economic growth cannot be placed exclusively on the fiscal and monetary policies of Government. * * * Of particular importance in a prosperous economy is the responsibility of leaders of business and labor to reach agreements on wages and other labor benefits that are consistent with productivity prospects and with the maintenance of a stable dollar."

A. Can you describe the mechanism by which leaders of business and labor can assume this responsibility?

B. Does this recommendation mean that in wage negotiations in, say, the steel industry, agreements should be based on the productivity prospects for the steel industry, or for the economy as a whole?

C. Assuming that the wage agreements are to be based on the productivity prospects of the particular industry, can the "leaders of business and labor" in that industry be expected to be able to obtain the required information

about "productivity prospects" and wage levels in that industry, consistent with "maintenance of a stable dollar"?

D. Suppose that, given demand conditions, a particular industry can increase the prices of its products without loss of sales. Does this recommendation, quoted above, suggest that the industry should refrain from raising its prices to a level at which the prices will serve to "clear the market" because of considerations of overall economic stabilization?

E. Doesn't this recommendation presuppose that business and labor leaders can evaluate the impact of wage and price changes in their particular industries on the economy as a whole? Can we place any reliance on this supposition as a basis for labor's and management's contributions to economic stabilization?

The President's report states, on page 2, that the management of business concerns have the responsibility for administering "their affairs so as to help avoid economic imbalance and dislocation." It also states that " * * * the increasing practice of planning expansion programs well into the future and organizing operations with a view to greater stability of employment" are evidence of business' acceptance of this responsibility. The report states that "business management has a clear responsibility * * *" to avoid excesses in the management of inventories, in the expansion of facilities, and in the use of credit and " * * * carry out its plans so as to contribute to steady economic growth."

A. Can you suggest the standards or guides which the management of any given business should use to determine whether it is carrying out its plans so as to contribute to steady economic growth? How is any given business management to know whether, from the point of view of overall economic stability, its plans and actions with respect to inventories, expansion of facilities, and use of credit are "excessive"?

B. Most businesses, presumably, will be guided in their management of inventory, facilities expansion, and credit-use policies by considerations of minimizing their costs and maximizing their profits. The free enterprise system is based on such motivations. Are actions so motivated necessarily consistent with steady economic growth? If not, do these assertions in the report recommend that business management permit considerations of economic stabilization to outweigh those of cost reduction and profit maximizing in their own companies?

II. GOVERNMENT STABILIZATION POLICIES

On page 48 the report states that " * * * the financial affairs of government should be so administered as to help stabilize the economy and to encourage sound growth. The principle of flexibility in fiscal policy calls for relating the budget as far as feasible to economic conditions, helping to counteract inflationary or deflationary tendencies as the situation requires."

A. Would you elaborate on this in detail?

1. In the context of an inflationary situation, what does this principle call for with respect to—

- (a) Government spending;
- (b) Government revenues—tax reductions or increases, general or otherwise;
- (c) Net budgetary situation;
- (d) Debt management?

2. In the context of a recession, what does this principle call for with respect to—

- (a) Government spending;
- (b) Government revenues—tax reductions or increases;
- (c) Net budgetary situation;
- (d) Debt management?

If we were to face a recession in fiscal 1958, would you recommend tax reductions, even if they meant an increase in the debt?

The President's report states on page 2 that government must " * * * take in taxes no more than absolutely necessary of the incomes of individuals and businesses." How do you define and measure the amount of taxes that are absolutely necessary? Is this amount related to the use of government fiscal powers for purposes of economic stabilization? How?

The report notes (p. 32) that rising costs, particularly after the middle of the year, underlay the rise in the prices of most commodities and services during 1956.

The report describes this "cost-price push" (p. 44) as follows: "When production, sales, and employment are high, wage and price increases in important industries create upward pressures on costs and prices generally. To depend exclusively on monetary and fiscal restraints as a means of containing the upward movement of prices would raise serious obstacles to the maintenance of economic growth and stability. In the face of a continuous upward pressure on costs and prices, moderate restraints would not be sufficient; yet stronger restraints would bear with undue severity on sectors of the economy having little if any responsibility for the movement toward a higher cost-price level and would court the risk of being excessively restrictive for the economy generally."

A. Can this "cost-price push" occur without an accomodating expansion of aggregate (money) demand? Could this "cost-price push" be prevented by making Federal Government fiscal and monetary policies sufficiently restraining?

B. If fiscal and monetary restraints adequate to prevent price rises would "* * * court the risk of being excessively restrictive for the economy generally," doesn't this imply a conflict between the objectives of price level stabilization (i. e., preserving the value of the dollar), and maintaining high levels of employment and production?

C. If such a conflict does exist, in the present context, should Federal Government economic policies give priority to price level stabilization or to maintaining high employment?

D. The report observes (p. 46) that "* * * the moderate upward drift of the price level may not yet have run its course * * *." Does this mean that we may expect further increases in the price level in 1957 over the end of 1956? Does the language on page 44, quoted above, imply a recommendation that if such price increases materialize—or threaten to occur—the Federal Reserve should not impose "stronger restraints"?

III. ECONOMIC SIGNIFICANCE OF PRESIDENT'S MID-EAST PROPOSALS

The report is virtually silent on the consequences of developments in the Mid-East in 1956 for the American economy. Does this imply that these consequences are insignificant? If not, will you elaborate in detail on the impact on the United States economy of the closing of the Suez Canal, the military intervention in Egypt, etc.?

The report is entirely silent with respect to the President's proposal for economic assistance in the Mid-East. Will this program, if adopted, be inconsequential so far as the United States economy is concerned? If not, will you discuss the problems and types of adjustments involved?

IV. AGRICULTURAL SECTOR OF THE ECONOMY

The report states on page 12 that "in general, adjustments have been in the direction of a better balanced farm economy. Most of the decline in the total number of farms has been among units that yield inadequate income to their operators; the number of moderate-sized family farms has increased; and the proportion of farms owned in whole or in part by the farm operator has risen."

Can you provide us the detailed data showing (1) the distribution of the decline in the number of farms by size of farm or by amount of farm operator's income from the farm; (2) the distribution by size and by type, family or commercial, of the present number of farms; and (3) distribution of operator ownership of farms by size of farm?

Representative MILLS. Does this recommendation mean that negotiations in, say, the steel industry should involve agreements based on productivity prospects for that particular industry or the economy as a whole. What are we talking about in the report there?

Dr. SAULNIER. Let me see if I can answer the question this way. I am an old college professor and I could do this a little better if I had a blackboard. Lacking a blackboard, let me draw some pictures on this pad.

If you take all the industries in our country today—if we knew the productivity prospects for each of them—we would find that they ranged from some very high prospects—I am talking now about the prospects for the next year or 2 years—all the way down to those

having no prospects for increase at all, and to those industries where the prospect may be for a loss of productivity.

Now, we could take our little mass of companies and order them according to their productivity prospects. If we did that, we might find that the data would tend to concentrate around a prospective productivity gain of say $2\frac{1}{2}$ percent or 2 percent, or some such figure.

Let us say $2\frac{1}{2}$ percent. There would be some companies with much brighter prospects, but fewer than those that concentrate at the norm. Then there are some that have very little prospect of gain.

You would get a spread something like this. All that the economic report says is that if, on the average, wage increases go beyond what is indicated at this concentration point, that is a factor making for general price increases.

That is a general proposition and refers to averages and not to specific industries and still less to specific companies.

Now, let me turn to the other question. Let us suppose that you are in an industry that has very very bright productivity prospects and your company happens to be one of those with the brightest prospects of all. You are away out here and you have been told by somebody, or you have reason to believe, that the average gain is $2\frac{1}{2}$ percent, but you can expect a lot more in your industry.

Now, what will happen? In negotiating a wage agreement you will, of course, take account of the situation in your own industry, as will those who represent labor. But, you will not pay a wage in that industry which is exactly in line with the productivity prospects for your industry. You will pay perhaps somewhat higher than the average because of the bright prospects of your industry, but only "somewhat" higher than the average.

Indeed, there is no reason why you should pay more than that. The bright productivity prospect in your industry is not attributable to the qualities of labor working in your industry because if they do not work for you they go into some other industry where productivity prospects are less bright and, therefore, by inference, their efficiency is less.

Representative MILLS. That is what I was getting at. This plan does contemplate enough flexibility for me as the management of a concern to come to the President with a wholesome desire of assuming this responsibility and doing what is suggested and still permit me acting under that responsibility to retain my work force and to accommodate their needs for increases if those needs exist even though my immediate prospect for increase in production is not in keeping with that which they and I might agree would be a reasonable figure for their wages for the future.

Dr. SAULNIER. I think that is a correct statement.

Representative MILLS. I think that that is all I have. Are there any further questions?

Representative CURTIS. I have a question. I think this has been explained but I have a note on this sentence here that Mr. Mills was attaching much importance to:

Reliance for stability in economic growth cannot be placed exclusively on the fiscal and monetary policies of Government.

Frankly, I was very much disturbed at that sentence because I read into it the overtones that I think are not there but I want to be sure.

The stability and economic growth in my judgment, cannot even be placed primarily on fiscal and monetary policies of Government. In our system of private enterprise it is bound to be in private enterprise and at most, all the Government can do, as the rest of the report indicates, is create good climate.

Yet this sentence was worded in such a way that it stated:

Reliance for stability and economic growth cannot be placed exclusively—and it implied that it could be primarily placed on it.

I do not think even that can be done.

Dr. SAULNIER. That interpretation should not be placed on that sentence. The reference is primarily to the efforts that must be made by Government and by individuals to control inflationary developments.

Representative CURTIS. The dollar value is what you had in mind?

Dr. SAULNIER. That is right.

Representative CURTIS. I wanted to make it clear that the overtones I read into it are not in there. I get your point about what you were referring to and the fact that that applied to the dollar value more than anything else.

Representative MILLS. I have just one further thing. This is not a question prompted by me but prompted by two conflicting statements that I have read by reporters skilled in interpretation of language. It had to do with one sentence of that paragraph which I read to you earlier on page 44.

In the face of a continuous upward pressure on costs and prices, moderate restraints would not be sufficient; yet stronger restraints would bear with undue severity on sectors of the economy having little if any responsibility for the movement toward a higher cost-price level and would court the risk of being excessively restrictive for the economy generally.

One writer said that the President here is telling the Federal Reserve System to lay off and not impose any greater monetary restrictions. Another writer is saying just the contrary. Which of the two have properly interpreted what is meant by this language?

Is this an instruction by the President to the Federal Reserve not to impose greater restraint in monetary policy?

Dr. SAULNIER. I think both reporters were wrong.

Representative MILLS. They are going to be disappointed.

Dr. SAULNIER. The President in this section of the Economic Report is not speaking directly to the Federal Reserve and not giving instructions to the Federal Reserve.

This section of the Economic Report is making an important observation on some of the implications of monetary policy and monetary restraints. I think these are observations on the implications of money policy with which most students of our financial markets would agree.

It is not necessary to tell the Federal Reserve System that they should avoid monetary restraints that are so severe as to produce a contraction or recession in the United States. I think they understand what they are doing well enough, and they have a keen enough appreciation of their public duties, to avoid such policies.

Representative MILLS. I do not mean to say this about the present members, but long ago they did not always act in such a way as to leave me certain that they were justified with that degree of confidence.

I am not criticizing anything that they are doing now and I know they are very sincere in what they do. What you are saying, I assume, would apply to the present members and not to all the members that have ever been on there.

Dr. SAULNIER. I am talking about the present Federal Reserve Board and present policy, altogether without prejudice to history. I have my own views about history.

Representative MILLS. I felt that these two writers were wrong myself. I had a different impression from what you stated though. It was my thought here that the President was making an observation that in order to completely control this inflationary spiral it is necessary to have more restraints than we have today. But, because greater restraints than we have today would bring about severity of treatment in certain sectors, we probably would not be justified in imposing those greater restraints and, therefore, we are going to countenance continuation of just a wee bit of inflation in the months ahead.

That was my reaction to it.

Dr. SAULNIER. I would not read it that way.

Representative MILLS. I hope your conclusions are correct.

Representative CURTIS. I hate to prolong this, but there was a basic question that I have been meaning to ask. It is a general impression that I have received over what is called the tight-money picture. It seems to me that in the situation there, tight consumer credit made sense, but it seemed that the tightness on the money was actually in investment money rather than in consumer money.

Now, that seemed to me to be the reverse process. If we have a situation that is inflationary, it is certainly to our advantage to increase production. Production is increased through additional investment expenditures.

Representative MILLS. Through savings.

Representative CURTIS. Yes, through savings, but also if you have a small business, for example, that is legitimately expanding its production because the market is there and it finds that it cannot expand because it cannot get the normal, or what was normal before, bank loans that it was getting for that very operation, or they are required to use money that they had used for operating expenses investmentwise for capital outlay, they then cannot meet the increased demands of the consumer.

Dr. SAULNIER. That is true. On the other hand, we must recognize that in the last 2 years, notably in the last 2 years, credit demands have risen to a very large degree from expansions of plant and equipment, which will enable consumer goods to be increased in the future.

Representative CURTIS. Take the cement industry. Everyone knows the demand for cement due to the home-building program, even though there has been some cutback, and the St. Lawrence seaway project and the big highway program. We are going to have to have increased production of cement.

That is the kind of business that lends itself to smaller businesses rather than large operations because there is an advantage economically to being well located due to freight cost. That is the type area where they are feeling this shortage of investment capital and bank borrowings.

It is hampering their ability to expand in order to meet the known demand for cement. That is bound to increase the cost of cement, I would think.

Dr. SAULNIER. That is right. It does contribute to price increases.

Representative CURTIS. In that instance, it would seem that a little laxity, or perhaps not laxity but liberalization on investment credit where it is known to be going into productivity on the part of the banks, would be beneficial.

Yet, it almost seems that it is the other way around. It has not been consumer credit that we are receiving complaints on, but it is in this area of investment dollars.

Dr. SAULNIER. There has been little complaint in 1956 over the use of credit in the consumer area. Credit use there has been only a fraction of what it was in 1955. Whether 1957 will see an increase in demand in that area or not is another matter although there are some indications now that increased demands will come from the consumer area. Let me say, Mr. Chairman, that one of the tasks to which the Council has to turn at once, and must give close attention, is the study of the very large investigation which has been completed for us at our request by the Federal Reserve Board on consumer credit.

As soon as we can, we must reach a conclusion on whether the Congress should be asked to grant the President standby authority to control consumer credit.

That is something which I anticipate will occupy us fully for some weeks.

Representative MILLS. There are some factors to consider in connection with a study of that kind.

Permit me to thank each of you for being with us this morning, and contributing to our understanding of the message of the President, known as the Economic Report.

We thank you very much.

Dr. SAULNIER. Thank you very much. Let me say, Mr. Chairman, that at this late moment I have deep feelings of regret that throughout this period of questioning I have not called on my two colleagues to share my task. I should have done so.

There are many points on which they are far better qualified than I am to answer your questions and I hope you, and they, will forgive me.

Representative MILLS. If they feel any degree of mistreatment by the Committee, we will grant them the right to extend their remarks in the record.

Without objection the Committee will adjourn until 10 o'clock in the morning.

(The correspondence referred to on p. 7 follows:)

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
December 11, 1956.

Dr. RAYMOND J. SAULNIER,
*Chairman, Council of Economic Advisers,
Executive Office of the President, Washington, D. C.*

DEAR DR. SAULNIER: We are pleased to learn of your appointment to the chairmanship of the Council of Economic Advisers. I congratulate you on this appointment and look forward to close working relationships between the Council and this committee.

Grover Ensley has reported to me your feelings with respect to meeting with the joint committee in late January at hearings reviewing the President's Economic Report. As you know from previous discussions and correspondence, this has been a matter which has resulted in confusion and strong feelings over the years.

In the past, 1 of 2 procedures has been followed :

1. An executive session with no transcript made. This was the procedure followed last year except that stenographic notes were taken but not typed. I gather from Grover that this is the arrangement you would prefer in the future, in that you believe it would give you greater freedom to talk frankly and in detail with respect to the assumptions and background underlying the President's Economic Report with those members of the committee who are able to attend the meeting.

2. An executive session with a transcript made which, after editing, is printed as part of the committee hearings. This was the procedure, for example, in January 1955. From the standpoint of the committee, I think it is correct to say that this is the most useful procedure in that it makes the record available to those members of the committee who of necessity are absent from the executive session. It also helps document the committee's own report to the Congress, and thus tends to be of maximum benefit to the President's legislative program in the Congress.

The question now becomes one of reconciling two logical and understandable positions in the interest of carrying out the objectives of the Employment Act by assisting the Congress in its consideration of the recommendations of the President, and at the same time preserve the unique position, objectivity, and frankness of the Council of Economic Advisers. Would you consider the following compromise procedure which I would hope might satisfy both of these objectives :

An executive session at which a transcript would be taken of those parts of the meeting which the Council felt would not jeopardize its position of anonymity. At any point in the hearing when the Council felt it was getting into an area where it wished to "roll up its sleeves" it would be given permission to go off the record—with no stenographic notes made. Upon completion of this delicate point the discussion could go back on the record. The part of the hearing that was transcribed could then be typed, and the Council could edit it to provide additional elaborations or to delete portions that on further consideration were felt to jeopardize its position. This could then be made a part of the printed hearings for the benefit of the members, the Congress, and the general public.

As I have indicated above, this proposed procedure would mean that absent members would not have the benefit of parts of the discussion. They, nevertheless, would have benefit of that part of the testimony which was more or less routine. At the same time it would protect the Council against stenographic notes and a record being made of any portion of the testimony which might jeopardize the Council's position.

I have just looked over the public record of the Council before the House Appropriations Committee on February 16, 1956, and this suggested compromise procedure, as I understand it, follows the practice which has been prevailing between the House Appropriations Committee and the Council.

I am writing you at this time in order to do all we can to avoid the confusion and misunderstanding that developed last year. At the committee's organization meeting next month, when there will undoubtedly be a discussion of plans for the hearings on the President's report, the committee will want to decide whether or not it wishes to invite the Council to testify and on what basis. This decision of the committee on whether or not the Council should be invited will, of course, depend upon the conditions under which the Council is willing to testify. While I am not sure that all members will be entirely happy with the compromise I have proposed I will do my best to have it accepted by the committee if it meets with your approval, recognizing that in your case, as in ours, it is a second choice—a compromise.

I know this is getting into your busy time but I would like to have some indication from you on this matter before our committee meets in early January. I am sure that you will find that this committee will be more than cooperative with you in seeking to protect the proper position of the Council.

Sincerely yours,

WRIGHT PATMAN, *Vice Chairman.*

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS,
Washington, December 19, 1956.

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

DEAR MR. PATMAN: Thank you very much for your December 11 letter on the subject of procedural arrangements for testimony before the Joint Economic Committee by the Chairman of the Council of Economic Advisers.

Although I would prefer to testify before the committee in executive session with no transcript, I appreciate your need for a record and I think your suggestion for obtaining it is a fair and workable one. My understanding of your proposal is that stenographic notes would be taken except where the testimony is given "off the record," and that a transcript would be prepared from these notes and printed in the proceedings of the committee after editing by the Chairman of the Council, such editing to permit the deletion or revision of substantive matter as well as purely literary changes. Unless some change is made in the proposed arrangement in the interim, and I see no need for any change, I will assume that my testimony before the Joint Economic Committee will be given on this basis.

It was good of you to write me as fully as you did, and I am pleased to have had this opportunity to reach a mutually agreeable arrangement well in advance of the committee's hearings. I look forward with pleasure to the opportunity which these hearings will provide to discuss the President's Economic Report with the committee.

Cordially,

RAYMOND J. SAULNIER.

(Whereupon at 1:10 p. m., the hearing in the above-entitled matter was recessed to reconvene at 10 a. m., Tuesday, January 29, 1957.)

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, JANUARY 29, 1957

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

The committee met at 10 a. m., pursuant to adjournment, in room P-63 of the Capitol, Hon. Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman (presiding), Mills, Talle, Curtis, and Kilburn; and Senators O'Mahoney, Flanders, and Watkins.

Present also: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Chairman PATMAN. The committee will please come to order.

The hearings on the President's Economic Report started yesterday when the committee held an executive session with members of the Council of Economic Advisers.

I might say to the public that a transcript was taken of yesterday's testimony which will be edited and released to the public as soon as possible. We are happy that this year we will be able to publish the testimony received from the Council members.

Today our hearing centers on the Federal budget. The President transmitted to the Congress on January 16 a Federal Budget totaling \$71.8 billion, an increase of \$3 billion from the current year and over \$5 billion from fiscal year 1956.

These increases in estimated budget expenditures must be viewed in the setting of a high-employment economic situation, in which prices are rising and the value of the dollar is decreasing. An important question of Government economic policy under the Employment Act is the influence of the budget on problems of economic stabilization and growth.

It is logical, therefore, to have as our witness today the Director of the Bureau of the Budget. As we all know, the Bureau of the Budget is located in the Office of the President of the United States. The Budget Director is the chief administrative arm of the President. He prepares the budget for the President. The Director of the Bureau of the Budget is Percival F. Brundage.

Mr. Brundage, we are glad to have you and your associates with us today and invite you to make any opening remarks that you may care to before we go into the question period.

STATEMENT OF PERCIVAL F. BRUNDAGE, DIRECTOR OF THE BUREAU OF THE BUDGET (ACCOMPANIED BY ROBERT E. MERRIAM, ASSISTANT DIRECTOR; RAYMOND T. BOWMAN, ASSISTANT DIRECTOR FOR STATISTICAL STANDARDS; WILLIAM F. McCANDLESS, ASSISTANT DIRECTOR FOR BUDGET REVIEW, AND SAMUEL M. COHN, CHIEF OF FISCAL ANALYSIS OF THE OFFICE OF BUDGET REVIEW)

Mr. BRUNDAGE. Mr. Chairman and members of the committee, it is a pleasure to have the opportunity to discuss the budget with you today. I have a summary statement and a few charts on the budget for the fiscal year 1958, which begins July 1 next, and then I shall be glad to answer your questions.

BUDGET POLICIES

There seems to be broad general agreement on the budget policy which should be followed at a time like the present when the economy is operating at a very high rate and is subject to inflationary pressures. Government should seek to alleviate rather than aggravate those pressures.

Of course, there is never general agreement on whether the size and contents of a recommended budget are proper. I do not suppose that any budget has ever been submitted which was not criticized by some for being too large and by others for being too small. Usually, the budget is criticized both for being too large in total and at the same time for excluding or allowing too little for each person's pet project or activity. This year has been no exception.

The task of formulating a budget is never an easy one, particularly for a period so far in advance. It is an exercise which tries to bring into reasonable balance demands and objectives which may be conflicting. On the one hand, it would certainly be desirable to reduce total Government spending so that a larger portion of national production could be used in accordance with individual, private decisions and so that inflationary pressures would be minimized. But on the other hand, it may be desirable to increase spending to secure still stronger defenses and to meet such urgent needs as more schools and better highways. Looking at the budget from the revenue side, it would be desirable to reduce taxes so as to remove present restraints on incentives, to simplify collections, to lessen temptation for avoidance or evasion, and to make more money available for long-run economic growth through private investment. However, it is essential that we help preserve financial stability by keeping taxes high enough to produce some budget surplus for reduction of the public debt and the lessening of inflationary pressures.

Last fall the outbreaks of fighting in Hungary and the Middle East illustrated the tensions and uncertainties that abound in the world today. They emphasized the necessity for our own military strength for the defense of this Nation and the free world. This year we have reached a stage of transition where a large variety of new weapons have been developed with greatly increased effectiveness which are in part replacing the more conventional types of weapons on which we have heretofore relied. The cost of these new weapons is several times the cost of the old, but their effectiveness has increased many times. The tactics and strategies that may be employed in future wars, if they should occur, will be entirely different from the old. On the other hand, we cannot abandon the conventional type of weapons, because localized conflicts are still breaking out for which we must maintain a readiness in all branches of the service.

The assumptions with respect to economic conditions which underlie this budget are that the Nation will continue to have a high rate of business activity with increasing national income and with prices relatively stable at about current levels. Secretary Humphrey has already transmitted to the committee the assumptions as to personal incomes and corporate profits which were used in making the revenue estimates. It is assumed that personal income will rise from \$325 billion in the calendar year 1956 to \$340 billion in the calendar year 1957—that is a little less than 5 percent—and that corporate profits before taxes will rise from 43 to 44 billion dollars for the same periods. I am sure that Secretary Humphrey will be glad to discuss these assumptions further when he appears before you. The expenditure estimates in the 1958 budget are consistent with the economic assumptions used with respect to the revenue estimates.

BUDGET SURPLUS

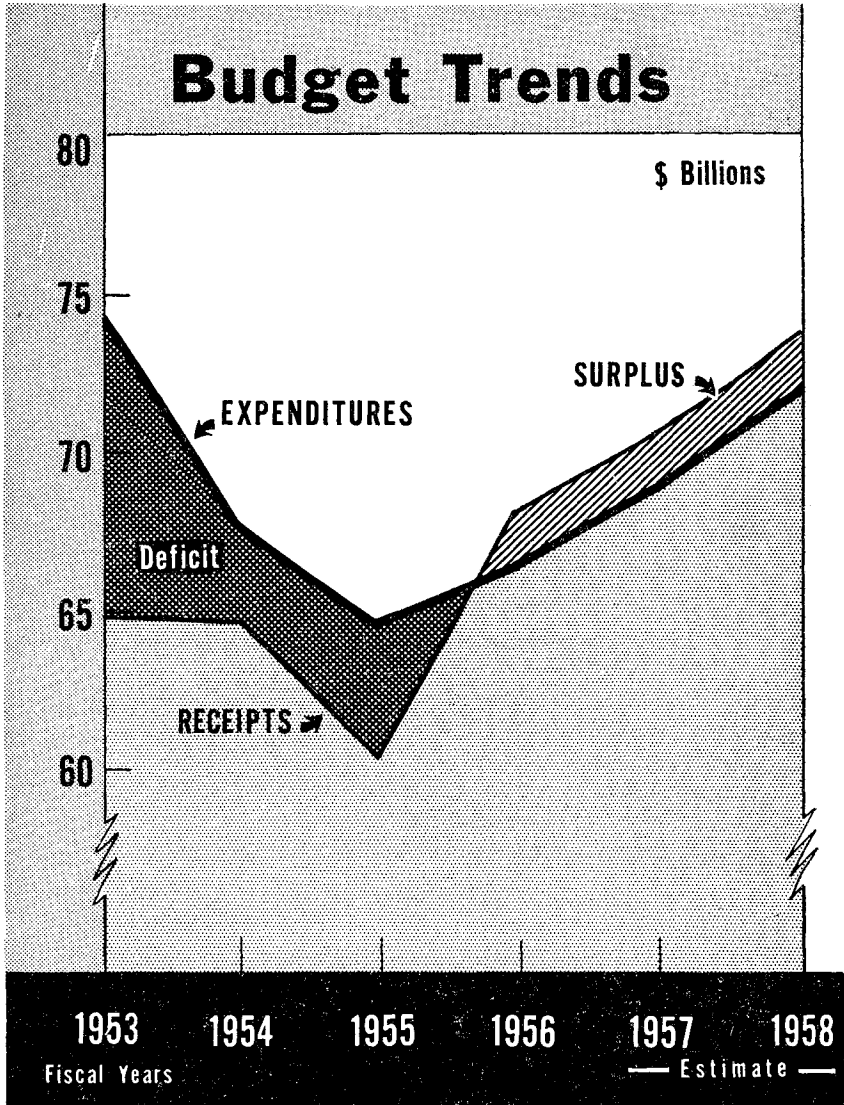
The recommended budget for 1958 is balanced. This will be the third successive budget with a surplus. The actual surplus for the fiscal year 1956, which ended June 30, was \$1.6 billion. The current estimate for the fiscal year 1957, which is now at its midpoint, is that the surplus will be slightly higher, \$1.7 billion. The estimates for 1958 show a surplus of \$1.8 billion, based on the continuation of current tax rates.

Thus the Federal budget will continue to contribute to the Nation's financial stability and to the preservation of the purchasing power of the dollar. The prospective budget surplus in the fiscal year 1958 will reinforce the restraints on inflation of present credit and monetary policies. But, as the President pointed out in his messages on the state of the Union, the budget, and the economic report, business and labor leadership must earnestly cooperate with the Government if inflation is to be prevented.

BUDGET RECEIPTS

If we turn now to chart I, we can see the comparison of the budget totals for 6 years.

CHART I



Executive Office of The President • Bureau of The Budget

The budget estimates show rising receipts since 1955, which was the low point, to \$68.1 billion in the fiscal year 1956, \$70.6 billion in 1957, and \$73.6 billion in 1958. In addition to an increasing national income, these estimates assume that the existing tax rates on corporation incomes and on excises will be extended for another year beyond

April 1. The extension of these rates will provide \$2.3 billion of the total revenues estimated for 1958—without which there would be a budget deficit. Since Secretary Humphrey is scheduled to appear before you, I will not go into any detail about revenues, but will move on to expenditures.

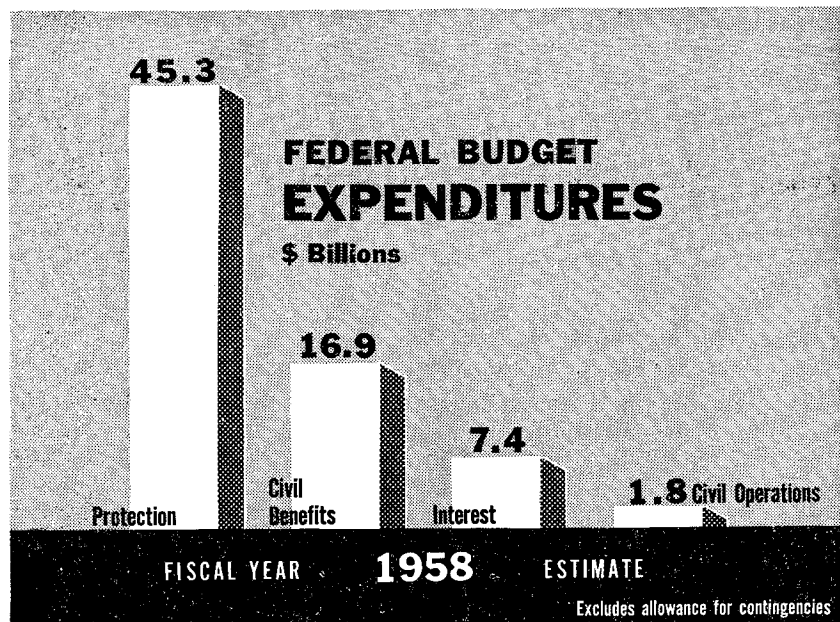
BUDGET EXPENDITURES

Referring again to chart I, you can see that expenditures are also estimated to rise. They were \$66.5 billion for the fiscal year 1956, which ended last June 30. For the current year, they are now estimated to be \$68.9 billion. In the coming fiscal year, 1958, total expenditures are estimated at \$71.8 billion.

I should point out that the estimates of budget receipts and expenditures for the years 1957 and 1958 are not entirely comparable to the actual figures for previous years. Under the provisions of legislation enacted last year, the financial transactions of the extended Federal-aid highway program are included in a self-liquidating trust fund and are not in the budget totals. If the highway transactions and the budget transactions were combined, the total receipts in 1958 would be larger, \$75.8 billion, and the total expenditures would be \$73.6 billion, yielding an estimated surplus of \$2.2 billion, instead of \$1.8 billion. The excess of receipts over expenditures of the highway fund in 1958 of \$400 million is not available for general purposes but is reserved for future highway expenditures. This is why we have not combined it with the regular budget figures, but have carried it as a separate trust fund.

The broad purposes for which Federal expenditures will be made in the fiscal year 1958 are summarized in chart II.

CHART II



Executive Office of The President • Bureau of The Budget

Protection accounts for 63 percent of the total. This is \$45.3 billion. This category includes the military functions of the Department of Defense, the military and economic parts of the mutual security program, the Atomic Energy Commission, stockpiling and defense production expansion, the United States Information Agency, and civil defense.

Budget expenditures in 1958 for civil benefits, which include most of the domestic programs except central administrative and maintenance activities, are estimated to be \$16.9 billion, which is 24 percent of the total. Interest is 10 percent of the total. Civil operations and administration, which might be called the real cost of carrying on our Government, will require a little over 2 percent, or \$1.8 billion.

In addition to the 4 broad purposes shown on this chart, the budget total includes an allowance for contingencies amounting to \$400 million. An estimate for contingencies is included in the budget totals each year as a matter of sound budgeting, to make allowance for probable future requests which may arise—including some relatively small amounts for present legislative proposals for which the timing of expenditures is uncertain. The Congress is not being asked to appropriate this item, but as needs arise, specific requests for funds will be made.

I have a table here, chart III, which shows at a glance how the expenditures for protection, interest, and all other purposes in the fiscal year 1958 will compare with those for the current year.

CHART III

*Budget comparison, 1957-58*¹

[Fiscal years; in billions of dollars]

	New obligational authority		Expenditures	
	1957	1958	1957	1958
Protection:				
Department of Defense:				
Military.....	\$36.4	\$38.5	\$36.0	\$38.0
Mutual security:				
Military.....	2.0	2.4	2.6	2.6
Economic.....	1.8	2.0	1.5	1.8
Atomic Energy Commission.....	2.0	2.5	1.9	2.3
Other.....	.2	.4	.6	.6
Total protection.....	42.4	45.8	42.7	45.3
Interest.....	7.3	7.4	7.3	7.4
All other.....	20.6	19.6	18.3	18.7
Contingency.....	.2	.5	.2	.4
Total.....	70.5	73.3	68.9	71.8

¹ Estimate.

NOTE.—Detail for 1957 expenditures does not add to total because of rounding.

The two columns on the right are for expenditures. The two on the left are for new obligational authority. You will see that the increase from 1957 to 1958 is concentrated in the programs for protection, most of it in the Department of Defense military functions. There are, of course, substantial increases in some civil activities and decreases in others.

The rise of \$2 billion for the Department of Defense results from several factors. One I have already mentioned—that we are in a transition stage where guided missiles and other new weapons are beginning to come into production but we must at the same time maintain our current readiness with more conventional weapons. Expenditures for missiles are estimated to be \$533 million higher while the total of all other expenditures for major procurement is the same. Another reason for the increase is that costs of maintenance and operation increase as our weapons systems become more complex. The newer planes take a lot more fuel and they are more costly to operate. Similarly, these more modern weapons require additional construction: for example, new launching sites, improved and dispersed airfields, warning networks for the continental defense system, and facilities in support of antisubmarine warfare and large aircraft carriers. Increases in expenditures from 1957 to 1958 are also estimated for military personnel and for reserve forces, reflecting the growing number of trained specialists rather than an increase in total numbers of personnel.

The "All other" item shown on the table includes both civil benefits and civil operations. The decrease estimated between 1957 and 1958 reflects the recommendation for adjustment of postal rates. We are actually recommending an adjustment of something over \$600 million. An adjustment in rates was approved by the House of Representatives just before adjournment last summer, and I certainly hope that one will be approved by both Houses of Congress this session.

An important new program of civil benefits which is recommended in the 1958 budget is the proposal for general assistance in school construction over a 4-year period. The budget includes recommended appropriations of \$451 million and estimated expenditures of \$185 million for this purpose in the fiscal year 1958. This was covered by the special message yesterday.

Another new program which the President recommended again is the proposal to assist communities with persistent unemployment to expand economic opportunities. This involves appropriations of \$53 million and expenditures of \$10 million in 1958.

The President has made several other legislative recommendations which are of interest to this committee. Many of these recommendations, such as improvements in antitrust and merger legislation, improvements in labor standards legislation, and broadening of unemployment compensation coverage, either will not require additional budget expenditures or will require relatively small amounts which the allowance for contingencies should be more than adequate to cover. Thus, all the legislative proposals of the President which were made in the state of the Union message, the budget message, or the Economic Report are covered in the budget, either by specific amounts or by the general allowance for contingencies. Where we had a pretty detailed or a large program, it is included under the particular department headings. The general contingency allowance includes smaller proposals which had not been definitely defined.

The budget also provided for a number of significant changes in existing programs. For example, there is an estimated increase of \$108 million in the expenditures of the Civil Aeronautics Administration, primarily for establishment and operation of improved air

traffic control facilities. That is looking toward the future greater use of jets, and the congestion in the air. Expenditures for public assistance grants are estimated to rise \$100 million as a result of the amendments to the social-security legislation enacted last year. Re-adjustment benefits for veterans are estimated to decrease \$44 million, while compensation and pensions increase \$107 million under existing legislation. The budget provides \$100 million to cover the 1958 cost of possible proposals which the President may make in a special message dealing with our system of veterans benefits. While increasing immediate costs, these improvements should, I hope, lead to long-run savings.

Largely because of commitments previously made, expenditures for loans for college housing, for rural electrification and telephones, and for farm operation and ownership will rise.

Carrying out previous commitments will also lead to an increase in expenditures by the Corps of Engineers and the Bureau of Reclamation. Together, their expenditures are estimated to be \$91 million more than in 1957, of which \$10 million is for the 1958 outlays on new projects to be started.

The National Park Service, which started its 10-year program of improvements this year, is budgeted to maintain the same rate of expenditures next year.

Payments under the various conservation programs of the Department of Agriculture are estimated to be \$56 million more than in 1957. Most of the rise is for the soil bank and the Great Plains program.

Grants for construction of waste treatment works under legislation enacted last year will grow from 7 to 62 million dollars. Other expenditures for the Public Health Service are estimated to increase \$47 million, primarily for research.

Another change in expenditures which should be mentioned in this quick review of the budget is that for interest. These expenditures are estimated to be \$100 million more in 1958 than in 1957, reaching a total of \$7.4 billion. This estimate does not reflect any further tightening of money, but simply the refinancing of maturing securities at present rates.

RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

When I reviewed the budget totals earlier in this statement, I mentioned the highway trust fund. As this committee is aware, the flow of cash between the public and the Government is obtained by a consolidation of the transactions of the budget, the trust funds, and certain Government-sponsored (mixed-ownership) enterprises. This consolidation eliminates interfund transactions and such noncash transactions as accrued interest expenditures. Because of the interest of economists in the consolidated cash statement, I thought it might be helpful to summarize for you the major differences between the estimated budget surplus and the excess of cash receipts from the public for each of the fiscal years 1957 and 1958.

In the fiscal year 1957, the budget surplus is estimated to be \$1.7 billion and the trust fund accumulations are estimated at \$2.4 billion. These two together amount to \$4.1 billion, but the excess of cash receipts from the public over cash payments will be \$3.5 billion. This

difference is due almost entirely to two factors. First, the anticipated payment in cash of \$1 billion of Treasury notes held by the International Monetary Fund and second, the partly offsetting difference between accrued interest and interest payments largely on series E bonds of \$340 million.

In the fiscal year 1958, the estimated budget surplus, \$1.8 billion, is somewhat larger than for 1957 but the trust fund accumulations are estimated to be considerably smaller than in 1957—\$1.5 billion. This is primarily due to the liberalization of social security enacted last year resulting in higher benefit payments without completely offsetting increases in receipts. The total of the budget surplus and the trust fund accumulations is again expected to be reduced by the net effects of accrued interest between the beginning and end of the year and of another payment on notes to the International Monetary Fund. In the fiscal year 1958, this redemption is estimated at \$500 million.

The United States subscription to the International Monetary Fund was made in the fiscal year 1947. Part of the subscription came from the exchange stabilization fund and part of it was a general fund expenditure which was then included in the budget. A large part of the subscription was in the form of non-interest-bearing notes, and did not involve substantial cash payments in the years up to 1956. The large estimated redemptions (and resulting cash payments) of \$1 billion in 1957 and \$500 million in 1958 are mainly because of the recent loan and cash advances which the fund made to the United Kingdom. It may be, of course, that the actual amount of loans will be less than these estimates. In such a case the excess of cash receipts from the public will be that much greater than estimated in the budget.

I am sure that this committee is also interested in the expression of the 1958 budget figures in terms of the national income and product accounts. While the budget was being prepared and printed, the Bureau of the Budget made the various proofs available to national income experts in the Office of Business Economics of the Department of Commerce. It is my understanding that with this early start, the Department of Commerce was able to give this committee a translation of the budget figures into the Government sector of the national income and product accounts.

PROSPECTS FOR THE FUTURE

It is difficult to describe in a few words the many ways in which the specific recommendations in the budget may affect the economy in the budget year and the years ahead. However, I believe the budget as a whole will continue to be an influence for economic growth and reasonable price stability. Economic growth will be fostered through the recommended investments in transportation, conservation, health, and education and through the provision of credit for housing, agriculture, small business, and foreign trade. Price stability will be helped through the recommended continuation of a budget surplus. The budget will also foster economic stability through the recommendations for safeguarding our citizens against economic and physical hazards.

The committee has asked me to discuss the commitments extending beyond the fiscal year 1958 which are contemplated in the 1958 budget.

The gravest commitment for the future is the reasonable protection of this country against attack. Expenditures for protection must continue to be large, very large, until an agreement has been reached for reduction and regulation of armaments under safeguarded inspection guaranties. When that occurs, it should be possible to change the entire budget picture.

In addition, there is some commitment, not necessarily binding, to complete various unfinished projects we have started. For example, we have started a 10-year program for the improvement of roads and facilities in our national parks and a 4-year program is proposed in this budget for assisting school construction. Other commitments are involved in natural resource projects which are already under way and in the limited number of projects for which starts are proposed in 1958. On the other hand, 38 natural-resource projects will be completed in 1958 and others, such as the St. Lawrence seaway, will be nearing completion.

All of these commitments are not subject at this time to financial measurement. Perhaps, therefore, the best way to summarize our commitments for the future is to refer only to budgetary commitments actually made, that is, to the balances of budget authorizations which will be available for expenditure after the fiscal year 1958. The total amount of authorizations carried forward at the end of the fiscal year 1956 was \$72.9 billion. This included available balances of unexpended appropriations, of authorizations to expend from public debt receipts, of contract authorizations, and of revolving and management funds.

It is estimated in the 1958 budget that by the end of 1957 the total available balances will have been reduced to \$70 billion and that by the end of the fiscal year 1958 they will be \$70.5 billion. In other words, the 1958 budget contemplates that the financial authorizations for future spending which will be available at the end of the fiscal year 1958 will be within \$0.5 billion of those available at the end of the fiscal year 1957, and about \$2 billion less than the amount available at the end of the fiscal year completed last June 30. The reduction since the end of the fiscal year 1953 will be \$32.2 billion. This differs from the figures in the résumé statement on page M4 of the budget as to the unexpected balances of appropriations carried forward, because it includes as well the unexpended balances of these other items of contract authorizations, and authorizations to expend from debt receipts, and revolving and management funds.

FEDERAL STATISTICAL PROGRAMS

One further point which the committee asked me to discuss concerned the provisions in the budget for improving the Federal statistical programs during the year.

I am pleased to note the continuing interest of the committee in the adequacy of the Government's statistical programs for the important purposes they serve. Recommendations for these programs are again set forth in a separate analysis in the 1958 budget—special analysis J. As shown in this analysis, the budget includes estimates of \$35.2 million for principal current statistical programs in 1958, providing increases totaling about \$3.4 million for specific programs.

Among the recommended increases of particular interest to the Joint Economic Committee are provisions for improved monthly data

on manufacturers' sales and inventories and for extension of the financial reports program to include trade and mining corporations, as recommended by the committee and its Subcommittee on Economic Statistics. Funds are also recommended to enable the Internal Revenue Service to prepare preliminary tabulations of key financial items in the income tax returns, so that these important business indicators may be available a year earlier than at present to give a firmer current basis to the national accounts. Other recommended programs of direct interest to the Joint Economic Committee are improvement of the work on price indexes and foreign-trade statistics, expansion of the production economics program of the Department of Agriculture to provide economic data needed for the development and appraisal of farm programs, a study of the effects of tariff changes on employment, and publication of a new edition of the National Income Supplement.

There are, however, a number of major steps yet to be taken to reach the goal of a better integrated Federal statistical system. In its work on programing the Government's statistical activities, the Bureau's Office of Statistical Standards, of which Ray Bowman is the head, is at present working on development of the most efficient programs possible to meet recognized needs for better statistics in several different areas. For example, a comprehensive review is being given to construction statistics, directed toward reformulating a program to meet the needs for more accurate and more detailed data on this important segment of the economy. This is something that the Council of Economic Advisers was particularly interested in our doing, also. Similarly, the Bureau of the Budget has contracted with the National Bureau of Economic Research for an independent appraisal of the national income and product accounts, directed primarily (1) at determining specific needs for improvement in the underlying statistical series, and (2) at means of bringing about future integration of these accounts with other comprehensive national accounting systems, such as the Federal Reserve work on the flow of funds. Study is also being made of the requirements for improved measures of labor productivity, and of means of meeting these requirements. Although projects like these are not reflected in the 1958 budget, they may be of interest to this committee as evidence of our work toward an improved statistical system.

Mr. MILLS. Does that complete your statement, Mr. Brundage?

Mr. BRUNDAGE. Yes; it does.

Mr. MILLS. Mr. Curtis of Missouri will inquire.

Mr. CURTIS. I would like to first find out what figures you have on our carryover of unexpended funds as well as unobligated funds. I notice from your chart on page 4 you show us the new obligational authority and the expenditures, but what about carryover of unspent funds as well as unspent and unobligated funds?

Mr. BRUNDAGE. Well, the appropriations carried forward are included in the résumé of the budget. I do not know whether I brought that chart along. If you have the budget document there, it is contained in that report.

Mr. CURTIS. I have it here; yes.

Mr. BRUNDAGE. That will give you the whole story. I might say roughly that the amount of unspent and unobligated appropriations of the Department of Defense is slightly over \$10 billion. That is the biggest item.

Mr. CURTIS. That is \$10 billion?

Mr. BRUNDAGE. It is a little more. It is estimated to be 10.6 billion at the start of the fiscal year 1958.

Mr. CURTIS. Now let me ask you this: As I recall, and I am going by memory, the unspent funds—and you mean by that, the unobligated?

Mr. BRUNDAGE. The unspent and unobligated funds. The total estimated unspent balances of appropriations of the Department are about \$38 billion at the start of 1958.

Mr. CURTIS. The total funds that would be possibly obligated, but unspent?

Mr. BRUNDAGE. Yes; they could obligate another \$10 billion. The difference between that and the \$38 billion is obligated but unspent.

Mr. CURTIS. As I recall, that figure of unspent but possibly obligated funds for the entire Government was over \$90 billion in 1953. Do you recall what that carryover is? I am interested in seeing how we have been doing as far as knocking down on these charge accounts that we have.

Mr. BRUNDAGE. The full detail is shown on table 7, on page A12. That only goes back to 1956, but I think that you are right. The total obligational authority carried over was over \$100 billion at the end of fiscal 1953. It was \$94 billion at the end of the fiscal year 1954 and is estimated to be down to \$70 billion in 1958. I can submit details for the record.

(The material referred to follows:)

Balances carried forward, by type of authority, at end of year, fiscal years 1954 through 1958

In millions]

	Appropriations	Authorizations to expend from debt receipts	Contract authorizations	Revolving and management funds	Total
Fiscal year 1954 (actual):					
Obligated.....	\$42,808	\$6,275	\$1,064	\$1,209	\$48,938
Unobligated.....	24,943	14,842	1,413	4,107	45,305
Total.....	67,751	21,117	2,477	2,898	94,243
Fiscal year 1955 (actual):					
Obligated.....	31,773	4,798	1,175	77	37,823
Unobligated.....	20,322	14,765	1,412	5,316	41,815
Total.....	52,095	19,563	2,587	5,393	79,638
Fiscal year 1956 (actual):					
Obligated.....	31,318	4,359	1,321	404	37,402
Unobligated.....	14,650	13,893	2,720	4,234	35,497
Total.....	45,968	18,252	4,041	4,638	72,899
Fiscal year 1957 (estimate):					
Obligated.....	* 34,374	5,122	295	459	40,250
Unobligated.....	11,971	13,428	750	3,562	29,711
Total.....	46,345	18,550	1,045	4,021	69,961
Fiscal year 1958 (estimate):					
Obligated.....	* 38,110	5,683	658	632	45,083
Unobligated.....	9,178	12,060	659	3,543	25,440
Total.....	47,288	17,743	1,317	4,175	70,523

* Deduct, excess of receivables over obligations.

* Includes all advances for contingencies: 1957, \$50 million; 1958, \$150 million.

Jan. 25, 1957.

Mr. CURTIS. Then looking at the budget, we have to look at the carryover of previous obligations, plus the new obligational authority in order to get a picture, plus our anticipated expenditures, in order to get a real picture of what the Congress might be doing in the way of additional appropriations. Do you understand what I mean?

Mr. BRUNDAGE. Yes.

Mr. CURTIS. That is whether the appropriation is a new one, or whether it is simply a carried over appropriation, it still remains as a possible expenditure of this administration.

Mr. BRUNDAGE. That is right.

Mr. CURTIS. So what are our expenditures based upon then? Your proposed expenditures in 1957 and 1958? Even if you have as much as \$36 billion carryover, and another \$70 billion additional obligational authority, making a total of \$106 billion, and your estimated expenditures are \$68.9 billion.

Mr. BRUNDAGE. The other page I gave you, A6, gives the total of budget authorizations available as \$143 billion.

Mr. CURTIS. Now, I—

Mr. BRUNDAGE. I might say that a good deal of the current operations, expenditures and payrolls, comes out of current authorizations. It is more the deliveries of procurement and construction items and so on that are made out of prior authorizations and obligational authority.

Mr. CURTIS. Do you have any figures to show any expired obligations? That is, expired without expenditure and about what rate are they going?

Mr. BRUNDAGE. On page A6, that was fairly substantial in the current year, in 1957, because of the transfer of the Federal aid highway authorizations to the trust fund. But the total was a little over \$5 billion. Of that, \$3.1 billion was the highway fund. In 1958 we are only assuming a termination of a little less than \$1 billion, or \$973 million.

Mr. CURTIS. How has that been running over the past few years, say the past 4 years? That is the unexpired without being utilized obligations.

Mr. BRUNDAGE. \$3.6 billion in 1956.

Mr. CURTIS. I have that figure for 1956, but I was wondering about the other years. You said that was a little unusual.

Mr. BRUNDAGE. It was 1957 that was unusual.

Mr. CURTIS. I am thinking of going back to 1953, 1954, and 1955 to get a picture of what happens to these obligated funds that never actually get spent.

Mr. BRUNDAGE. There is quite a little variation between years. I do not have the figures back of 1956. I will be glad to supply those for the record.

Mr. CURTIS. I would like to get that.
(The material referred to follows:)

Budget authorizations ceasing to be available

Fiscal years:	<i>Amount (in millions)</i>
1953-----	\$2, 523
1954-----	6, 648
1955-----	4, 279
1956-----	3, 656

Mr. CURTIS. Now, do you have any figures showing the deobligated funds which get reobligated without coming back to Congress? There is such a process, I know. It is deobligated for a particular thing. Let me illustrate:

As I believe your budgetary procedures recognize, there can be a letter of intent to obligate, and that is considered an obligation. Now, a letter of intent is certainly not a firm contract, and after the magic date of June 30 passes these letters of intent get rewritten, or there is a contract that sometimes has little relation to the letter of intent that obligated the funds. That process has been called a deobligation and then a reobligation. I was wondering whether your department followed that.

Mr. BRUNDAGE. I don't think that we distinguish that.

Mr. CURTIS. Would you know how much deobligating goes on, and then reobligating afterward, instead of allowing the authorization to expire or the appropriation to expire?

Mr. BRUNDAGE. I don't know. Mr. McCandless may be able to answer that. I don't think that we distinguish that.

Mr. McCANDLESS. We do follow that during the course of the year. Where it is significant, I think we have it identified back in the budget and that would be in the detailed part of the budget. It is largely in the Department of Defense where those things occur.

Mr. CURTIS. That is where most of this occurs.

Mr. McCANDLESS. We do try to keep up with it.

Mr. CURTIS. Could you supply for this committee an annual figure going back 4 or 5 years as to the total amount of deobligation and reobligation?

Mr. McCANDLESS. I am not sure that we could because we have only been identifying it, as I recall, in the last 2 or 3 years, and then only where it is a significant amount of money. We could pick out or put together for you what we have, of what we can identify, but the accounting system has only started picking that up in the last couple of years.

Mr. CURTIS. I suggest if you went into it a little more thoroughly, you might find some real areas where considerable sums of money might be relooked at an area which the Congress really has never looked at, and I doubt if the Bureau of the Budget has ever really looked at it. There is a question of a deobligation, and then a reobligation.

That always involves the point of whether the new program is really sufficiently similar to the original obligation to justify the new obligation.

Mr. BRUNDAGE. We look at all new requests for obligational authority pretty carefully, whether it is a reobligation or a brand new one.

Mr. CURTIS. Do you?

Mr. BRUNDAGE. Yes, sir; those that come to us.

Mr. CURTIS. I would think then you would be able to get those figures and show what the total size is. We could confine it to the Defense Department, because that is what I am particularly interested in.

(The material referred to follows:)

"Deobligation" and "reobligation" of funds are shown in the 1958 budget to the extent that (1) they have a material effect on the program, and (2) the accounting and reporting systems have thus far made such figures available. They are shown in the detailed schedules of part II (for budget funds) and part III (for trust funds) of the budget document under the heading "Recovery of Prior Year Obligations." A detailed listing of these items is given below.

Since the accounting and reporting system of the Department of Defense does not provide most of the amounts in question, figures are shown for only five accounts in the Department. If further information is desired, a special effort on the part of the Department of Defense would have to be made to develop estimates for other accounts. There is no question, however, but that the amounts involved are much larger than the amounts shown in the following table:

Items listed in budget schedules under the heading "Recovery of prior year obligations" in 1958 budget

	1956	1957	1958
BUDGET FUNDS			
Legislative branch:			
Library of Congress:			
General increase of the Library of Congress.....	\$179		
Increase of the law library, Library of Congress.....	55		
Funds appropriated to the President:			
Mutual security:			
Military assistance, Executive.....	57,942,592		
Other programs.....	182,712,817	\$125,000,000	
Foreign currency.....	2,670,605		
President's special international program.....	135,586	76,298	
Expansion of defense production, investment in.....	12,490,216	110,322,297	\$67,822,000
Independent offices:			
Atomic Energy Commission: Plant acquisition and construction.....	154,449,000	15,201,000	
Commission on Organization of the Executive Branch of the Government: Salaries and expenses.....	11,408		
U. S. Information Agency: Salaries and expenses.....	106,896		
Export-Import Bank of Washington fund.....	269,781,394	53,992,744	56,240,895
Farm Credit Administration.....	5,687		
Federal Farm Mortgage Corporation, investment in.....	38,000	30,000	30,000
Federal intermediate credit banks.....	300,000	2,700,000	
Revolving funds.....	2,240,000		
Small Business Administration, revolving fund.....	12,256,636	10,135,000	
General Services Administration:			
Repair and improvement of federally owned buildings.....	22,424		
U. S. courthouse and post office, Nome, Alaska.....	185,225		
Strategic and critical materials.....	856,696	11,360,000	6,500,000
Housing and Home Finance Agency:			
Office of the Administrator:			
Investment in college housing loans.....	7,841,223	755,000	650,000
Investment in public facility loans.....	104,610	1,160,600	1,546,550
Investment in urban renewal.....	20,729,023	58,846,000	80,334,100
Capital grants for slum clearance.....	13,142	250,000	400,000
Federal National Mortgage Association:			
Special assistance functions fund.....	118,860	580,000	25,464,000
Management and liquidating functions fund.....	17,274,569	944,507	
Department of Agriculture:			
Research facilities, ARS.....	113,900		
Miscellaneous accounts, Forest Service.....	25		
Food prevention, Soil Conservation Service.....	3,131		
Agricultural Conservation program.....	23,095		
Loans: REA.....	4,442,455	2,000,000	2,000,000
Farmers' Home Administration: Disaster loans, etc., revolving fund.....	1,705,384		
Removal of surplus agricultural commodities.....	1,359,758		
Commodity Credit Corporation.....	3,177,209	5,000,000	5,000,000
Advances and reimbursements, Commodity Stabilization Service.....	1,047		
Department of Commerce:			
Grants-in-aid for airports, CAA.....	1,289		
Miscellaneous accounts, CAA.....	47,550		
Payments to air carriers, CAB.....	5,212,795	9,596,224	
Ship construction (liquidation of contract authorization), Maritime activities.....	623,965		
Inland Waterways Corporation fund.....	96,240	100,000	100,000

Items listed in budget schedules under the heading "Recovery of prior year obligations" in 1958 budget—Continued

	1956	1957	1958
BUDGET funds—continued			
Department of Defense—Military functions:			
Shipbuilding and conversion, Navy.....	\$9,593,208	\$7,440,000	
Construction of ships, Navy.....	629,993		
Ordinance for new construction (liquidation of contract authorization), Navy.....	365,774		
Navy management fund.....	139,602		
Advances and reimbursements, Army.....	46,375		
Department of Defense—Civil functions:			
Construction, general, Corps of Engineers.....	5,201	5,233,606	
U. S. Soldiers' Home.....	7,443		
Capital outlay, Canal Zone Government.....	681,132		
Department of Health, Education, and Welfare:			
Assistance for school construction, Office of Education.....	200,231		
Advances and reimbursements, Office of the Secretary.....	76		
Department of the Interior:			
Miscellaneous accounts, Bureau of Indian Affairs.....	1,936		
Construction and rehabilitation, Bureau of Reclamation.....	253,003	41,000	
Department of Labor:			
Advances and reimbursements: Bureau of Labor Statistics.....	680		
Department of State:			
International commissions: Restoration of Salmon Runs, Fraser River system, International Salmon Fisheries Commission.....		73,470	
Educational exchange: Educational aid for China and Korea.....	22,314		
Treasury Department:			
Bureau of Accounts: Claims, judgments, and private relief acts.....	9,341	27,105	
Office of the Secretary: Miscellaneous permanents.....	2,057		
TRUST FUNDS			
Gift and trust fund income accounts, Library of Congress.....	5,342		
Foreign currency, funds appropriated to the President.....	373,764		
War claims, Foreign Claims Settlement Commission.....	2,494		
Railroad retirement account.....	151,271		
Railroad unemployment insurance administration fund, RRB.....	14,385		
American National Red Cross, District of Columbia chapter building, public buildings, GSA.....	126		
Advances for supplies and expenses, United Nations Korean Reconstruction Agency, GSA.....	95,748		
Other trust funds, GSA.....	3,989		
Defense—Civil: Trust funds, rivers and harbors and flood control.....	22,022		
Interior: Reclamation trust funds.....	20		
Labor: Special statistical work.....	70		
State: Trust funds, Educational exchange.....	1,530		
District of Columbia: Grants by Public Health Service.....	171		

Mr. CURTIS. Now there is one other item, and I wanted to find out whether the Bureau of the Budget goes into this:

Have you been following the amount of surplus property that the Military Establishment generates each year?

Mr. BRUNDAGE. We surely have.

Mr. CURTIS. I have received some hurried figures from some people who know about this and the indication is that it runs as much as 3 or 4 billion dollars a year in surplus properties generated by the Military Establishment. I think that we are averaging about 8 cents on the dollar in the sale of these surpluses. Would you know whether that estimate is within reason?

Mr. BRUNDAGE. That is both in supplies, materials, and equipment, and in buildings and in lands. It is handled separately, but the surplus covers all of those areas. We have a special unit in the Bureau of the Budget that is following that. That amount is a little high. It is a very substantial figure, however.

Mr. CURTIS. I am giving it as an annual figure, and apparently a recurring one. I have gone through some of the details in the lists

of surplus goods that are made available, and a great deal of it is what we call common-use items—paper, paint, pencils, typewriters, flashlight batteries, and so on. It would immediately suggest to me, of course, if these amounts are that vast, that there might be something wrong in the procurement practices in the beginning that would create such an unused surplus.

Mr. BRUNDAGE. Both procurement practices and inventory controls, and we have been working on that very assiduously. I think it is being improved all the time. Much of the surplus now being declared reflects the efforts to clear out obsolete equipment and to dispose of stocks carried over from the past.

Mr. CURTIS. I would like to get, if you can give it to me, what figures you do have on the amount of surpluses that are being generated, with particular emphasis on the common-use item field. I would also be interested in the general figure.

Mr. BRUNDAGE. We will get you those figures. The surplus items are made available, of course, to the schools and to the States and to various purposes. Some of them have very little net return.

Mr. CURTIS. I would be interested in checking the figure that I estimated, about 8 cents to the dollar is what we get on this.

(The material referred to follow :)

Available reports do not give data on common-use items separately. General Services Administration reports on surplus disposal show the following:

Analysis of surplus personal property disposal other than scrap, Department of Defense

[Fiscal years; in millions of dollars]

	1954	1955	1956
Total acquisition cost of surplus property disposals, other than scrap ¹	\$1,273	\$1,578	\$1,497
Method of disposition:			
Abandoned or destroyed.....	25	53	55
Donated.....	64	118	159
Sales other than scrap.....	1,184	1,407	1,283
Proceeds from sales other than scrap.....	67	103	96
Percent proceeds to acquisition cost of property sold.....	5.7	7.0	7.5

¹ In addition to the amounts shown, acquisition costs of excess property transferred to other Federal agencies was \$53 million in 1954, \$109 million in 1955, and \$70 million in 1956. Receipts from sale of scrap were \$17 million in 1954, \$40 million in 1955, and \$57 million in 1956. Acquisition cost of items scrapped is not reported.

Mr. CURTIS. I am curious to know if the Bureau of the Budget has at all followed the progress in the Military Establishment on their unification of some of their services in the field of what might be termed common-use items. To illustrate, the unification of medical supply of procurement and distribution. Have you followed that at all?

Mr. BRUNDAGE. Yes. It is going a lot slower than we would like to see it. However, I think it is making some progress.

Mr. CURTIS. Sometimes it is difficult to see the progress.

Mr. BRUNDAGE. Yes.

Mr. CURTIS. Do you know whether the Military Establishment has carried over the example in medical supplies to other areas where

there could be the same formula of unification in procurement and distribution? Has the Bureau taken any interest in that?

Mr. BRUNDAGE. Unification has not been carried nearly far enough. I would like to see it go further.

Mr. CURTIS. The Congress very specifically wrote laws, the O'Mahoney amendment in particular, requiring that to be done. There are some of us, and I might say I am among them, who feel that the Military Establishment has not been complying with that law. There are various areas of savings where we could actually get better defense as a result if they would go through these processes.

To illustrate, I do not believe anything has been done in the Chaplains Corps in the way of procurement and supply. It is a little thing, but it is an example.

The main questions which I am directing to you is whether the Bureau of the Budget in reviewing these requests of the Military Establishment for additional appropriations has asked them these questions and gone into the matter to see what progress they are making.

Mr. BRUNDAGE. Yes, we have. It is under study, but it is awfully hard to get it out of the study stage into the action stage.

Mr. CURTIS. I agree with you on that.

I have a general question prepared that I would like an answer to.

There is a widespread concern about the size of the Federal budget for fiscal year 1958, particularly with respect to its implications for: (1) the extent of the Government's participation in total economic activity; and (2) the possible inflationary consequences of expending budget expenditures; and (3) the prospects for tax reduction.

One or more of these aspects has been referred to in the statements made by the President, Secretary Humphrey, and by you, since the presentation of the budget. The Congress has been invited by all three of you to reduce proposed expenditures. At the same time, the Congress must assume that the executive branch has done the best job it could in keeping proposed budget expenditures to a minimum.

In view of that assumption, what specific, as well as general, standards would you recommend the Congress use in acting upon the budget expenditure recommendations, and in what respect do these standards differ from those employed by the executive branch in preparing the budget?

Mr. BRUNDAGE. That is quite a big question.

I will say that the Secretary and I have been pursuing this problem of economy very aggressively and persistently, not only this last year, but ever since we have been down here. The problems which have met us are the demands of the people and the Congress for a number of good programs. There is no question about the programs. We all recognize the needs of defense.

As you see here, the big increase this year is in the protection category. We are expanding our defense partly because of world conditions and partly because of the cost of replacing the older weapons, and while the newer weapons are so much more effective they are so much more expensive. The B-29 bombers, for instance, cost on the average of a little over \$600,000 and the B-36 cost an average of \$4 million, and the B-52, \$8 million. That is just an example.

There is a tremendous amount of research and development. We are spending over \$5 billion in the military in the whole area of re-

search and development, including procurement of weapons that are used for experimental purposes besides those added to stock, and for all personnel in development and testing.

Then, atomic energy, as you see, is going up from \$1.9 billion to \$2.3 billion in expenditures and from \$2 billion to \$2.5 billion in new obligational authority—that is practically all either research and development, or in the general defensive area.

We have a program, as you know, for peacetime uses of atomic energy. There is a lot of research and development going into reactors, but the actual amount of fissionable material which is being handed out is still pretty small.

Mr. CURTIS. Could I say this in the light of your answer to my previous questions regarding some of these problems on military procurement and supply:

When you said you were still conducting studies in that area to see what could be done, would I be right in saying that in these areas where you still are studying but have not reached conclusions, that might be the areas that the Congress could possibly pick up and carry the studies further to try to reach some conclusions?

Mr. BRUNDAGE. Well, I will welcome any cuts that you can make without sacrificing our protection or the needed services.

You may remember in our budget message that we called attention to the fact that we had these terrific competitions and pressures and inflationary pressures, and we were asking all of the departments and agencies to limit their construction expenditures particularly, and also their personnel increases, even though they are provided for in the budget. This budget does not start to be spent for another 6 months, and then it will not be finished for 18 months, and we firmly believe that reductions and savings can be made.

Mr. CURTIS. Mr. Brundage, the question I would like to ask that refers to this basic point I am presenting is this:

Do you believe that the Government participation in our total economic activity for the size of \$68.9 billion in 1957, and 1958 is \$71.8 billion—Do you believe that that participation is going to create such inflationary forces that probably we will not be able to control them?

While that is my tentative conviction now, I would like to have you comment on a positive statement. If we spend \$68.9 billion in our present economic development, it seems to me whether the budget is balanced or not we are going to create such inflationary forces that we will be hard put to controlling it.

Mr. BRUNDAGE. I think any increase in spending is an added inflationary force. You cannot deny that. However, as long as you have a budget surplus, and some retirement of debt, it seems to me that it is not too serious.

After all, if we had a tax reduction, which was all used by the individuals to increase their consumption of consumer goods, and increase their purchases of consumer goods, you would have just as much of an inflationary aspect, only in a different area.

Mr. CURTIS. I agree with you, but suppose the tax reduction were in such a way that the money, instead of going into consumer credit, went into investment. You would have the opposite, would you not?

Mr. BRUNDAGE. That would be savings; yes.

Mr. CURTIS. Actually, is not that where the pinch seems to be, in the investments dollar right now, rather than in the consumer dollar?

Mr. BRUNDAGE. Well, there is a tremendous shortage of investment funds, there is no question about that.

Mr. CURTIS. Which usually means that there is more consumer demand than there is ability to produce to satisfy it. That means usually that there is not enough investment in plant and facilities to produce to meet the consumer demand.

Mr. BRUNDAGE. We are helping that by our retirement of public debt this year, of \$2.2 billion. That will go to retire debt and make that much more available for other investments.

Mr. CURTIS. Thank you, Mr. Chairman.

Mr. MILLS. Senator O'Mahoney will inquire.

Senator O'MAHONEY. I was involved with another matter and so I have been delayed in getting here, and I am sorry I did not have an opportunity to listen to your opening statement, Mr. Brundage.

I have hastily glanced over it and it immediately suggests some, I think, important questions.

I would like to call your attention to page 5 of your statement. There in the second paragraph from the end, the second sentence says:

Many of these recommendations, such as improvements in antitrust and merger legislation, improvements in labor standards legislation, and broadening of unemployment compensation coverage—

That aroused my completely sympathetic interest. I know the antitrust and merger legislation which has been pending before the Judiciary Committee, of which I am a member, and of which last year I was the acting chairman of the Subcommittee on Antitrust and Monopoly.

The Department is in full agreement with the enactment of legislation, and I am happy to have the President endorse this. But I know that the Department of Justice does not begin to have the money that will enable them to carry out the President's program when and if we pass this law. As a matter of fact, they do not have money enough now to review the cases which are presented. All you have to do is look at the business section of the newspapers for the past year to read about merger after merger which are concentrating our national economic system and making it impossible for people in the States, and businessmen in the States and in the local communities to carry on as they should. That is one of the reasons the President wants the antimerger bill passed. It is a prenotification bill, to call upon corporations which are planning to merge, to notify the Federal Trade Commission and the Department of Justice in advance so that those two Commissions could determine whether or not the mergers were in violation of law, and in the public interest.

In the conversation I had with the Department last year, I learned they wanted and needed at least 100 more lawyers to do the research. I can cite to you the research which your Bureau requires as an illustration of the necessity for supplying the Department of Justice with sufficient staff to look into these most complex matters.

Your budget does grant an increase to the Federal Trade Commission, but you ask less for the Antitrust Division this year than you gave them last year. That is less than Congress gave them last year. This I suggest is not in harmony with the President's message.

Mr. BRUNDAGE. We gave them all they asked for, Senator O'Mahoney.

Senator O'MAHONEY. Would you look into that again, please?

Mr. BRUNDAGE. There is a new man, and they had been preparing some further estimates which I believe they would like to have submitted as a supplemental.

Senator O'MAHONEY. Let me say a word in support of the supplemental estimates because I think it is in the public interest.

Mr. BRUNDAGE. The appropriations of Antitrust Division, according to the table on page 806 of the budget, went up from \$3,464,000 in 1956, to \$3,569,000 in 1957, and \$3,785,000 in 1958, and I think that they have some further requests under consideration.

Senator O'MAHONEY. I do not know from what you are reading, but I read the release that you gave out. I do not have it with me at this time. When the budget was coming up, and the appropriation for the Antitrust Division was mentioned, the request was less for 1958 than the appropriation was for 1957.

Mr. BRUNDAGE. That is not correct.

Senator O'MAHONEY. If I am mistaken in that, I will check it up and see that the record is corrected.

Mr. BRUNDAGE. The figure is on page 806 of the budget document for 1957. The new authorization for 1956 was \$3,464,000, and for 1957 it was \$3,569,000. For 1958 it is \$3,785,000, and the expenditure for 1956 was \$3,545,000, and for 1957, \$3,625,000, and for 1958, \$3,774,000.

As I say, I think that they have some further requests to make.

Senator O'MAHONEY. They have supplemental requests?

Mr. BRUNDAGE. Yes; that is right.

Senator O'MAHONEY. Of course, we all know that Congress itself is struggling with the problem of the increased payment for retirement. We have to pay 6½ percent now for the staffs of the various committees, whereas it was much less than that a year ago. I suspect that some of the increase of which you speak there has to do not with the number of persons on the staff but with the increased costs of administration.

Mr. BRUNDAGE. That has been distributed among all of the branches and agencies of the departments.

Senator O'MAHONEY. Would you be good enough to check up on that personnel item?

Mr. BRUNDAGE. I will be glad to.

Senator O'MAHONEY. And particularly with respect to increasing the supplemental.

Mr. BRUNDAGE. We did not cut their request, however, Senator.

Senator O'MAHONEY. I am glad to have you make that a part of the record and I will accept that statement as coming from an authoritative source. But I want to point out this further fact, that the Antitrust Division in the past when diligently and effectively administered has been a source of revenue to the Government.

The Antitrust Division under Thurman Arnold, and I mention him because he comes from my State, earned for the Government in fines and costs from violators of the antitrust law more than the appropriation for the Division usually amounted to. That is right if my recollection is correct.

All of these questions that I am asking now arise from my knowledge that some expenditures are productive of revenue. Some expenditures are completely lost. The money that is spent on shooting instru-

ments produce no revenue at all. They win victories and eventually the peace, we hope.

For years we have had a very uncertain peace, but in the domestic field we have many projects which would produce revenue for the Government and for the people and improve their living standards.

Some of these are included in the discussion on page 6 of your statement. That is:

Carrying out previous commitments will also lead to an increase in expenditures by the Corps of Engineers and the Bureau of Reclamation. Together, their expenditures are estimated to be \$91 million more than in 1957, of which \$10 million is for the 1958 outlays on new projects to be started.

The President has just completed an airplane tour over the drought-stricken States so that he and all the country knows the great damage that was done by the drought and is being done. It is cutting off revenue and the earnings of the people in those areas.

For many years we have struggled, we who live in the upper Colorado River Basin, to secure the authorization of improvements in that system and in the construction of dams to store the water and to prevent floods.

Finally, last year, Congress passed the bill which the President signed, authorizing the improvement of this upper Colorado River Basin at an estimated cost of about \$753 million. The President opened that project by pushing a button sometime last October. He was sitting in Washington and a blast was set off in Utah, I believe.

It was very helpful and it gave notice that the project was going to begin. But the appropriation which you allowed is so small that it will take 32 years to complete that project. In the meantime, the water which rises in the upper basin States will be flowing past the doors of the people up there and down into the lower basin and ultimately into the sea.

I wrote a letter to the Secretary of the Interior at the time of this opening and urged the Secretary of the Interior to see if it would not be possible to have a statement made at the ceremonial opening that the Bureau of the Budget would not be permitted to place a ceiling upon the development of the Colorado River Basin. The ceiling, however, is here.

I think the total appropriation is so small that in my State on several of the projects which are very essential for the people living there, the planning will not be finished until 1960 or 1962.

Mr. BRUNDAGE. For the first years expenditures, they are always small, Senator, you know because of the planning. Assistant Director Merriam here has this under his direct surveillance. Can you comment on that, Mr. Merriam?

Senator O'MAHONEY. I know that. What I am saying to you is this: The more haste you can put into this thing the sooner you will be improving the conditions of the people who live in that basin and the sooner you will be increasing their capacity to pay income taxes on which you depend for the balancing of the budget.

Mr. MERRIAM. As you know, of course, the President has from the start pushed very vigorously for this project and certainly the administration is in complete agreement with what you have said. Are you talking about the participating projects now, or the actual dams?

Senator O'MAHONEY. Some of them are participating projects.

Mr. MERRIAM. As you unquestionably know, as far as the participating projects are concerned, the President did ask the Department of Agriculture in conjunction with the Department of the Interior to take a relook at exactly how those projects were being developed.

There has been, quite correctly as you have stated, some delay in the participating projects, but not in the dams themselves which are going ahead at what we and the Department think is an economic rate. There is no ceiling. I think that ought to be clear.

Senator O'MAHONEY. I want to get your sympathy for this thing and I am not criticizing.

Mr. MERRIAM. You have it. You do not have to get it.

Senator O'MAHONEY. I am asking you to take note of the fact that you say in this paragraph that I have just read, that these expenditures for the Corps of Engineers to stop floods which clearly destroy the property and the income of the people and the Bureau of Reclamation which build new homes and new farms will be increased.

You say it is increased by \$91 million. But four paragraphs down in your statement you say, "With respect to the interest on the national debt, these expenditures are estimated to be \$100 million more in 1958 than in 1957."

In other words, your presentation to us relates the sad fact that we have to increase the amount expended for interest on the national debt by \$9 million more than you are increasing expenditures to prevent disaster here at home and to build constructive waterways for the benefit of the people of the United States.

I think you must bear in mind that statement in your further consideration of supplemental estimates.

Mr. BRUNDAGE. I would like to say that we are spending something over \$1 billion on these projects altogether including flood control and development.

Senator O'MAHONEY. Let us see where you show them on the charts. Here is chart No. 2, "Protection"—that is a good name to give that column—is \$45.3 billion. "Civil benefits" is \$16.9 billion. Interest, and that is interest on the national debt, is \$7.4 billion. "Civil operations" is \$1.8 billion.

Now, I seriously believe that if the Bureau of the Budget will give some attention to increasing expenditures on civil operations whereby we will develop our natural resources more rapidly than they are being developed and increase the capacity of the people to produce, you will be doing more toward balancing the budget than by following the policy which pays more for interest on the national debt and more for foreign aid.

There is now \$200 million that is now proposed to be expended without a single standard in the Middle East. You can produce a good deal more in the United States. You can produce oil in the United States.

Mr. BRUNDAGE. The civil operations to which you refer is confined to administrative and maintenance operations of the Government. Many of the expenditures for conservation projects are included with the civil benefit programs. "Special analysis (L)" on pages 1149 and 1150 shows that the programs for conservation and development of land and water resources will be \$1,070 million, in 1958, as against \$940 million in 1957 and \$803 million in 1956.

Senator O'MAHONEY. Where is this?

Mr. BRUNDAGE. This is on page 1150 in the back of the book, the very last page. That is under "Natural resources."

Senator O'MAHONEY. I have the document before me. That is the conservation and development of land and water resources. That has been estimated for 1958 at \$1,070 million. That is what you stated?

Mr. BRUNDAGE. Yes, sir.

Senator O'MAHONEY. But that does not change at all the comparison which you made in your statement. The interest on the national debt is increasing by \$9 million more than the increase on the Corps of Engineers and the Bureau of Reclamation expenditures.

There is not any doubt about that for you wrote it.

Mr. BRUNDAGE. That is not taking all of it.

Senator O'MAHONEY. Do you wish to correct the statement?

Mr. BRUNDAGE. No; there are other programs besides the Corps of Engineers and the Bureau of Reclamation.

Senator O'MAHONEY. Of course, that is true. But can you give me the total for those? Where are they broken down in your statement?

Mr. BRUNDAGE. They are all shown in the budget. I will be glad to give you a table on it.

Senator O'MAHONEY. Would you please put it in the record here at this point?

Mr. BRUNDAGE. I will be glad to.

(The information is as follows:)

Expenditures for land and water resources included in natural resources function of the budget

[Fiscal years; in millions of dollars]

Agency	1956 actual	1957 estimate	1958 estimate
Corps of Engineers, civil functions.....	\$534	\$800	\$660
Department of the Interior:			
Bureau of Reclamation.....	161	174	204
Bonneville Power Administration.....	35	32	35
Southeastern Power Administration.....	1	2	2
Southwestern Power Administration.....	7	8	7
Bureau of Indian Affairs.....	40	45	49
Bureau of Land Management.....	19	25	28
Office of Saline Water.....	1	1	1
St. Lawrence Seaway Development Cooperation.....	9	39	46
Tennessee Valley Authority.....	-10	3	27
Department of State (international boundary commissions)....	3	7	5
Federal Power Commission.....	5	5	6
Total.....	803	940	1,070

NOTE.—Detail may not add precisely to totals because of rounding.

Senator O'MAHONEY. You show a surplus on chart No. 1. That is, a surplus for 1956, 1957, and 1958. You discuss this on page 2 of your statement.

The recommended budget for 1958 is balanced. This will be the third successive budget with a surplus. The actual surplus for the fiscal year 1956, which ended last June 30, was \$1.6 billion. The current estimate for the fiscal year 1957, which is now at its midpoint, is that the surplus will be slightly higher, \$1.7 billion. The estimates for 1958 show a surplus of \$1.8 billion, based on the continuation of current tax rates.

Is it not a fact that during this period the debt has been increasing?

Mr. BRUNDAGE. No.

Senator O'MAHONEY. What is the national debt now?

Mr. BRUNDAGE. It is down. The details are shown in the budget. That is on page M-10, right in the beginning. The public debt at the start of the year 1956 was \$274.4 billion. At the end of 1956 it was \$272.8 billion. At the end of 1957 it is estimated to be \$270.6 billion. At the end of 1958 it is estimated to be \$269.2 billion.

Senator O'MAHONEY. I have in my hands the Economic Indicators for January of 1957. It was prepared for this committee by the Council of Economic Advisers.

Mr. BRUNDAGE. I have it here.

Senator O'MAHONEY. On page 31 on the last column you will find the heading "Public Debt, End of Period."

Mr. BRUNDAGE. That is the end of the first 5 months.

Senator O'MAHONEY. I beg your pardon. We begin at the top, under "Public Debt, End of Period." That is fiscal year 1944, it was \$202.6 billion. In 1947, \$258.4 billion. Fiscal 1948, \$252.4 billion, a reduction. In 1949 it was 252.8. In 1950, 257.4. 1951, 255.3. In 1952, 259.2. In 1953, 266.1. 1954, 271.3. In 1955, 274.4.

During this period, which includes, I think, part of the period for which you are claiming a surplus, the debt was increasing. In 1956 it went down to 271.5. In October of 1955 it was estimated to have risen to 279.9. Now, this was about the time that Congress began to pass resolutions allowing special increases in the hope that the collections might be sufficient to increase the receipts and thereby balance the budget.

Mr. BRUNDAGE. That is right.

Senator O'MAHONEY. Now it appears that the fiscal condition of the Government is such that we are constantly increasing the rate of interest upon the debt. That is right, is it not?

Mr. BRUNDAGE. The interest has been going up because money rates have been going up.

Senator O'MAHONEY. The New York Times for yesterday morning in its business section published, as it always does on Monday, the total of Treasury securities which must be met within the ensuing calendar year.

This morning, as I recall the figures, it was about \$77.6 billion and that was greater than it was a year ago and greater than it was a week ago. On these securities which are being brought out, we are paying constantly higher rates of interest.

The Federal Reserve Board, testifying from exactly the position in which you are sitting before this committee, in December acknowledged that foreign countries are buying the securities of the United States, even the short-term securities on which we are paying these rates of interest.

These are the very foreign countries to whom we are granting more and more aid out of our deficits who are buying these bonds.

Mr. BRUNDAGE. I doubt if it is the same foreign countries. They are probably other foreign countries.

Senator O'MAHONEY. Now, that is an expression of doubt on your part. I suggest that you look up the facts.

Mr. BRUNDAGE. Most of our economic aid is not going to countries which have any substantial foreign balances.

Senator O'MAHONEY. Would you be kind enough to look it up and put it in the record, please.

Mr. BRUNDAGE. I will be glad to do that; yes.
(The material referred to follows:)

As shown in the table below, the countries which have increased their holdings of United States Government bonds and notes in the year from September 1955 to September 1956 are Belgium, Germany, Norway, and Switzerland, none of whom receive economic assistance.

Estimated holdings of U. S. Government bonds and notes by foreign countries

[Position at end of period in millions of dollars]

Area and country	September 1955	September 1956 (preliminary)
Continental Western Europe:		
Belgium-Luxembourg (and Belgian Congo).....	10	12
Federal Republic of Germany.....	5	13
France (and dependencies).....	161	7
Netherlands (and Netherlands West Indies and Surinam).....	41	23
Norway.....	53	83
Switzerland.....	44	126
Other countries (including Bank for International Settlements).....	31	40
Total.....	345	304
Sterling area:		
United Kingdom.....	286	265
Other countries.....	16	12
Total.....	302	277
Canada.....	397	357
Latin America:		
Cuba.....	169	167
Other countries.....	25	24
Total.....	194	191
Other areas:		
Indonesia.....	15	(¹)
Other countries.....	21	25
Total.....	36	25
Total foreign countries.....	1,274	1,154

¹ Less than one-half million dollars.

Source: P. 63 of Treasury Bulletin, December 1956.

Senator O'MAHONEY. I am pointing out to you, sir, the reasons which compel me to think that the objective of the Bureau of the Budget should be to increase expenditures here at home where we can increase the revenue of the people who pay the taxes to meet the rising interest on the rising national debt.

Representative MILLS. I have a very few questions, Mr. Brundage. You said in your statement on page 2 in the second full paragraph:

The assumptions with respect to economic conditions which underlie this budget are that the Nation will continue to have a high rate of business activity with increasing national income and with prices relatively stable at about current levels.

Secretary Humphrey in a letter to the committee dated January 16, which was included in the record of yesterday, made the statement that—

We do not assume any change in prices for the present with respect to the estimates.

Now, does that denote a difference in the thinking between the Department of the Treasury and the Bureau of the Budget with respect to those estimates of revenue?

Mr. BRUNDAGE. No, indeed.

Representative MILLS. You mean the same thing?

Mr. BRUNDAGE. It is on the same basis; yes.

Representative MILLS. Now, if prices are to remain at present levels, I take it to mean that there is relative stability in the price picture.

Mr. BRUNDAGE. Well, some are estimated to increase a bit on the basis of information we have at this time. For example, I believe in the Defense Department they are estimating a few price increases in procurement of special lines, particularly electronics, but it is relatively stable. That is what we mean.

Representative MILLS. The point that both you and the Secretary of the Treasury were endeavoring to make with respect to the budget and the estimates of revenue in connection with the budget is that you do not predicate additional revenues in the fiscal year 1958 as a result of further inflationary trends and conditions.

Mr. BRUNDAGE. That is correct. The big increases in our revenue during the past 3 years have occurred during a period of relatively stable prices.

Representative MILLS. You referred to the estimate of personal income rising to \$340 billion in calendar year 1957 compared to \$325.5 billion in calendar year 1956.

Mr. BRUNDAGE. That was 1957 and 1958, I think.

Representative MILLS. It has to do with the calendar year rather than the fiscal year?

Mr. BRUNDAGE. Yes; that is right.

Representative MILLS. That represents an increase, you say, of approximately 5 percent in personal income.

Mr. BRUNDAGE. Yes.

Representative MILLS. That then, is a reflection of an increase, an anticipated increase, in calendar year 1957 over 1956 in the gross national product; is it not?

Mr. BRUNDAGE. It is a big increase, but the big increase that we had in the national income and in our receipts came in fiscal 1956.

Representative MILLS. We were told yesterday that that increase in personal income would result from an anticipated increase of 3 or 3½ percent in gross national product in calendar year 1957 over calendar year 1956. I do not know whether you have a different figure in mind.

Mr. BRUNDAGE. One is the gross national product and the other is national income.

Representative MILLS. If you have a 5 percent increase in personal income as predicted for purposes of the budget, then you would have an increase of 3 or 3½ percent in gross national product which, I take it, is the factual situation with respect to the estimates in the budget.

Mr. BRUNDAGE. I believe so, yes. The Treasury made those estimates, but we incorporated them in our budget and in our computations.

Representative MILLS. That would mean then, that we would have to have as much or more increase in gross national product in 1957

over 1956 as we had in 1956 over 1955 in order to have a balanced budget if the Congress appropriates the funds suggested in this proposed budget, and we do not have inflation.

Mr. BRUNDAGE. Of course, the income is partly held over. We are only partly on a pay-as-you-go basis. The income of fiscal 1956 affects our budget in 1957.

Representative MILLS. The point I am getting at, Mr. Brundage, is this: In order for us to have a balanced budget and \$1.8 billion surplus in fiscal year 1958, it would be necessary for us at least for 6 months of that fiscal year, to enjoy the predicted increase in gross national product that I have referred to of 3 or 3½ percent.

If we are going to have relatively stable prices, that would be true.

Mr. BRUNDAGE. I would think so, yes.

Representative MILLS. That would mean, would it not, that our budget estimates are predicated upon as much or more growth economically in this country in calendar year 1957 over 1956 as occurred in 1956 over 1955?

Mr. BRUNDAGE. I would think approximately so, sir.

Representative MILLS. That means that the Congress has a responsibility to delve into the future with respect to a determination of economic conditions if it appropriates what is contained in this budget with reasonable expectation that those appropriations will not create deficit financing.

I am always very dubious, myself, of making concrete appropriations which necessitate increases in revenue predicated upon a growth in gross national product of that dimension in order to have a balanced budget.

I would much prefer and I feel more secure, and I am sure you would as a businessman and as a former certified public accountant, with a budget which on its face shows that it will be in balance if economic conditions are not better or not worse than those in the previous calendar year.

Mr. BRUNDAGE. I think George Humphrey and I both agree on that.

Representative MILLS. Now I wanted to talk to the Secretary of the Treasury when he came here about the point that is reflected in the Economic Indicators of January 1957 which you have before you. On page 8 there is a reflection of decreases in corporate profits for the calendar year 1956. This budget surplus is predicated, in part at least, on an increase of \$1 billion in corporate profits in 1957 over 1956.

I think that we are on somewhat precarious ground there, as well as, perhaps, with respect to the increase predicted in personal income, although I am not and I do not propose to be a prophet in the field of economic activity. I am sure that none of us would want to take on that mantle.

To go back to my point, however, I am very much concerned about the possibility of what we do to our economy, not only in the long run but in the short run, through the appropriation of this staggering amount that is involved in this budget.

There are too many "ifs" in the way for us, I think, to tell the country now that we can appropriate this much money and assure a continuation of a balanced budget at the end of the fiscal year 1958, which would be June 30, 1958.

That is looking quite a bit ahead of today and making estimates of revenue predicated upon what I would consider to be the most favor-

able economic conditions that we could expect to enjoy during that period of time.

The budget itself is predicated upon no downturn in business activity any time during the calendar year 1957. That would have to follow if we enjoyed 3 or 3½ percent increase in our gross national product.

I am much concerned as to whether or not we are safe in appropriating on the basis of those estimates of economic activity and contending as we appropriate that we will end up with a balanced budget. I think that you are eminently right. I think the President is right and I think the Secretary of the Treasury is right and I am crediting to all of you the highest degree of sincerity when you suggest to the Congress that this budget should be whittled by the Congress if it can be whittled.

I am sure that each of the three of you, however, are not suggesting that the Congress use the broad-ax approach to the reduction of this budget.

Mr. BRUNDAGE. We would like to see it selective. I would also like to say, Mr. Mills, that these assumptions are in broad harmony with views of the experts in the Council of Economic Advisors and the Treasury, as well as the Bureau of the Budget.

It is their considered judgment as to the most reasonable assumptions to use. As you say, I think that we all would like to have more of a surplus and a little more leeway.

Representative MILLS. Of course, what we are doing actually in our Government expenditures, is to increase our expenditures either for defense or nondefense, whatever it might be, at about as rapid a rate as our revenues are increasing as a result of this increased economic activity.

This is reflected in your contemplated surpluses which are, apparently, to remain relatively stable, whereas your receipts are going up much faster and your expenditures following your receipts are going up at a relatively even keel.

So we are faced, I think, with the absolute necessity of trying to bring this budget down to a more reasonable level, at least in the opinion of the people that I have talked to and heard from.

They think it has reached too high a level in peacetime. They have been sold on the idea that we are at peace and it is a little hard for them to understand a wartime budget or a budget of wartime levels in what they have been told is a peaceful era.

Of course, you and I know it is not as peaceful as we sometimes say it is in political campaigns. However, I am interested in trying to find from you, if it is possible, and even though this is not primarily the function of this committee, whether or not you feel that you are in a position to completely defend this budget on the basis of the standards which are utilized in the Bureau of the Budget for purposes, first of all, of determining whether an item will be included in a budget and then as to what the amount will be for that particular item.

Mr. BRUNDAGE. It is a compromise, Mr. Chairman, as all budgets are. The agencies almost uniformly came in with substantially higher requests. Aside from the military, the protection item, I think the cuts we made were something over \$3 billion.

Now we could have cut more, there is no question about it. But the question was, Would that prejudice some of the good programs like those to which Senator O'Mahoney referred? The conclusion we reached was that this is a compromise, but it is a fair compromise and it is a reasonable provision for the protection of this country and for the conduct of the operations which our people seem to demand.

I think that you can make more economies. But I think if you make any very substantial reduction, I think you have to cut out some of these programs.

Representative MILLS. Now you are not saying to us, Mr. Brundage, in your statement, I am sure, that the Bureau of the Budget compromised the standards which the Bureau of the Budget uses for determining whether or not an item should be included in the budget and at what level it should be included.

You did not compromise the standards which you used for determining expenditures, did you? That is not what you mean.

Mr. BRUNDAGE. That is not what I mean. It is a compromise between opinions as to how fast and how far you should go and when.

Representative MILLS. Those standards that you used for determining expenditure recommendations to the Congress are, in your opinion, the best possible standards that could be developed within the Bureau, are they not?

Mr. BRUNDAGE. I believe so.

Representative MILLS. The best you have been able to develop?

Mr. BRUNDAGE. That is right.

Representative MILLS. I am sure they are as good as any standards anybody else has developed because I have a very high regard for your ability, frankly, and the ability of those that work with you.

Now, if you have utilized the very best standards that you could conceive in determining expenditures and recommendations, does not the statement which you make and which the President makes either assume that the Congress will use a broadax approach to economy, or that the Congress can develop better standards than the administration can develop for determining expenditures for the fiscal year 1958?

Mr. BRUNDAGE. I would hope that the Congress, which has the responsibility just like we do, would reexamine as you always do the policy decisions that have been reached. We are going to try to cut expenditures within the budget, as has already been brought out, in reducing our construction and limiting our personnel increases and so on.

We have already started to work on those things. The other decisions, I think, will have to be policy decisions for which the Congress is equally responsible. A lot of these things that we are doing have been instigated, or encouraged at least, by the Congress.

You take these health programs. We estimate over \$600 million of expenditure on our health programs for this next year. Now, maybe you may decide that that is going too far too fast. That amount provides for what you legislated last year. Maybe you will decide that we do not need to go so far so fast, and that we can depend upon private charity or local and State authorities for things like hospitals and all of these other programs.

Senator O'MAHONEY. Will you yield for a moment? I noticed a rather amusing cartoon in one of the papers the other day that repre-

sented the presentation to the Congress of the budget accompanied by a pair of scissors, implying that what was being done in presenting the budget here was a presentation with the fond hope that we would take the responsibility of making the cuts.

What I am interested in finding out is whether there is any substantial agreement between the Bureau of the Budget and the Secretary of the Treasury as to where the cuts should be made. I know the chairman is interested in that subject, too.

Representative MILLS. I had in mind propounding that question and trying to obtain from you, because you are in a better position than any of us to know, just what areas exist within the budget which hold out the greatest hope, upon further consideration by the Congress, of some reduction.

Mr. BRUNDAGE. We are hoping that we will not have to send up supplementals, that there will not be increases in pay and that you will give us the increase in the postal rates that we are asking for. Those kinds of things would be particularly helpful, and then on the broad programs you know as well as I do where the money is going and I think that you have to evaluate it just as we are doing.

We have tried to study it and we have tried to balance the desires of people for projects with their real needs and with what our fiscal resources are. I think we have come up with a pretty good balance, myself, between the programs and between the different needs and desires and our fiscal resources. I would like to have you take a look at it and a careful look, and I hope that you will be able to come up with reductions.

Representative MILLS. We have talked entirely with respect to the budget for 1958. You have alluded to the future. In connection with that, you have pointed out that some of these expenditures that we now are making must, of necessity, remain high until we can reach some agreement with respect to limitations of armaments and inspection involved in that problem.

Let us assume for purposes of my question that you are correct and that these expenditures for national defense for the next few years ahead will not be reducible because of our failure to reach agreements upon which we can rely for disarmament.

Let us assume that our interest on the Federal debt does not increase beyond what it is today. Let us assume we do enact this budget and the programs which are recommended in the economic message and other messages.

Do you see any prospect in the succeeding fiscal year, under those circumstances, that our budget estimates of expenditure and actual expenditures will be less than the \$71.8 billion which is projected in this budget?

Mr. BRUNDAGE. I doubt it. I am going to try, but we are already starting on our 1959 projections and I would hope that we would be able to hold to the present levels, but I doubt if we could cut it very much.

Representative MILLS. Well, that causes us in this committee even greater concern, I think, with respect to the economic effect of what we are doing now in the expenditure of funds.

Now, as I pointed out, it has been developed that in order for us to have a balanced budget and appropriate what is contained in this request, there must occur a growth in our gross national product of

some 3 or 3½ percent. In order for us to have a balanced budget, that rate of growth will have to continue even beyond the calendar year 1957 and through the calendar year 1958 and on into 1959.

That is true or else we will be involved again in deficit financing with these amounts of expenditures. Now, you know and I know that the projection of these expenditures over that period of time on the very tenuous basis that economic growth will sustain a balanced budget is a dubious projection and a dubious position for us to be in, is it not?

Mr. BRUNDAGE. Well, I think if we are able to hold our expenditures within the \$70 million to \$72 million level, our economic growth will enable a substantial surplus and, I would hope, consideration of tax reductions in 1958, in the spring of calendar year 1958 for fiscal 1959.

Representative MILLS. If we could hold our expenditures at this level?

Mr. BRUNDAGE. That is what I say. That is what I am hoping to do in 1959.

Representative MILLS. And if we enjoy a rate of growth of 6 or 7 percent in the 2-year period, perhaps that growth would permit reductions in taxes. But I would not want to promise the American people that we could reduce taxes and have a balanced budget on that basis.

Mr. BRUNDAGE. I would not either.

Representative MILLS. I am sure you would not.

Mr. BRUNDAGE. No.

Representative MILLS. So that we are faced with a very serious problem with respect to the economic effects that we create in this action this year in the Congress. I had some further questions but I will not delay the committee.

Senator FLANDERS. Unfortunately, I have only just been able to get here. I had both the Mideastern hearing and then a problem with the Engineer Corps on a condemnation proceedings in my hometown and I could not dodge that one. I am sorry I was not here earlier.

There is one point just raised by Mr. Mills about which I wish to say a word. It is the general assumption that defense expenditures cannot be reduced. In spite of all of the turmoil and uncertainty and all of the negative results of approaches to disarmament, I do not at the present time feel that a reduction in armaments is impossible.

I am not going to make a speech. I am just going to make the suggestion. I feel it is possible to find an arrangement in the self-interest of both the Soviet Government and of the Western Powers which can result in a considerable decrease in our commitments in return for a better sense of military security and a withdrawal of Russia in return for that from some of the occupied territory. I shall bring these points out in greater detail later.

I do not wish at this time to write off as an impossibility the idea of somewhat reducing our military commitments.

Senator O'MAHONEY. Mr. Chairman, before Senator Flanders arrived this morning at this hearing, Congressman Curtis raised some questions about the consolidation of the purchasing operations of the Defense Department.

Senator FLANDERS. Those are very pertinent questions to raise.

Senator O'MAHONEY. It was in 1952 that I sponsored an amendment to the Defense Appropriations Act requiring the purchasing agencies of the Department of the Army, the Department of the Navy and the Department of the Air Force to get together as soon as they could.

Mr. Hoover, in the reorganization of the Government also recommended that consolidation. The hearings which the Appropriations Committee held over many years while I was a member of it showed there was constant duplication among the three branches.

I have no doubt that considerable gain could be made if the Department of Defense would only carry out that law. I think probably you would save more money than you expect to gain by increasing the postal rates.

Representative CURTIS. Will the gentleman yield for a further comment? This is in the area of common-use items which does not involve tanks and guided missiles and things that the military regard as sacrosanct.

Senator O'MAHONEY. It is in the area of items which are used in every war that this Nation has ever fought and has resulted in the accumulation of vast reserves of unused materials that were never of any use to anyone, except those which could be sold as surplus property.

Too much is bought consistently.

Senator FLANDERS. As a member of the Armed Services Committee, I want to give assent to that statement.

Senator O'MAHONEY. I think that you can really get somewhere if you go at it, and put as much pressure on the Department of Defense as the Secretary of the Treasury is putting upon you.

Mr. BRUNDAGE. We are working at that, I assure you, and any help you can give will be greatly appreciated. There is a terrific resistance to this, as you know.

Senator O'MAHONEY. I know what you are up against all of the time.

Mr. Chairman, may I ask Mr. Brundage a question?

Representative MILLS. Had you concluded?

Senator FLANDERS. Yes.

Representative MILLS. Senator Flanders, my assumption followed the statement which Mr. Brundage had made to us in connection with his prepared statement that expenditures for defense purposes would have to remain high until we could reach some agreement on disarmament that we could rely upon.

I was going along with an assumption predicated upon his statement rather than any thought in my own mind that there could not be some reduction.

Senator FLANDERS. May I say that in any given fiscal year, we should proceed on no other assumption.

Representative MILLS. That is right.

Mr. BRUNDAGE. I personally feel that there is some hope for the idea which Senator Flanders has announced. It seems to me that the Soviet must be having all of the troubles that we are having and a lot more.

Senator O'MAHONEY. I have just one question. May I call your attention, Mr. Brundage, to this chart No. 1 in your statement. This is the chart which shows the surplus of which you have spoken by a graph which indicates that the receipts will during 1957 and 1958 be above the expenditures. The figures upon which that chart is drawn for 1957 and 1958 are labeled "estimates."

Mr. BRUNDAGE. That is right.

Senator O'MAHONEY. Where do I find the breakdown of the expected receipts?

Mr. BRUNDAGE. It is right in the budget.

Senator O'MAHONEY. I know there was a table but it escaped my attention.

Mr. BRUNDAGE. Yes; here it is on page 1069.

Senator O'MAHONEY. I think it would be well, Mr. Chairman, to have that table inserted in the record at this point.

The CHAIRMAN. Without objection, the table requested by Senator O'Mahoney will be included in the record.

(The table referred to follows:)

Budget receipts (by source)

[In millions]

Source	1957 estimate	1958 estimate	Increase (+) or de- crease (-), 1958 over 1957
Individual income taxes.....	\$38,500	\$41,000	+\$2,500
Corporation income taxes.....	21,400	22,000	+600
Excise taxes.....	10,691	11,071	+380
Employment taxes.....	7,750	8,420	+670
Estate and gift taxes.....	1,380	1,475	+95
Taxes not otherwise classified.....	5	5	---
Customs.....	775	800	+25
Miscellaneous receipts.....	2,986	3,278	+292
Deduct—			
Transfer to Federal old-age and survivors insurance trust fund.....	6,445	6,609	+164
Transfer to Federal disability insurance trust fund.....	335	826	+491
Transfer to railroad retirement account.....	660	665	+5
Transfer to highway trust fund.....	1,539	2,173	+634
Refunds of receipts.....	3,880	4,156	+276
Net budget receipts.....	70,628	73,620	+2,992

Mr. BRUNDAGE. There is an accompanying analysis beginning on page 1068. It gives more details.

Senator O'MAHONEY. I think the reference merely to this page would be sufficient for our record. We do not need to republish it.

Representative CURTIS. I wanted to comment on an implication that I was afraid might be left from Mr. Mills' line of inquiry. I am pretty sure he did not intend the implication but I just wanted to be sure that the Congress has no source of information or wisdom apart from the Executive that it can apply to this big problem of our expenditures.

In my judgment, I feel that Congress has many techniques and sources of information which are not available to the Bureau of the Budget or the executive department. The Government Accounting Office, as many people fail to remember, is an arm of the Congress. We have a vast quantity of information that we can acquire on expenditures and what we might say were extravagances in the past.

Furthermore, we have the means of providing our citizens with a forum whereby they can give information that is within their knowledge on the expenditures of Federal funds.

I think that to imply, and I do not believe the implication was intended, that the Congress did not have a tremendous responsibility in this field would not be correct.

The Executive has commented upon that responsibility of its sister branch of the Government. There should not be such an implication. The Congress is limited to what the executive branch brings before us. I feel we have available tremendous tools and knowledge and that we can perform a real service within this area.

Mr. Brundage, as I view your approach, and that of Mr. Humphrey and the President, it is calling upon this sister branch of the Government to use its information and knowledge. Is that a fair interpretation?

Mr. BRUNDAGE. That is quite correct.

Representative CURTIS. I thank you, because I did not want to leave those overtones remaining. I, as a Congressman, feel quite jealous of the prerogatives of the Congress and of its independence of the executive department and our need to do a job in this area.

Representative MILLS. I have the same jealous regard for the Congress that my colleague from Missouri has and I did not desire to leave any implication.

I wanted to call attention to the fact that the responsibility given Congress this time to cut a budget is one that is staggering in its importance and it does imply that the Congress can utilize better standards, if it is not to use the meat-ax approach, than the Bureau of the Budget has yet been able to develop.

Perhaps, the Congress can develop those better standards.

Representative CURTIS. Evidently, there is an area of disagreement. I think the standards that the Bureau of the Budget has applied in handling this budget have been excellent. I am suggesting that the Congress, because of its different nature can apply different techniques which the Bureau of the Budget by its nature and the executive department by its nature cannot apply. It is not that our standards are better, it is the fact that we can use a different approach and do some things that they cannot do.

Now, I think if I would be critical, I would be more critical of the Congress for not having applied standards that they could have applied and in my judgment should, even to this day, apply in approaching the budgets that are presented to us.

It is our standards that in my judgment have been weak more than the executive department standards.

Senator FLANDERS. I desire to state that the Senate likewise has strongly maintained the coordinating powers of the Congress. If there is any doubt about that matter, I would like to repeat it.

Representative MILLS. There is no doubt in my mind, Senator, that we both exercise independence as evidenced by our record of generally appropriating more money than the budget has requested for the past several years.

That is regardless of who happened to be in control of the Congress. So that we are independent and we do exercise our independent judgment.

I fear that we will do it this time but in the direction opposite to what I hope will occur.

Mr. BRUNDAGE. I know your capabilities and you can join the Budget Bureau any time you want to.

Representative MILLS. I may come to you some day.

Representative CURTIS. Could I ask one specific question that was suggested by another line of questions?

I notice that the customs receipts are listed as expected to rise by about 10 percent, reflecting a higher level of business activity. That is on page 1069 of the budget. Yet the estimate of growth on corporation taxes is much smaller, about half a percent, which incidentally I believe was about the lowest in 4 years.

Now, does this mean that there will be little growth of domestic activity and a great increase of foreign activity or is this based upon different facts or predictions.

This relates to Mr. Mills' observation that this is all predicated on an increase in gross national product of about 3 to 3.5 percent. Yet, the corporate tax return is only up about half a percent, if my figures are correct.

Mr. BRUNDAGE. We expect increasing foreign trade, but somewhat narrower margins of profit. I think the total volume is expected to go up. This, as I said, is primarily a Treasury estimate but we worked it out jointly with the Counsel of Economic Advisers.

Representative CURTIS. In other words, the apparent inconsistency lies in the fact that the corporations although increasing the amount of their activity, will not be having as much profit. Then the increased income from taxes will be derived from personal income, wages, and salaries, and so on.

Mr. BRUNDAGE. That is right.

Representative CURTIS. I get the picture. Thank you.

Representative MILLS. If there are no further questions, the committee will stand adjourned until 10 o'clock in the morning and we appreciate, Mr. Brundage, your presence and the presence of the members of your staff and the information you have given.

In the morning our discussion will be directed at the economic outlook for the coming year, which is very appropriately scheduled.

(Whereupon, at 12:10 p. m., the committee was recessed, to reconvene at 10 a. m. Wednesday, January 30, 1957.)

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 30, 1957

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

The committee met at 10 a. m., pursuant to recess, in room P-36 of the Capitol, Hon. Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman (presiding), Mills, Talle, Curtis, and Kilburn.

Present also: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Chairman PATMAN. The committee will please come to order.

The President's Economic Report contains much information on economic developments of recent years and particularly of 1956. It was cautious, however, in discussing what is likely to happen during the coming year to the labor force, Government, business, and consumer demand, and agriculture.

I might say that the executive session on Monday with the Council of Economic Advisers provides considerable elaboration of the Council's views on the outlook for 1957. This testimony will be released as soon as it can be edited and printed.

Today the committee has 5 experts from Government and from research organizations to discuss in considerable detail the outlook for the next 12 months and beyond. We have asked these witnesses to present facts and survey results and to provide us their personal judgments. The policy implications derived from this discussion, and the appropriate action for the Federal Government, will be discussed at later sessions of the committee.

In order to expedite the discussion this morning, the Chair will recognize each of the 5 panel members for purposes of making an opening statement of 8 minutes, summarizing the facts and in the area to each individual witness. We will proceed without interruption through the opening statements, following which there will be a general discussion by members of the committee and the panel. I understand that this procedure is agreeable to the panel and that they have requested that the committee staff notify each when his 8 minutes has expired.

As chairman of the committee I would like to indicate at this time the plan for questioning which I propose to govern this set of hearings. Each committee member will be recognized for 10 minutes for purposes of questioning the witnesses. This will apply during first go around in order that each member of the committee may have time to participate in the questioning.

I will ask the staff to notify each member when his 10 minutes has expired.

The first topic this morning is labor force, hours, productivity, and potential output. This area will be discussed by Mr. Ewan Clague, Commissioner of Labor Statistics of the Department of Labor.

STATEMENT OF EWAN CLAGUE, COMMISSIONER OF LABOR STATISTICS, UNITED STATES DEPARTMENT OF LABOR

Mr. CLAGUE. Mr. Chairman, you have asked me to discuss recent developments in some of the fields which fall within the scope of the data-collecting responsibilities of the United States Department of Labor's Bureau of Labor Statistics, and to give you some appraisal of the significant factors which are now influencing, or are likely to influence, economic trends in 1957.

I have with me, for insertion in the record, a presentation on the subjects which you assigned to me—labor force, hours of work, productivity, wages, and prices. I might say that the statement that I present contains three segments. It contains my short statement which I am reading here today, a complete report, and lastly, a set of the charts. I hope that this more detailed material will be useful to you in your deliberations. In my brief statement here today, I shall attempt to summarize some of the more notable highlights, using some of the charts which are attached.

LABOR FORCE

Out of the many facts which we know about the labor force, the one which I find most significant at the moment is that its growth in any one year cannot be predicted with any certainty. As chart No. 1 shows, there was no year from 1950 to 1956 during which actual labor force changes were the same as the amounts that might have been expected. However, as the second chart shows, over a span of years the actual additions to the working force have in fact matched the amounts expected by the technicians. This, I believe, highlights one of the conclusions which can be drawn from the data for 1956: growth in the economy does not occur on a straight-line year-after-the-year basis.

As you will note from chart 2, we have carried forward the 1950-55 projections to 1960. We are starting this year well above the trend line, mostly because there has been a much greater than expected rise in employment of youngsters and of women 35 to 64 years of age. You will see that in chart 1. We could get another such rise this year—the reservoir of housewives and students is far from exhausted—or we could get a return toward the trend line. About the most that we can say now, in response to the request of the committee and its staff, is that if the labor force expands to the total now being projected for 1960, there would be an increase of about 800,000 in 1957. Of this, almost 700,000 would be due to the increase in the population of working age.

Another important highlight in recent employment trends is that the increases in employment have been primarily in nonmanufacturing industries, and even the gain in manufacturing has been mainly among nonproduction workers. See chart 3.

Using Bureau of Labor Statistics data seasonally adjusted, we have made a comparison of the changes in employment from the peak of mid-1953 up to the end of 1956. Total employment in the goods-producing industries—manufacturing, mining, and construction—was approximately the same at the beginning and at the end of the period. By contrast, total employment in the remainder of the nonfarm establishments (including trade, transportation, Government, and the other service industries) was over 7 percent higher at the end of 1956 than it had been at the end of the Korean hostilities.

HOURS OF WORK

Trends in the size of the workweek are much less clean-cut, even over a span of years, than are trends in the labor force and employment. We know that in agriculture and in a large number of the non-manufacturing industries there has been a long-term downward trend which is still continuing. This downtrend has been muddied to some extent by the recent sharp rise in the number of part-time workers. Nearly half of the 1956 increase in employment consisted of part-time workers.

In manufacturing, on the other hand, there does not seem to have been any clear trend in recent years. Within the past few days I have received the first tabulations of a new set of figures prepared by the Bureau; that is, seasonally adjusted hours of work. A quick glance at these summary figures—which we have plotted on chart 4—furnishes some clues which indicate that changes in the factory workweek tend to precede changes in employment. In other words, employers tend to use the workweek—overtime or short time, as the case may be—as the first method of adjusting for changes in demand.

In making future projections the continued downtrend in the workweek in nonmanufacturing industries justifies assuming some further decline in the average workweek for the economy as a whole; but, as far as manufacturing is concerned, it is better not to predict the workweek without first making some assumptions about the trend of output.

The size of the workweek is only one of the factors which determine total man-hours worked per year. Also important is the uptrend in the number of paid holidays and weeks of vacation.

PRODUCTIVITY

When we come to the subject of productivity we discover that what I said about labor force, that almost anything can happen in a single year, is even more true. It is characteristic of productivity trends that they do not move uniformly from year to year. A year of rapid expansion may be followed by one of leveling off.

As this committee knows, we have prepared estimates on productivity trends over the years through 1953. For the 3 most recent years the data are still so skimpy that it is impossible to do anything but make very preliminary estimates which have a rather low degree of reliability. As nearly as we can tell from the data which are now available, the increase in manufacturing productivity in 1954 and 1955 was substantially higher than the previous postwar average, but the increase in 1956 was small.

As indicated in the more detailed presentation, output per man-hour of production workers in manufacturing increased 3 to 3.6 percent a year from 1947 to 1953, about 4½ percent a year from 1953 to 1955, and from 1 to 2½ percent in 1956, depending on which of various production estimates are used.

If the estimates are based on the hours of work of all factory employees, rather than production workers alone, the average increases would be reduced by at least one-half a percentage point for the period up to 1953, and about 1 percentage point for the last 3 years.

If we take into account the whole private nonagricultural economy, we find an average annual gain of about 3½ percent from 1947 to 1953, 3 percent annually in 1954-55, and practically no increase in 1956. This is based on hours of all persons at work.

Figures are still so crude and so lacking in detail that it is very difficult to account specifically for the 1956 decline in the rate of productivity growth. Some possible factors include the moderate gain in output in 1956, utilization of marginal resources, production adjustments to new equipment, and the large increase in the labor force.

I must repeat: Productivity does not move in a straight line. The decline in the rate of productivity growth in 1956 followed 2 years of higher than average increases, at least in manufacturing, and is not necessarily an indicator of a new trend.

WAGES

Some aspects of the wage situation are fairly clear. Wage-rate increases negotiated in 1956 tended to be higher than those agreed to in 1955. About 3 out of 4 of the workers covered by major settlements concluded during 1956 received increases in rates of pay averaging at least 10 cents an hour. Hourly earnings rose significantly in a number of nonmanufacturing industries as well as in manufacturing (see charts 5A, 5B, and 5C).

There are now at least 5 million workers who can expect wage increases during this coming year on the basis of contracts concluded in 1955 and 1956. These workers are found in almost every industry, but are concentrated in metalworking, construction, transportation, food, and mining. About half of them will receive pay adjustments of between 6 and 8 cents an hour. In addition, cost-of-living escalator clauses may affect the incomes of nearly 4 million workers.

The 1957 deferred increases in these long-term contracts are generally lower than the raises which became effective at the beginning of those contracts in 1955 or 1956.

These deferred increases will undoubtedly have some effect on 1957 negotiations in other industries, but nevertheless there can be no certainty as to the size of the wage increases which will be negotiated this year. Among the important industries in which contracts are due to expire or are subject to reopening on wages this year are petroleum, rubber, lumber, chemicals, textiles, coal mining, paper, telephone and other utilities, trade, and construction. The major influence in these negotiations will be the general economic climate modified by the outlook in each individual industry.

PRICES

When we come to the last of the subjects assigned to me, prices, we move into an area in which there is no agreement at all as to the "normal" trend. We are now in the midst of the third period of price increases during the past 10 years. The first (1947-48) was due to heavy demand arising out of war-created shortages of goods. The second (1950-51) was due primarily to the outbreak in Korea. Unlike the two earlier ones, the present price rise, which began in mid-1955, is due entirely to strong forces of domestic origin in both consumer and producer markets.

The charts show that there are several distinctly different factors at work in the current price situation, in addition to the continuing strong demands resulting from our rising standards of living and increasing population. One of these has been the extremely strong business demand for new plant and equipment (see chart 9). A second factor in price movements in 1956 was the firming up of the farm situation after several years of steady decline. From the peak in early 1951 to the end of 1955, farm prices fell about 30 percent, but there was a substantial recovery in 1956. A third factor, which is particularly important in consumer prices, is the steady rise in rents and services, which shows no sign of abating (see chart 11); and, of course, there has been the special impact of the Suez situation on a few commodities.

So far as the immediate future is concerned, if the demand factors which gave rise to the price increases show no further strengthening—in other words, if investment demand flattens out and if consumer buying follows the income curve and consumer credit is expanded only moderately—there may well be more stability in the price picture.

As of this time, signs of upward price pressures are still evident in those sectors of the economy where demand continues to burgeon; signs of price weakness are appearing only in those fields where demand is less urgent than it formerly was. In addition, there is no indication of any halting of the long-run uptrend in the cost of services; the demand for personal and professional services is continually rising. At the same time, price declines in the agricultural sector are no longer offsetting increases elsewhere.

(The material referred to is as follows:)

MATERIAL SUBMITTED BY EWAN CLAGUE, COMMISSIONER OF LABOR STATISTICS, UNITED STATES DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, TO JOINT ECONOMIC COMMITTEE

I. LABOR FORCE TRENDS

The total labor force averaged 70.4 million in 1956, an increase over 1955 of 1½ million—about twice the amount of growth expected on the basis of population increase and long-term trends in rates of labor force participation. The occurrence of such a large increase following the substantial gain of 1.1 million in the preceding year illustrates the difficulty of determining how much labor force growth there is likely to be in a given year. The annual increases since 1950 are shown in chart 1. In this period they ranged from a low of 400,000 in 1952-53 to the 1955-56 high of 1½ million.

Our experience since World War II indicates that it is possible to make projections of labor force over longer periods of time which come fairly close to actual developments. For example, in early 1951, the Bureau of Labor Statistics

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projected labor force growth through 1955.¹ The projections included growth resulting from increased population and assumed a continuation of 1920-50 trends in rates of labor force participation for each age-sex group with an adjustment in the rates of adult women to take account of accelerated increases observed in 1947-50. For the 5-year period the estimated expansion of 3.7 million workers almost exactly matched the actual growth. As can be seen in the upper half of chart 2, however, the year-to-year increases did not follow the trend line. In some years the labor force expansion was far greater and in other years much less than the average expected growth of 750,000 and in some years the expansion was much less.

The deviations of actual labor force from trend during the years 1951-54 (table 1 and chart 1) appear to be related to the general expansion of military and economic activity following the Korean hostilities and to the recession which followed. Between 1950 and 1951 the labor force increased by $1\frac{1}{4}$, almost one-half million more than was anticipated. The expanded size of the Armed Forces brought a large increase in the labor force activity of men under 25. At the same time, the number of women entering the labor force exceeded the long-run expectation. In the following year the labor force was still above the projected trend level but the amount of excess had shrunk. There appeared a deficit among women under 25, probably related to the increase in marriages following the Korean outbreak and the subsequent rise in the number of births. Women over 25 continued to be added to the labor force in excess of the numbers expected.

¹Harold Wool, Long-Term Projections of Labor Force, Studies in Income and Wealth, vol. XVI, National Bureau of Economic Research. The original projections have been revised to take account of revised population data.

TABLE 1.—Deviation of actual from trend¹ labor force, by age and sex, annual average 1951–56

[In thousands]

Age and sex	1950	1951			1952			1953		
	Actual labor force ²	Actual labor force ²	Trend labor force	Deviation of actual from trend	Actual labor force ²	Trend labor force	Deviation of actual from trend	Actual labor force	Trend labor force	Deviation of actual from trend
Total, 14 and over.....	65, 135	66, 401	65, 942	459	66, 977	66, 706	271	67, 362	67, 417	-55
Male, 14 and over.....	46, 417	47, 072	46, 828	244	47, 301	47, 186	205	47, 692	47, 528	164
14 to 24.....	8, 474	8, 586	8, 419	167	8, 510	8, 383	127	8, 423	8, 342	81
25 to 64.....	35, 348	35, 878	35, 771	107	36, 342	36, 124	218	36, 729	36, 454	275
65 and over.....	2, 595	2, 608	2, 638	-30	2, 539	2, 679	-140	2, 544	2, 732	-188
Female, 14 and over.....	18, 718	19, 329	19, 114	215	19, 586	19, 520	66	19, 668	19, 889	-221
14 to 24.....	4, 675	4, 683	4, 622	61	4, 513	4, 583	-70	4, 399	4, 546	-147
25 to 64.....	13, 427	14, 064	13, 843	221	14, 453	14, 255	198	14, 571	14, 619	-48
65 and over.....	616	582	649	-67	620	682	-62	693	724	-31

Age and sex	1954			1955			1956		
	Actual labor force	Trend labor force	Deviation of actual from trend	Actual labor force	Trend labor force	Deviation of actual from trend	Actual labor force	Trend labor force	Deviation of actual from trend
Total, 14 and over.....	67, 818	68, 144	-326	68, 896	68, 854	+42	70, 387	79, 750	637
Male, 14 and over.....	47, 847	47, 832	+15	48, 054	48, 108	-54	48, 579	48, 389	190
14 to 24.....	8, 257	8, 303	-46	8, 229	8, 261	-32	8, 424	8, 278	146
25 to 64.....	37, 065	36, 778	+287	37, 299	37, 052	+247	37, 552	37, 587	-35
65 and over.....	2, 525	2, 751	-226	2, 525	2, 795	-270	2, 603	2, 524	79
Female, 14 and over.....	19, 971	20, 312	-341	20, 842	20, 746	+96	21, 808	21, 361	447
14 to 24.....	4, 380	4, 530	-150	4, 445	4, 541	-96	4, 648	4, 500	148
25 to 64.....	14, 925	15, 028	-103	15, 617	15, 410	+207	16, 338	16, 053	285
65 and over.....	666	754	-88	779	795	-16	821	808	13

¹ Trend labor forces for 1951–55, made in 1951, are based on 1950 and assume continuation of 1920–50 trends in age-sex labor force participation rates with an adjustment in the rates for adult women to take account of accelerated increases observed in 1947–50; the 1956 trend labor force, made in 1956, is based on 1955 data and assumes continuation of 1947–55 trends in age-sex labor force participation rates.

² The actual labor force estimates for 1950, 1951, and 1952 are based on revised population estimates and therefore differ from published census figures for the same dates.

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

Source: U. S. Bureau of the Census and Bureau of Labor Statistics.

With the slowing down of defense activity in 1953, the labor force showed only a small increase. The inflow of additional women workers was sharply reduced and the participation of men over 65 continued to drop, erasing the excess of the actual labor force over the trend projection.

Between 1953 and 1954, with increased unemployment and curtailed activity in many sections of the economy, labor-force growth was again less than expected and the actual was 300,000 below trend line. The recovery in 1955 brought a substantial amount of labor force growth and the 1955 average labor force was back to the long-term trend level of 68.9 million.

The labor force increase of $1\frac{1}{2}$ million workers between 1955 and 1956 consisted of about 600,000 additions resulting from population growth, about 200,000 from continuation of long-term trends in labor-force participation rates, and about 650,000 from a greater-than-expected increase in worker rates for women 35 to 64 years of age and for youngsters of school age. These increases for adult women and young workers appear to be related to the high level of economic activity and provide evidence that these groups enter the labor market in greater numbers when job opportunities are plentiful. Many of these women and youngsters are in part-time jobs. Between 1955 and 1956 there was an unusually large increase of 850,000 in the number of persons employed less than 35 hours a week.

The lower half of chart 2 shows the projected trend labor force to 1960, and the actual 1955 and 1956 labor forces. The extrapolation of trends in labor-force rates to 1960 was revised in 1956 to take account of additional data through 1955.

By 1960, the labor force can be expected to number almost $73\frac{1}{2}$ million on the basis of trend, an increase of about $4\frac{1}{2}$ million over 1955, or an average of about 900,000 each year between 1955 and 1960. However, the 1956 actual labor force increased by about 600,000 more than expected. Therefore the expected increase between 1956 and 1960 is reduced to about 3 million or 800,000 a year for the next 4 years. Even if the projection to 1960 proves to be correct, we do not expect the growth to occur in equal annual increments.

Nonfarm employment in 1956

The number of workers on nonfarm payrolls continued at record levels for each month of 1956, mainly as a result of persistently greater-than-seasonal gains in the nonmanufacturing sector. For the year as a whole, employment in nonagricultural establishments averaged 51.5 million, more than 1.5 million higher than the average for 1955. Employment in nonmanufacturing industries accounted for 1.2 million of this job increase, a 3.6 percent gain from 1955. Every major nonmanufacturing division reported an employment increase. Manufacturing employment, at 16.9 million, rose only 330,000, or 2 percent from 1955 levels as large gains in a few industries were offset by scattered losses or only modest gains in other industries.

Large gains, resulting in record job levels, were made in retail and wholesale trade, contract construction, State and local governments, and the service industries. In manufacturing, substantial over-the-year increases in employment were reported in the machinery and electrical machinery industries, as well as in primary metals, chemicals, printing, and paper. A 12 percent drop in automobile employment in 1956 outweighed substantial over-the-year gains in aircraft and shipyard employment, resulting in a large decline in jobs in the transportation equipment industry. Over-the-year job losses were also registered in lumber, textiles, tobacco, leather, and ordnance.

While nonmanufacturing employment moved steadily upward during all of 1956 (allowing for seasonal variation), manufacturing employment was relatively stable during the first three quarters of the year, beginning to move upward in October when large-scale job expansions occurred in industries producing automobiles and their component parts. The steel strike in July had only a temporary effect on job totals.

One of the more interesting developments in manufacturing employment in 1956 was the relatively large increase in the number of nonproduction workers. While the average number of production workers increased by less than 1 percent during the year, the number of nonproduction workers increased by more than 6 percent. Two-thirds of the over-the-year gain of 330,000 in total manufacturing employment was made up of nonproduction workers. Most of the increase in nonproduction workers occurred in aircraft, machinery, and electrical equipment plants, where personnel requirements for research and development have been increasing sharply in the past year.

II. TRENDS IN THE WORKWEEK

Hours of work in 1956

The average workweek in the entire economy in 1956, as measured by the Bureau of the Census, was 39.5 hours, two-tenths of an hour below the level of the previous year. The decline was somewhat less than had been projected for 1956 on the basis of an assumed long-term downtrend in the length of the workweek.²

The workweek in manufacturing, as measured by the Bureau of Labor Statistics, averaged 40.5 hours in 1956, down two-tenths hour from 1955. The length of the factory workweek started an abrupt decline in the early part of 1956, after more than a year and a half of almost continuous rise (allowing for seasonal fluctuations). A leveling off or turnabout in this upward trend of hours was characteristic of most manufacturing industries, but was especially evident in the automobile and its supplier industries (notably rubber), and in industries connected with home construction (lumber and furniture).

In June, the general decline had been halted and an upturn commenced. By the last quarter of the year, hours of work in manufacturing had recovered much of the loss suffered since the end of 1955 and were about at, or slightly above, the postwar average.

Postwar trends in the workweek

The most significant factor in the average workweek in past decades has been a long-term downtrend in both agricultural and nonagricultural industries. This secular decline in hours of work, temporarily reversed by World War II, apparently again has been resumed in the postwar period. The workweek in agriculture, as measured by the Bureau of the Census, declined from 48.8 hours in 1947 to 45.4 in 1956. Hours of work in nonagricultural industries have also shown a marked decline since 1947 according to Census Bureau statistics, dropping from 40.4 hours in 1947 to 38.8 in 1956. (See table 2.)

TABLE 2.—*Weekly hours of wage and salary workers in agriculture and in nonagricultural industries*¹

[Annual averages 1947-56]

Year	Total weekly hours	Agriculture	Nonagricultural industries	Year	Total weekly hours	Agriculture	Nonagricultural industries
1947.....	41.6	48.8	40.4	1952.....	40.4	47.4	39.6
1948.....	40.8	48.5	39.6	1953.....	40.1	48.0	39.1
1949.....	40.3	48.1	39.0	1954.....	38.9	47.0	37.9
1950.....	39.9	47.2	38.8	1955.....	39.7	46.3	38.9
1951.....	40.4	47.8	39.4	1956.....	39.5	45.4	38.8

¹ Averages include workers reporting no hours of work.

Source: U. S. Department of Commerce, Bureau of the Census.

The decline is especially evident in nonmanufacturing and has been the result of several factors. A growing proportion of workers have had their scheduled workweeks reduced to 40 hours or below. This is indicated by the smaller proportion of nonagricultural employees working 41 hours or more.

TABLE 3.—*Hours worked in nonagricultural industries*

	Percentage of employees working—		
	1 to 34 hours	35 to 40 hours	41 hours or more
May 1947.....	12.6	48.0	39.4
May 1956.....	17.0	49.4	33.6

Source: U. S. Department of Commerce, Bureau of the Census.

² A reduction of "slightly less than 1 percent"—or about 0.4 hour was projected in the report of the Joint Committee on the Economic Report on the January 1956 report of the President, 84th Cong., 2d sess., March 1956, p. 86.

This pattern is true of all major groups in nonagricultural industries from May 1947 to May 1956. Census data show the following declines during this period in the proportion working 41 hours or more: in construction, from 35.1 to 26.7 percent; in transportation, communication, and other public utilities, from 55.3 to 25.6 percent; in wholesale and retail trade, from 55.7 to 43.3 percent; and in service industries, from 39.7 to 31.4 percent. The decline in manufacturing was the smallest of the major groups—from 28.2 to 24.1 percent—primarily because the overwhelming proportion of manufacturing industries already were on a regularly scheduled 40-hour week.

An increase in part-time workers is another major factor affecting the average workweek. The increase of 1.8 million in civilian employment between 1955 and 1956 was made up about equally of men and women. To a large extent the increases were part-time workers. Nearly half of the 1956 employment increase of 1.8 million consisted of people who were working less than 35 hours a week. As compared with 1955, there were about 450,000 more women and 400,000 more men working less than full time, the great majority in nonagricultural industries.

In agriculture, the decline in the workweek has also been influenced by the decrease in the proportion of self-employed farmers and unpaid family workers—who usually work long hours—and the corresponding growth in the proportion of hired farmworkers.

Although a long-term downtrend in hours of work was also evident in manufacturing industries before the war, short-term economic influences have apparently been of more importance in determining the factory workweek in the post-World War II period. Bureau of Labor statistics figures on annual average weekly hours in manufacturing have ranged, in the period since 1947, from a high of 40.7 hours to a low of 39.2 hours, with no clear evidence of an overall downtrend. There have been sharply divergent trends in the workweeks of individual industries. Durable-goods industries showed an increase in weekly hours, while nondurable-goods industries failed to show a gain. (See chart 4.)

Hours of work tend to be a factor in equating supply and demand for labor in the short run. When changes in demand require changes in labor input, the first response appears to be changes in hours of work. There are a number of advantages to a firm in this approach. First, if the firm is not certain that the new conditions of demand will persist, increasing or decreasing hours of work are methods of adjusting labor inputs which, on the downswing, minimize the loss of trained work force and creation of morale problems. In a period of rising demand, increasing the hours of work avoids the expense and difficulties of recruiting and training good workers. In addition, in a tight labor market, overtime and premium pay may be an inducement in recruiting and longer hours may be the only alternative to hiring less desirable, untrained workers. However, since overtime work typically is costly because of premium wage rates, and has other disadvantages as well, the firm will generally employ additional labor or make other adjustments within a relatively short time.

These facts are evident on chart 4, which presents seasonally adjusted monthly data on production worker employment together with preliminary data which I have just received on seasonally adjusted average weekly hours for 1947-56. I have had these new estimates charted, and they indicate that changes in the workweek tend to precede changes in employment for both durable and nondurable groups.

The seasonally adjusted data on hours of work presented in this chart will be available in complete tabular form in about a month. I expect that this series will provide valuable insight on the relationship between employment and hours. Supplementing the seasonally adjusted employment series, these forthcoming data on seasonally adjusted factory hours in manufacturing will make possible adjusted man-hours data which will provide another useful tool for current economic analysis.

Overtime hours

The Bureau of Labor Statistics has recently inaugurated another series, designed to give precise information on overtime hours worked by factory production workers for premium pay. The period of 1 year for which these data have been collected is as yet too short to realize the full potential of this measure, particularly the application of overtime hours as a lead indicator of changes in the factory workweek, and possibly of employment as well. To analyze the economic relationship of overtime hours to total hours and to employment, it will

be necessary to have several years of data in order to determine seasonal patterns in overtime work.

The overtime series have, nevertheless, already yielded useful information on the differential patterns of overtime in various manufacturing industries, on the relationship of overtime to economic activity and the relationship of overtime work to earnings.

For example, of the average of 40.5 hours a week of factory production workers in 1950, we know that 2.3 hours have been overtime hours at premium pay. Based on time and a half for the overtime work, factory workers received on the average \$8 per week for this work, or 10 percent of their average gross weekly earnings of \$80.

III. RECENT TRENDS IN PRODUCTIVITY

Long-run and postwar trends

Manufacturing.—During the course of the hearings held in October 1955 by the Subcommittee on Economic Stabilization of the Joint Economic Committee on Automation and Technological Change, the findings of BLS Report 100, Trends in Output Per Man-Hour and Man-Hours Per Unit of Output, Manufacturing, 1939-53, were discussed and the report itself was included in the record of the hearings. The report indicated that the long-run average annual increase in output per production worker man-hour of manufacturing industries, prior to 1939, was about 3.3 percent. The wartime dislocations and subsequent problems of reconversion resulted in a much smaller rate of increase, about 1 percent, between 1939 and 1947, followed by a return to the long-run average of 3 to 3.6 percent during the postwar years 1947-53.

Other measures may be computed to take account of the employment in manufacturing of nonproduction workers, although a major problem is the absence of data on weekly hours of nonproduction workers. Estimates have been prepared, using the alternative assumptions that nonproduction workers work the same hours as production workers, or that they work a standard 40-hour week. For the postwar period as a whole, either assumption yields about the same result. Since the proportion of nonproduction workers to total employees has been increasing during the postwar period, productivity in manufacturing based on hours of all employees would show less of an increase than a measure based on production-worker-hours only.

For the 1947-53 period, output per total employee-hour would show an average annual increase of about $2\frac{1}{2}$ to 3 percent, that is, about one-half of 1 percent less than that based on production-worker-hours only.

Total nonagriculture.—In its report, Potential Economic Growth of the United States, the Joint Economic Committee published a table providing estimates of output per man-hour for the total private economy, with separate estimates for the farm and nonfarm sectors. The estimates covered the years 1910 through 1953. In this statement we will be primarily concerned with the trend for the nonfarm sector.

Estimates of the average annual increase in output per man-hour for total nonagricultural industries, based on the JEC report, were published as part of the BLS Report 100 on manufacturing productivity. These estimates indicated an average annual increase of about 2 percent for the 1910-53 period, but a much larger increase of about 3.4 percent for the postwar period.

Trends since 1953

Manufacturing, 1953-56.—The detailed quantity, value, and price data of the type used in BLS Report 100 for computing output per man-hour of manufacturing industries are not yet available for the years after 1953, and extension of the estimates will have to wait for the publication of the detailed figures of the 1954 census of manufactures and subsequent surveys.

In the meantime, because of the great interest in recent productivity trends, the Bureau of Labor Statistics has attempted to develop interim measures. These estimates, based on cruder data and methods, should be considered as preliminary interim indicators and have a lower degree of reliability than the careful and detailed work done for the earlier period.

The Federal Reserve Board index of production has been used rather frequently to derive current estimates of changes in output per man-hour. This method has some serious limitations, from the viewpoint of productivity measurement, because the production estimates for recent years already embody a productivity assumption; that is, production indexes for industries covering

about half of manufacturing are based on man-hour trends adjusted for extrapolated changes in productivity.

The BLS has experimented with other interim measures. One is based on selected FRB industry indexes, excluding those derived from man-hours adjusted for productivity trends. The other is based on Department of Commerce, Office of Business Economics, data on shipments, adjusted for change in inventories of finished goods and goods in process, and deflated to eliminate the influence of changes in price. The interim measures developed by the BLS are far from satisfactory and suffer from limitations of their own, but they do not embody any productivity assumptions. An analysis and technical description of these measures was presented in a paper given by members of the Bureau of Labor Statistics at the December 1955 annual meeting of the American Statistical Association.

Using the published FRB indexes and the measures developed by BLS, latest available data indicate that the increase in output per hour of production workers was about 4½ percent per year between 1953 and 1955—substantially higher than the postwar average of about 3 to 3.6 percent.*

These estimates also indicate a considerable slackening of the rate of increase in 1956, although there is a substantial variation depending on which measure is used. An estimate based on the published total FRB production index shows an increase of about 2½ percent in output per man-hour of production workers in 1956; measures based on deflated OBE data show increases of about 1 percent.†

If estimates are based on hours of all employees, rather than production workers alone, the 1953–55 average is lowered to something close to 3½ percent. In 1956, the change in output per man-hour would drop to a range of about zero to 1½ percent increase.

Total nonagriculture, 1953–56.—Estimates for the years 1954 and 1955 were published by the Joint Economic Committee in their 1956 Joint Economic Report. However, these estimates are not based on the same data for man-hours used in previous estimates and may, therefore, not be entirely consistent with them.

The estimates up to 1953 were based on detailed industry employment and hours data, which were aggregated for major sectors. The most recent estimates are based primarily on census labor force data on employment and hours.

Taking into account revisions to the basic data for both output and man-hours, the estimates as revised indicate an increase of about 6 percent in output per man-hour, of all persons employed, between 1953 and 1955, or about 3 percent per year. This is higher than the long-run average but slightly below the postwar average. As in the case of manufacturing, more than half the increase took place in 1955.

Preliminary data for 1956 indicate almost no change in output per man-hour in the total nonagricultural sector. The data used to derive preliminary estimates of output per hour for 1956 are the same as those used in the 1956 Joint Economic Report to develop estimates for 1954 and 1955.

Factors which may have affected productivity in 1956.—In evaluating the decline in the rate of increase in output per hour during 1956, one should bear in mind that these estimates refer to broad aggregates such as total nonfarm and total manufacturing. Based on past experience it is quite probable that within these aggregates there may have been substantial variations, with some industries continuing to show substantial gains while others may have actually experienced declines in productivity.

Another general observation which relates to the evaluation of productivity for any one year is that while there is rarely an overall decline in productivity, there is little uniformity in the year-to-year rates of change. A year of rapid expansion may be followed by one of leveling off, or vice versa. In fact, according to the preliminary indicators, the low rate of increase in 1956 was preceded by a year of more than average gain. Moreover, the high capital investment of 1956 and prior years, including investment in automation and other forms of advanced technology, could pay off in 1957 in the form of significantly higher productivity.

* Measures derived from selected FRB industry indexes (i. e., excluding those based on man-hours) show a higher increase for the years 1954 and 1955, and a smaller increase for 1956. Since these are a selected group of industries, they are not necessarily representative of total manufacturing.

In the present economy of full employment and high levels of output, it is possible that utilization of marginal resources and strained capacity in many plants may have affected the productivity potential. Continued high investment in new equipment in many plants and industries may have required extensive production adjustments before full efficiency could be realized. In addition, there were undoubtedly weak spots in a few industries where production was curtailed, and these volume declines may have been accompanied by a decline in the rate of productivity increase, if not an actual decline in the level of productivity. It should be noted in this connection that volume of output did not expand at a high rate in 1956, and it is not unusual for the rate of productivity growth to slacken off during periods of moderate production gains.

It is possible that the much larger than usual increase in employment during 1956 may have required adjustments in some plants and industries, particularly in view of the large increase in employment which occurred in 1955, following the recession of 1954.

As a final word of caution, and to repeat the warnings made earlier in the statement, these estimates of recent productivity trends are based on preliminary production and man-hour data, all of which are subject to revision.

IV. WAGE DEVELOPMENTS, 1956 AND 1957

The past year

Wage-rate increases negotiated in 1956 tended to be higher than those agreed to in 1955 and, as in 1955, were generally accompanied by changes in one or more supplementary benefits. There was some reduction in the number of major agreements concluded during the year as compared with 1955; this decline was due to the fact that fewer large agreements were subject to negotiation in 1956. (Most of the long-term contracts—notably those in the automobile, farm equipment, and trucking industries—that had been in existence prior to 1955 were renegotiated in that year and were not subject to reopening in 1956.) Workers covered by most major agreements not reopened in 1956 received wage rate increases which had been agreed to earlier.

Negotiated wage rate increases.—A summary of a group of major collective bargaining settlements concluded during 1956 indicates that about 3 out of 4 of the workers covered by these settlements received increases in rates of pay averaging at least 10 cents an hour. Settlements providing average increases of 10, but less than 11, cents applied to about 4 out of 10 employees.⁴

Deferred and cost-of-living increases effective in 1956.—In addition to the workers affected by contracts agreed to in 1956, about 2½ million workers received deferred wage increases specified by contracts negotiated in 1955 or earlier years. Many of these workers also obtained further increases in money wage rates as a result of cost-of-living escalator clauses. The most common wage rate increases resulting from deferred and cost-of-living increases together amounted to about 12 cents an hour. Thus, the automobile workers received an annual improvement factor increase of slightly more than 6 cents plus escalator adjustments of 6 cents.

Hourly and weekly earnings.—Hourly earnings, reflecting negotiated wage rate increases as well as deferred and cost-of-living wage changes and other factors,⁵ also rose substantially during 1956. In December of that year hourly earnings of factory production workers were about 12 cents, or 6.2 percent higher than in December 1955. Weekly earnings advanced by about 5.4 percent on the average. Earnings in most nonmanufacturing industries also rose significantly. For example, between November 1955 and November 1956, hourly earnings of employees in retail trade rose 6 cents (3.9 percent); in gas and electric utilities

⁴ This summary covers collective bargaining settlements involving 1,000 or more workers reported in the Bureau of Labor Statistics' Monthly Report on Current Wage Developments. These settlements accounted for a total of over 5.5 million workers. The summary covers all major industry groups except construction, the service trades, finance, and government; information on union scale changes in the construction trades is presented separately on table 5. Information on deferred increases for both 1956 and 1957 as presented later in the text includes construction, but because data are less complete for this industry than for the others included in this summary it is excluded from the table showing deferred increases. Data included for the final 3 months of 1956 are preliminary.

All increases are presented as averages for all workers affected by a settlement. Actually, many settlements provide for varying the cents-per-hour increase among occupations so that not all workers receive the average.

⁵ Including the effect of the \$1 minimum wage under the Fair Labor Standards Act, increases for workers not covered by collective agreements, merit or length of service pay raises, changes in the composition of the labor force, and changes in incentive earnings.

the increase amounted to 12 cents, or 5.6 percent over the year; and in bituminous coal mining hourly earnings rose about 29 cents, or 10.9 percent. (See table 4 and charts 5A, B, and C.)

TABLE 4.—Average hourly earnings of production workers or nonsupervisory employees in selected industries, annual averages, 1955 and 1956, and November 1955 and 1956

Industry	1956		1955		Percent change average 1955 to average 1956
	November ¹	Annual average ¹	November	Annual average	
Mining:					
Metal.....	\$2.34	\$2.31	\$2.27	\$2.19	+5.5
Anthracite.....	2.71	2.61	2.55	2.53	+2.2
Bituminous coal.....	2.95	2.81	2.66	2.56	+9.8
Contract construction	2.81	2.74	2.65	2.60	+5.4
Nonbuilding construction.....	2.55	2.49	2.40	2.36	+5.5
Building construction.....	2.87	2.80	2.71	2.66	+5.3
General contractors.....	2.70	2.64	2.58	2.52	+4.8
Special trade contractors.....	2.99	2.92	2.80	2.77	+5.4
Manufacturing	2.03	1.98	1.93	1.88	+5.3
Durable goods.....	2.16	2.10	2.05	2.01	+4.5
Nondurable goods.....	1.85	1.81	1.74	1.71	+5.8
Ordinance and accessories.....	2.25	2.19	2.10	2.05	+6.8
Food and kindred products.....	1.91	1.85	1.80	1.75	+5.7
Tobacco manufactures.....	1.44	1.44	1.33	1.33	+8.3
Textile mill products.....	1.50	1.45	1.42	1.39	+4.3
Apparel and other finished textile products.....	1.47	1.44	1.36	1.35	+6.7
Lumber and wood products.....	1.76	1.76	1.69	1.69	+4.1
Furniture and fixtures.....	1.71	1.69	1.65	1.62	+4.3
Paper and allied products.....	1.98	1.94	1.87	1.83	+6.0
Printing.....	2.45	2.42	2.36	2.35	+3.0
Chemicals and allied products.....	2.13	2.10	2.04	1.99	+5.5
Products of petroleum and coal.....	2.57	2.54	2.41	2.36	+7.6
Rubber products.....	2.19	2.17	2.17	2.10	+3.3
Leather and leather products.....	1.52	1.50	1.44	1.41	+6.4
Stone, clay, and glass products.....	1.99	1.95	1.90	1.85	+5.4
Primary metal industries.....	2.44	2.37	2.31	2.24	+5.8
Fabricated metal products.....	2.13	2.07	2.03	1.98	+4.5
Machinery (except electrical).....	2.25	2.21	2.15	2.09	+5.7
Electrical machinery.....	2.04	1.98	1.91	1.88	+5.3
Transportation equipment.....	2.39	2.31	2.30	2.23	+3.6
Instruments and related products.....	2.04	2.01	1.94	1.91	+5.2
Miscellaneous manufacturing industries.....	1.78	1.75	1.69	1.66	+5.4
Class I railroads	(²)	(²)	1.98	1.95	(²)
Local railways	1.98	1.96	1.90	1.87	+4.8
Communication:					
Telephone.....	1.88	1.86	1.88	1.82	+2.2
Telegraph.....	2.02	1.97	1.87	1.87	+5.3
Other public utilities: Gas and electric utilities	2.27	2.22	2.15	2.10	+5.7
Wholesale and retail trade:					
Wholesale trade.....	2.04	2.02	1.94	1.91	+5.8
Retail trade.....	1.58	1.57	1.52	1.50	+4.7
Service and miscellaneous:					
Laundries.....	1.06	1.05	1.02	1.01	+4.0
Cleaning and dyeing plants.....	1.28	1.26	1.20	1.20	+5.0

¹ Preliminary.

² Not available.

Source: Bureau of Labor Statistics, U. S. Department of Labor.

Union wage scales in construction

During 1956 union scales in the construction trades in major cities in the United States rose approximately 14 cents an hour as compared with 10 cents in 1955. As table 5 indicates, over 4 out of 10 of these scales were increased at least 15 cents an hour during 1956 as compared with 1 out of 5 in 1955. The most common single increase in 1956 was 15 cents an hour, the change in about 1 out of 5 union scales; in 1955 the single most frequent increase amounted to 10 cents an hour.

TABLE 5.—Percentage distribution of changes in union wage scales in 7 construction trades in major cities,¹ 1955 and 1956

Cents-per-hour increases	Percentage of scales in—	
	1955	1956
All scales.....	* 100	* 100
All increases.....	77	87
Under 5.0.....	2	1
5.0 and under 10.0.....	18	12
5.0.....	8	5
7.5.....	7	5
10.0 and under 15.0.....	38	30
10.0.....	23	17
12.5.....	11	9
15.0 and under 20.0.....	12	24
15.0.....	9	19
20.0 and under 25.0.....	4	9
20.0.....	3	7
25.0 and over.....	4	11
25.0.....	3	8
No change.....	21	13

¹ The 7 trades studied were bricklayers, carpenters, electricians, painters, plasterers, plumbers, and building laborers. The information relates to changes effective during the year regardless of when they were negotiated.

² Because of rounding, sums of individual items do not necessarily equal the totals.

Source: Bureau of Labor Statistics, U. S. Department of Labor.

Unlike most years, 1956 evidenced a change in almost a fifth of the scales in the fourth quarter of the year. The increase in average hourly rates during the fourth quarter of 1956 amounted to 2.8 cents, approximately double that registered in the corresponding quarter of 1955.

Supplementary benefits.—About 3 out of 4 of the major agreements concluded in 1956 liberalized or added one or more supplementary benefits in addition to increasing wage rates. Health and welfare benefits were most frequently affected. Changes in provisions for paid vacations, paid holidays, and pensions also were frequent. Supplemental unemployment benefit plans were adopted in a number of major industries, notably steel, aluminum, and rubber.

Spread of long-term agreements.—A notable feature of bargaining in 1956, as in 1955, was the spread of long-term agreements specifying wage-rate increases for a period of 2, 3, or even 5 years. Settlements covering about half the workers affected by all major agreements concluded during 1956 were negotiated for a period of more than a year and specified increases to go into effect in subsequent contract years. Among the industries in which such contracts were negotiated in 1956 were basic steel, aluminum, meat packing, railroads, and nonferrous metals. In addition, many of these agreements incorporated cost-of-living escalator clauses and thus made provision for the protection of the real value of the wage rates of the workers covered by the contracts. The resurgence of interest in cost-of-living escalation that accompanied the growth of long-term agreements brought the total coverage of escalator clauses to a level equaling or slightly exceeding their previous peak (in 1952) of about 3.8 million workers.

The wage outlook

Deferred increases.—Since many of the contracts concluded in 1955 and 1956 specified wage increases to go into effect in future years, the magnitude of the 1957 wage movement can be in part anticipated with reasonable accuracy. As pointed out above, however, many of these long-term contracts also contain cost-of-living escalator clauses; hence, the exact change in money wage rates for most of the workers affected will depend on changes in the level of retail prices.

Another area of uncertainty regarding the precise magnitude of the 1957 wage movement arises from the fact that a substantial number of major collective bargaining agreements are due to expire or are subject to reopening on wages during the year. Among the industries in which important union contracts permit wage negotiations during 1957 are petroleum, rubber, lumber, chemicals, textiles, coal mining,⁶ paper, telephone and other utilities, trade, and construc-

⁶ In this industry workers will receive an increase in April 1957 as a result of 1956 negotiations, but the agreements are subject to renegotiation on or after September 30, 1957, upon 60-day notice.

tion. The extent to which wage increases will be negotiated in these situations will clearly be affected by the general economic climate and business conditions in each of these industries. Existing provisions for deferred increases in other industries will probably have some indirect effect on these negotiations.

Within the framework of these limitations, a summary of the increases already specified for 1957 may provide some clue as to the nature of the changes in money wages that may occur more generally during the year.

By the beginning of 1957 there were at least 550 major bargaining situations covering at least 5 million workers on which agreement had already been reached regarding specific wage increases to go into effect during the year. Some deferred increases will go into effect in almost every industry group, but the bulk of the workers affected are concentrated in metalworking, construction, transportation, food, and mining. Roughly half of the workers scheduled to receive deferred increases are employed in the automobile, farm equipment, electrical equipment, aircraft, primary metals (steel, aluminum, and other nonferrous metals), and other metalworking industries. More than a fifth are in transportation, notably railroads and trucking.

Generally, deferred increases are somewhat lower on the average than those scheduled to go into effect during the first year of a long-term contract. These differences in magnitude are due to two factors: In some cases (e. g., in the automobile and farm-equipment contracts negotiated in 1955) skilled workers received greater increases in the initial than in subsequent contract years; in others (e. g., basic steel, aluminum, railroads, and some construction agreements), the general wage increase for all workers was higher in the first than in subsequent contract years. Nonwage items, notably various supplementary benefits, typically became applicable at the time of contract negotiations, thus further enhancing the value of the initial "package" settlement.

Pay increases already specified for 1957 will generally amount to 5 but less than 11 cents an hour; increases of this magnitude are provided by contracts covering 9 out of 10 workers who are to receive deferred pay advances. About 2.5 million workers (half the workers scheduled to benefit from deferred increases in 1957) will be covered by pay advances of 6 but less than 8 cents an hour. Rate increases amounting to 9 but less than 10 cents are scheduled to go into effect for approximately three-fourths of a million workers. The deferred increases due in 1957 are summarized in tables 6a and 6b.

TABLE 6-A.—Deferred wage increases scheduled to go into effect in 1957 in situations affecting 1,000 or more workers in manufacturing and selected nonmanufacturing industries

Amount of average wage increase	Number of situations ²	Approximate number of workers affected (in thousands) ¹											Percentage of—		
		All industries ²	Total manufacturing ²	Food and kindred products	Paper and allied products	Printing and publishing	Chemicals and allied products	Metalworking	Total non-manufacturing studied	Mining ⁴	Warehousing, wholesale and retail trade	Transportation	Public utilities	Situations ²	Workers affected ²
Total.....	534	4,512	3,020	210	44	25	55	2,569	1,492	230	92	1,106	65	100	100
Under 5 cents.....	30	145	95	7			1	56	50		8	42		6	3
5 but less than 6 cents.....	71	407	358	67	6		4	245	49		12	14	23	13	9
6 but less than 7 cents.....	147	1,199	1,165	7		1	12	1,121	35		14	7	14	28	27
7 but less than 8 cents.....	103	1,280	486	107	3		17	355	794		21	770	3	19	28
8 but less than 9 cents.....	35	279	76	3		6	16	42	203		6	197		7	6
9 but less than 10 cents.....	87	759	722	1	34	3		675	38	30		6	2	16	17
10 but less than 11 cents.....	27	294	74	1	1		4	59	220	200	4	16		5	7
11 but less than 12 cents.....	5	24	22	6		7		10	2		2			1	1
12 but less than 13 cents.....	9	33	11	11					22		5	17		2	1
13 cents and over.....	6	10	4					4	6		4	1	1	1	(⁵)
Amount not specified.....	14	82	9			6		3	73		16	35	23	3	2

¹ Because of rounding, sums of individual items do not necessarily equal totals.
² Does not include construction industry settlements.
³ Includes a few settlements in the following industry groups for which separate data are not provided: 19,000 workers in textiles, 23,000 in apparel, 10,000 in lumber and furniture, 5,000 in rubber, 11,000 in leather and leather products, 44,000 in stone, clay, and glass, and 2,000 workers in miscellaneous manufacturing.

⁴ Data for nonferrous mining included with metalworking.
⁵ Less than ½ of 1 percent.
 Source: Bureau of Labor Statistics, U. S. Department of Labor.

TABLE 6-B.—Number of workers who will be affected by deferred increases in selected union wage scales in the construction industry due in 1957

Increase in scales	Number of workers	Increase in scales	Number of workers
Total.....	382, 000	11 and under 13 cents per hour.....	10, 000
Under 5 cents per hour.....	8, 000	13 and under 15 cents per hour.....	22, 000
5 and under 7 cents per hour.....	50, 000	15 and under 17 cents per hour.....	70, 000
7 and under 9 cents per hour.....	26, 000	17 cents per hour and over.....	14, 500
9 and under 11 cents per hour.....	115, 000	Not specified.....	46, 500

Source: Bureau of Labor Statistics, U. S. Department of Labor.

Cost-of-living escalator clauses.—As previously noted, the precise changes in money rates of pay for most workers covered by deferred increases will depend on changes in the level of retail prices, since a substantial majority of the workers who will receive deferred increases are also covered by cost-of-living escalator clauses. By the beginning of 1957, as previously pointed out, the real rates of pay of at least 3.8 million workers were protected by clauses providing for periodic adjustments in wage rates geared to changes in the Bureau of Labor Statistics Consumer Price Index (table 7.).

Almost all of the agreements with cost-of-living escalator clauses provide for adjusting wage rates with price changes on a quarterly or semiannual basis. Most of the contracts specify that all workers (from skilled to unskilled) shall receive the same cents-an-hour adjustment in rates of pay. The agreements affecting the vast majority of workers under cost-of-living escalators provide for a 1-cent change in wage rates for a change of 0.4 to 0.5 of a point in the price index. This means that these escalator provisions call generally for a change in rates of pay of roughly 1 percent for a 1-percent change in the Consumer Price Index.

TABLE 7.—Estimated number of workers covered by cost-of-living escalator clauses, Jan. 1, 1957¹

Industry	Estimated number of workers covered by escalator clauses ² (total)	Most common types of escalator adjustments	
		Frequency	Amount of adjustment
All industries.....	3, 840, 000	-----	-----
Industries in which major groups of these workers are concentrated:			
Automobiles and parts.....	910, 000	Quarterly.....	1 cent for 0.5-point change in BLS-CPI.
Railroads.....	850, 000	Semiannual....	1 cent for each 0.5-point change.
Steel (basic steel and steel fabricating).	640, 000	....do.....	2 cents for each 0.9-point change (1 cent for alternate 0.4- and 0.5-point increase. Decreases to occur only if index declines at least 0.9-point).
Electrical machinery.....	390, 000	Quarterly.....	Formulas vary.
Trucking and transit.....	270, 000	Semiannual....	1 cent for each 0.55-point change.
Aircraft and parts.....	200, 000	Quarterly.....	1 cent for each 0.5-point change.
Agricultural machinery.....	115, 000	....do.....	1 cent for 0.5-point change.
Meatpacking.....	100, 000	Semiannual....	1 cent for 0.5-point increase; decreases computed differently.
Aluminum.....	60, 000	....do.....	Same as steel.
Iron ore mining.....	30, 000	....do.....	Do.

¹ Based on situations affecting 1,000 or more workers as reported in the Bureau of Labor Statistics Monthly Report on Current Wage Developments.

² Includes over 3.5 million workers covered by collective agreements and about 300,000 workers not covered by such agreements.

³ Includes workers in some industries not shown separately.

V. FACTORS AFFECTING PRICES IN 1956

After several years of relative stability, the major price indexes moved upward in 1956. We are now in the third period of general price rises since the end of World War II (see chart 8). The first, the immediate postwar period, was one where the increases reflected the influence of postwar civilian shortages plus the end of price controls. The second period of general price increase was the direct result of the Korean conflict as a result of both hoarding and the diversion of resources towards military activity. In the current period the general rise appears to be mainly the result of strictly civilian forces with no direct military overtones.

A host of factors can be pointed to as playing a role in the recent price rise, but behind the great bulk of them lies the fact that strong and rising demand, especially for capital goods, has placed such great strains upon our plant and manpower capacity as to foster an accumulation of cost increases. These cost increases—some actual and some anticipated—have been pyramided as they were passed on through the business structure.

Wholesale price index.—The upward movement of primary prices began in mid-1955. In the following 18 months, this index has risen more than 5 percent, and the group of commodities exclusive of farm and foods was up about 8 percent. Seven of the 13 nonagricultural commodity groups of the wholesale price index reached new post-World War II highs in the last quarter of 1956 (see table 8). The significant increases were mainly but not exclusively among the durable goods, particularly the producers' goods, such as machinery and equipment, and the important metal materials.

TABLE 8.—Primary market price indexes for major commodity groups, highs and lows, 1954–56

Group	High point		Low point	
	Index	Date	Index	Date
All commodities.....	116.5	February 1951.....	92.3	January 1947.
Farm products.....	117.6	March 1951.....	82.9	December 1955.
Processed foods.....	112.9	February 1951.....	94.0	January 1950.
All but farm and foods.....	124.6	December 1956 ¹	91.8	January 1947.
Textile products and apparel.....	115.9	March 1951.....	92.8	May 1950.
Hides, skins, leather and products.....	127.7	February 1951.....	91.8	December 1954.
Fuel, power, and lighting materials.....	113.1	December 1956 ¹	82.7	January 1947.
Chemicals and allied products.....	112.6	February 1951.....	92.0	March 1950.
Rubber and rubber products.....	153.0	January 1951.....	84.1	July 1947.
Lumber and products.....	128.5	April 1956.....	84.9	January 1947.
Pulp, paper, and products.....	128.1	October 1956.....	95.7	August 1949.
Metals and metal products.....	152.4	December 1956 ¹	87.9	January 1947.
Machinery and motive products.....	143.5	December 1956 ¹	89.7	January 1947.
Furniture and other household durables.....	121.4	December 1956 ¹	93.8	January 1947.
Nonmetallic minerals, structural.....	131.5	October 1956.....	90.9	January 1947.
Tobacco manufacturers and bottled beverages.....	123.6	December 1956 ¹	96.8	January 1947.
Miscellaneous products.....	120.0	January 1948.....	87.7	February 1947.

¹ Preliminary.

Source: Bureau of Labor Statistics, U. S. Department of Labor.

Two important commodity groups—chemicals and textiles, including apparel—held fairly stable over the year. To a considerable extent, this reflected divergent trends within the groups; for instance, industrial chemicals rose while fertilizer prices fell, and wool products increased substantially in price in mid-1956, but cotton products and synthetic textiles price declined. And two groups—rubber and lumber—were lower at year end than a year earlier, reflecting changes in the demand for those particular commodities.

Actually, as a study of the chart on wholesale prices shows (chart 8), the upward pressure on industrial prices was at work well before the overall index started moving up in mid-1955. But these pressures had been offset in the grand total by the weakness of farm products and foods. Prices of farm products fell steeply to a low in December 1955, then recovered somewhat in 1956. Processed-food prices, which had drifted downward at a slower pace, also made gains in 1956. Thus, the strengthening of the agricultural sectors of the index,

reflecting Government programs and export demand which helped to cut down supplies, came at the same time as the industrial price rise was accelerating.

Analysis of wholesale-price movements by degree of fabrication, after elimination of the food and feedstuffs, indicates that the remaining crude materials, which account for less than 5 percent of the total wholesale price index, were the first to turn upward after the post-Korea adjustment. The intermediate and finished durable goods have been the major influences in the upswing since mid-1955 (see chart 9). The producers-finished goods, with a weight of about 10 percent, have made by far the sharpest rises in the past year and a half. At the other extreme, the finished consumer nondurables, constituting about 15 percent of the total, have held fairly steady.

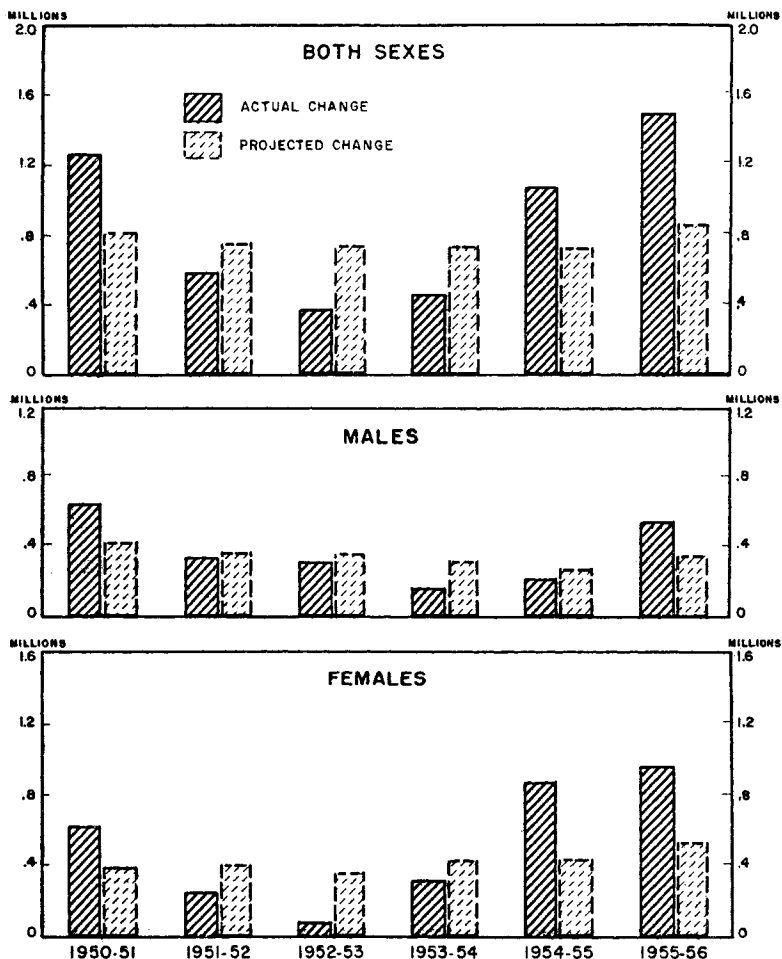
Consumer price index.—The average of all consumer prices began moving upward in the spring of 1956, after 4 years of exceptional overall stability (charts 10 and 11). During this 4-year period, services and rents had been rising steadily, but declines in commodity prices had offset their advance. This past spring, however, the declining trend in commodity prices was reversed. The most important shift was in foods, with meats recovering from an abnormally low level, and fruits and vegetables also going up substantially. The appearance in the autumn of the new 1957 automobiles, at substantially higher prices, caused a rise in the transportation index. In December, new cars were priced 6.5 percent above the comparable models of a year earlier. Commodities as a group rose 3 percent from April to December; this was their first significant increase since 1951. Services (medical care, personal care, transportation, laundry, cleaning, etc.) rose nearly 2 percent over this same 8-month period—about the same rate of rise as during 1955.

Despite the recent rise, commodities were costing the consumer less than they did 4 years earlier; only apparel (mainly shoes) had a higher average price than in December 1952, although still below the postwar peak. Services, on the other hand, were up about 12 percent, in these past 4 years and rent about 11 percent. Thus, the 1956 rise in consumer prices was due in part to a return of commodity prices to earlier levels, but also in part to the steady rise in the costs of the various services. In this latter connection, chart 11 shows that the costs of services and rents still have increased less since the pre-World War II period than have commodities.

Forces currently at work.—There are, of course, numerous demand and supply forces at the individual commodity and group levels which have not been discussed systematically in this review. The behavior of the overall indexes, however, makes certain factors abundantly clear. One of these is the especially strong demand for investment goods, which has raised the whole cost structure of the industries producing metal goods and nonmetallic structural minerals. Another is that the straining of capacity in some industries and areas tends to result in cost increases which then fan out into other industries and areas. Still another is that, when wages rise because of a variety of factors not connected with direct productivity gains, they are added into prices as businesses seek to protect their profit margin. In addition, there has been the special impact of the Suez situation upon a few commodities. Underlying all of these factors has been the continuing strong demands arising from our rising standard of living, our increasing population, and our expanding labor force.

So far as the immediate future is concerned, if the demand factors which gave rise to the price increases show no further strengthening—in other words, if investment demand flattens out and if consumer buying follows the income curve and consumer credit is expanded only moderately—there may well be more stability in the price situation. As of this time, signs of upward price pressures are still evident in those sectors of the economy where demand continues to burgeon; signs of price weakness are appearing only in those fields where demand is less urgent than it formerly was. In addition, there is no indication of any reversal of the long-run uptrend in the cost of services; the demand for personal and professional services is continually rising. At the same time, price declines in the agricultural sector are no longer offsetting increases elsewhere.

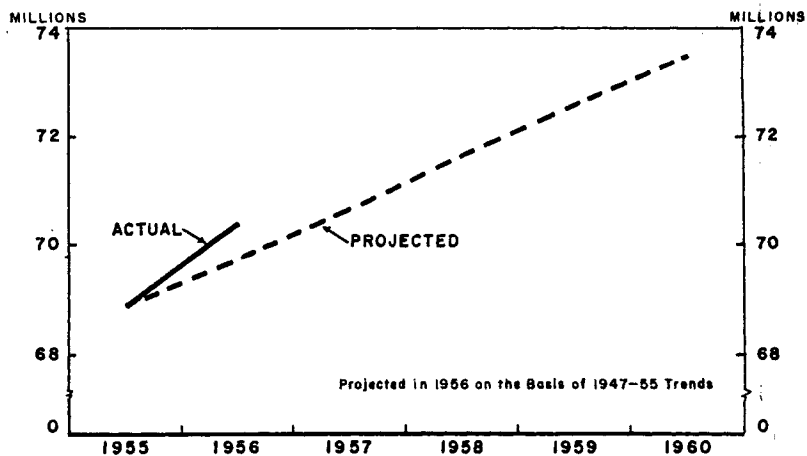
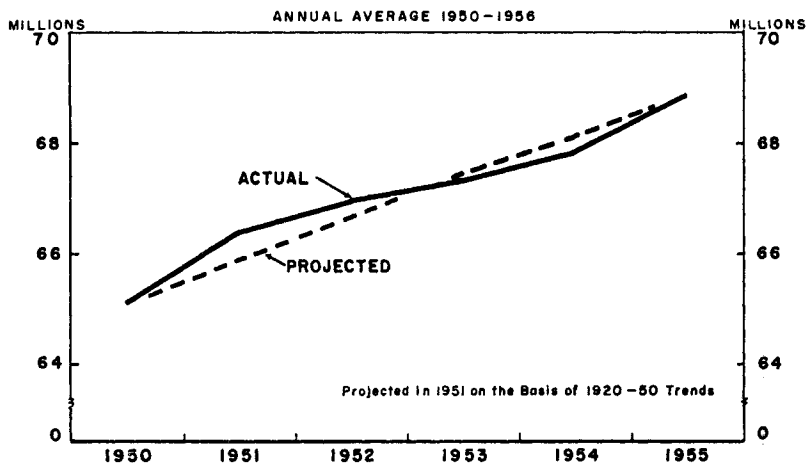
ANNUAL CHANGES IN TOTAL LABOR FORCE, BY Sex
 ACTUAL COMPARED WITH PROJECTED
 ANNUAL AVERAGE 1950-1956



UNITED STATES DEPARTMENT OF LABOR
 BUREAU OF LABOR STATISTICS

Source: U. S. Bureau of the Census;
 Bureau of Labor Statistics

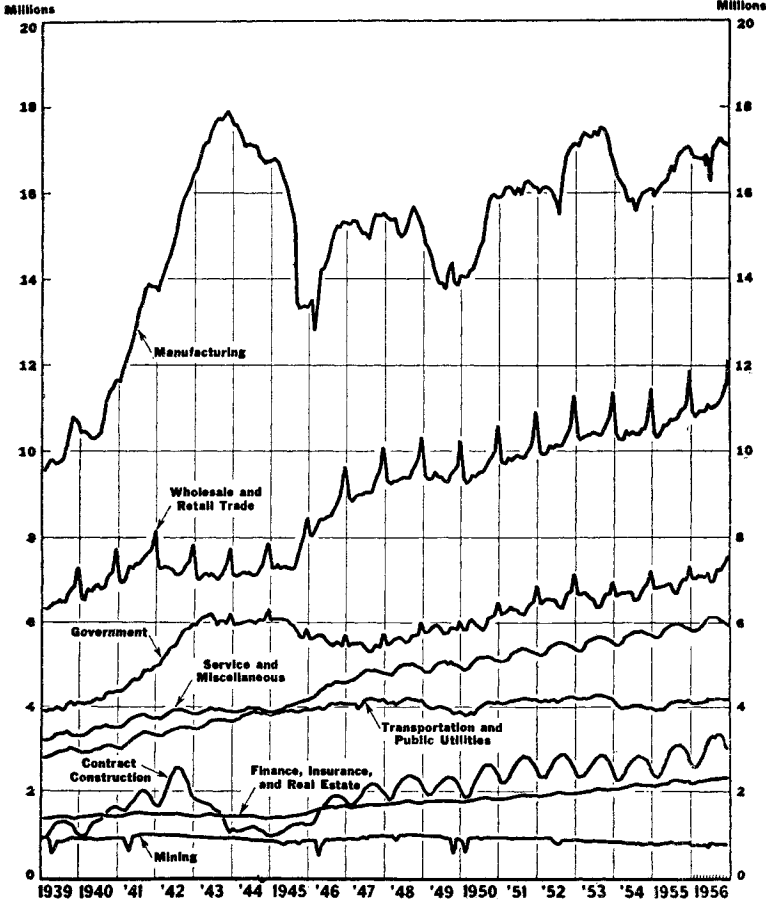
COMPARISON OF ACTUAL AND PROJECTED TOTAL LABOR FORCE



UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

Source: U.S. Bureau of the Census,
Bureau of Labor Statistics

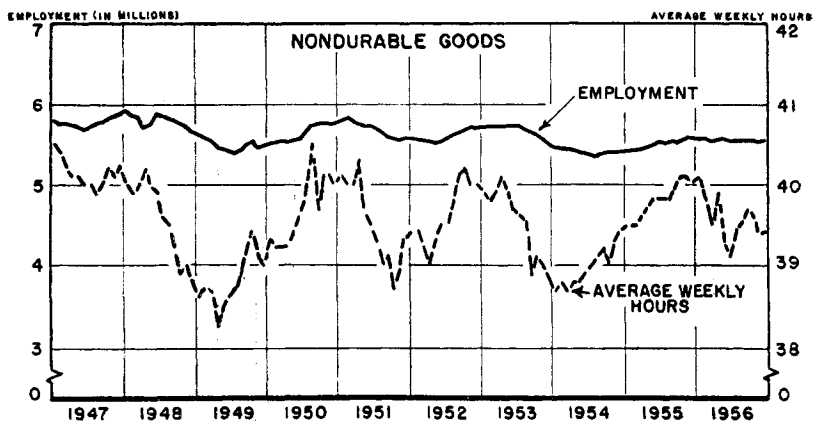
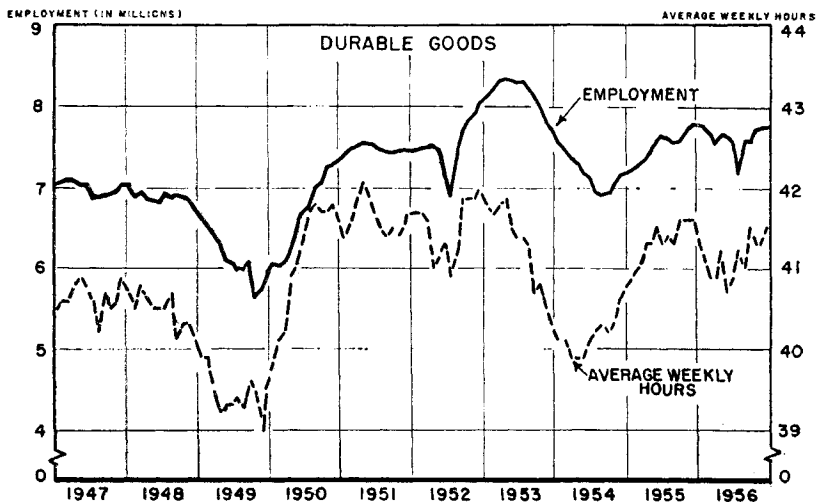
EMPLOYEES IN NONAGRICULTURAL ESTABLISHMENTS BY MAJOR INDUSTRY DIVISION



UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

LATEST DATA: DECEMBER 1956

EMPLOYMENT AND AVERAGE WEEKLY HOURS OF PRODUCTION WORKERS IN DURABLE AND NONDURABLE GOODS MANUFACTURING
 BY MONTHS, 1947-56
 (Adjusted for Seasonal Variation)



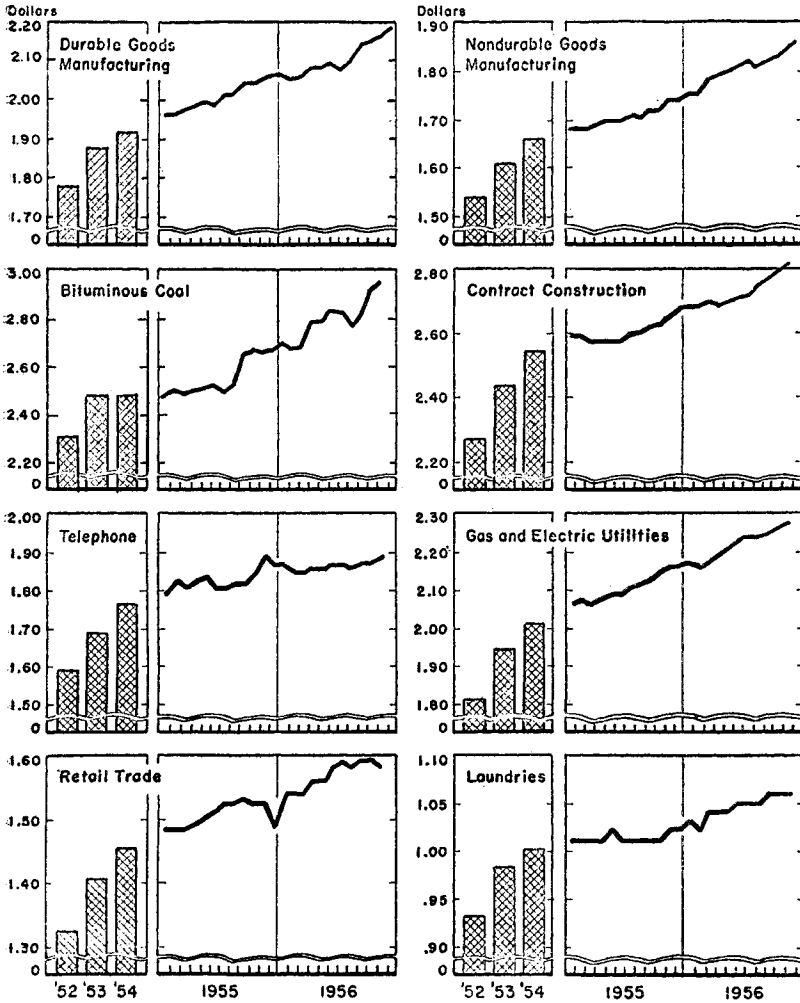
DATA FOR NOVEMBER AND DECEMBER 1956: PRELIMINARY
 NOTE: SEASONAL ADJUSTMENTS FOR AVERAGE WEEKLY HOURS ARE PRELIMINARY.

UNITED STATES DEPARTMENT OF LABOR
 BUREAU OF LABOR STATISTICS

Source: Bureau of Labor Statistics

AVERAGE HOURLY EARNINGS IN SELECTED INDUSTRIES

1952-54 Annually; 1955-56 Monthly

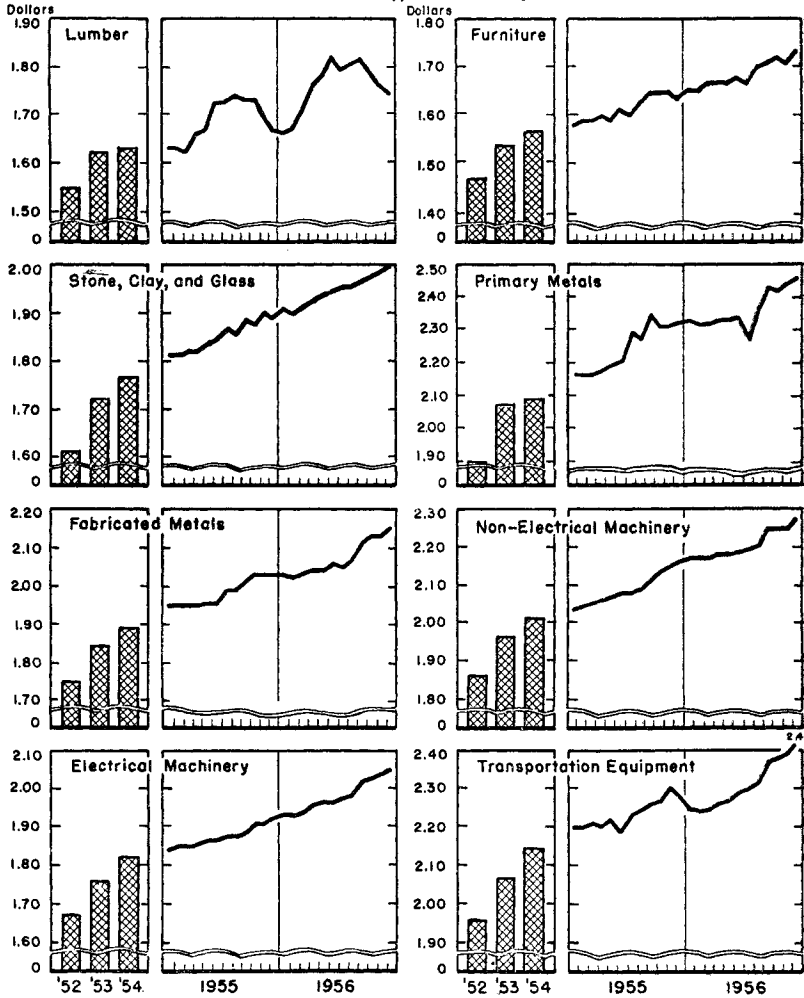


UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

LATEST DATA: MANUFACTURING - DECEMBER 1956
NONMANUFACTURING - NOVEMBER 1956

**AVERAGE HOURLY EARNINGS IN
SELECTED DURABLE GOODS INDUSTRIES**

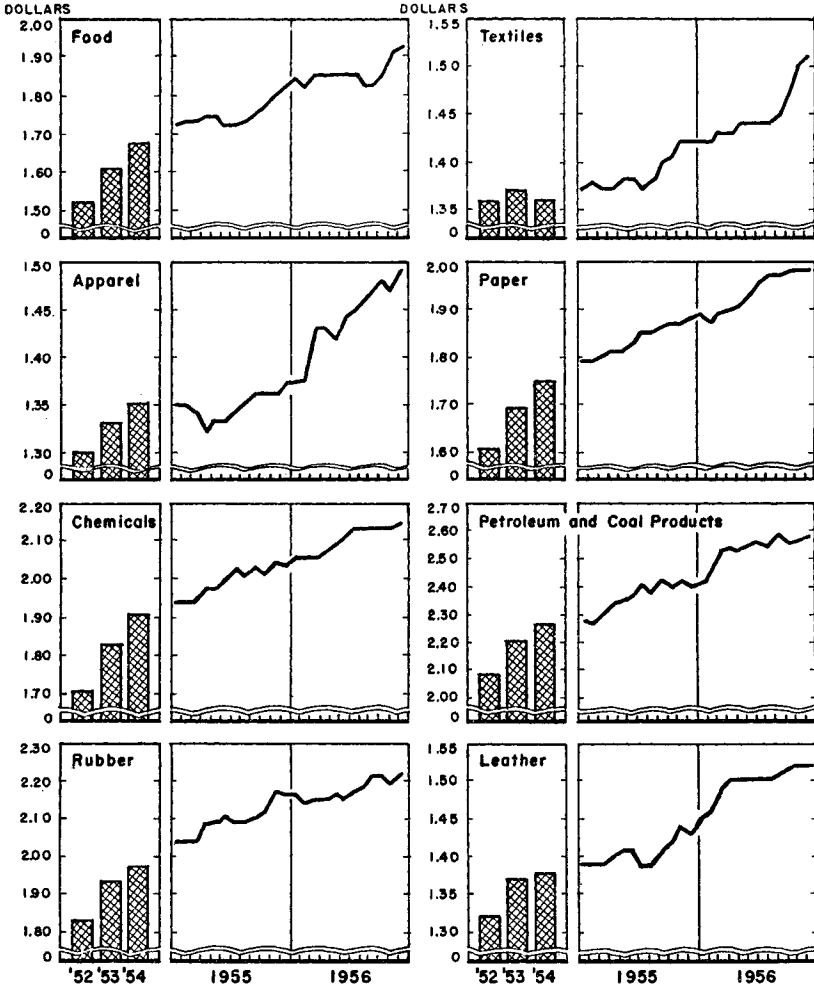
1952-54 Annually, 1955-56 Monthly



UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

LATEST DATA: DECEMBER 1956

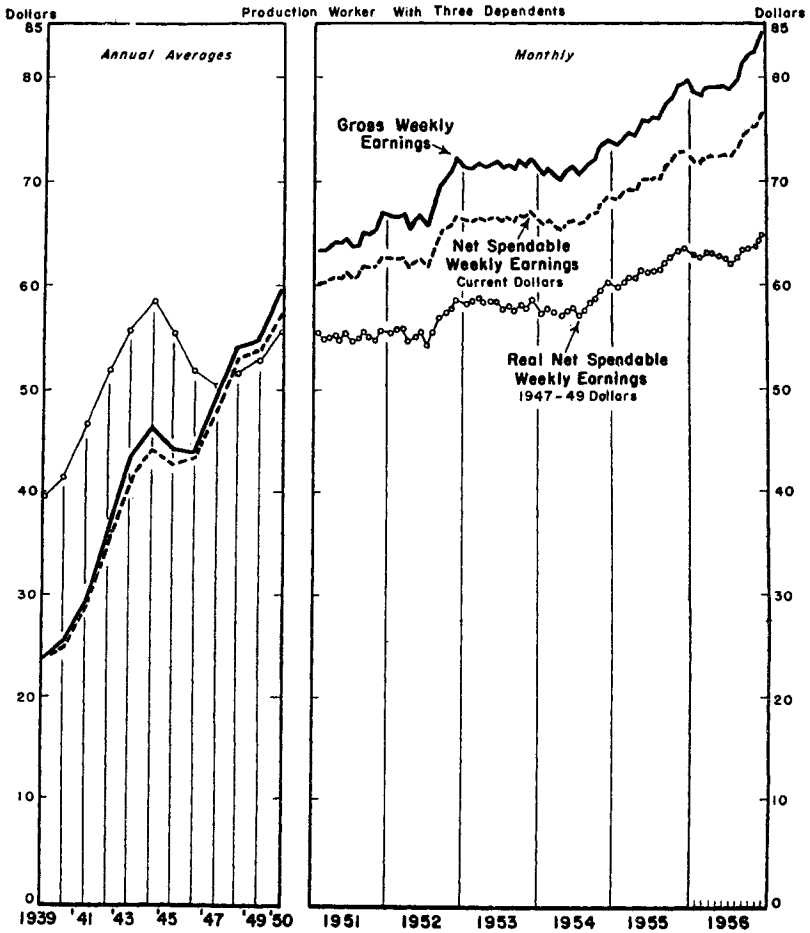
**AVERAGE HOURLY EARNINGS IN
SELECTED NONDURABLE GOODS INDUSTRIES**
1952-54 Annually; 1955-56 Monthly



UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

LATEST DATA: OCTOBER 1956

**FACTORY WEEKLY EARNINGS, GROSS AND NET SPENDABLE*
 COMPARED WITH REAL NET SPENDABLE EARNINGS
 EXPRESSED IN 1947-49 DOLLARS**

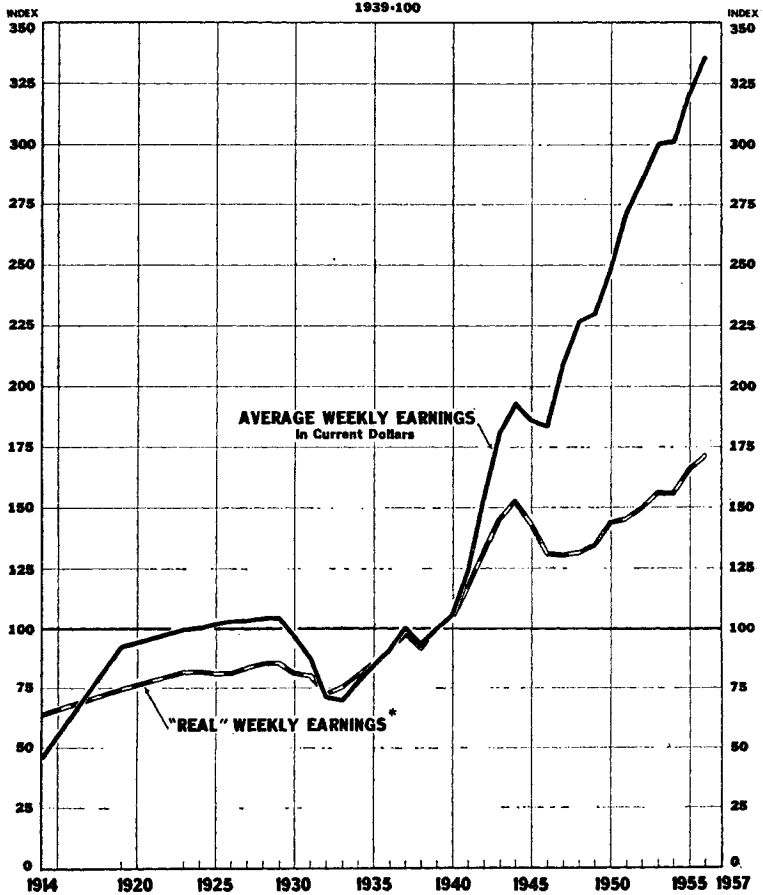


LATEST DATA: DECEMBER 1956

UNITED STATES DEPARTMENT OF LABOR
 BUREAU OF LABOR STATISTICS

* Earnings after deduction of Federal income and Social Security taxes

AVERAGE WEEKLY EARNINGS AND "REAL" WEEKLY EARNINGS IN MANUFACTURING

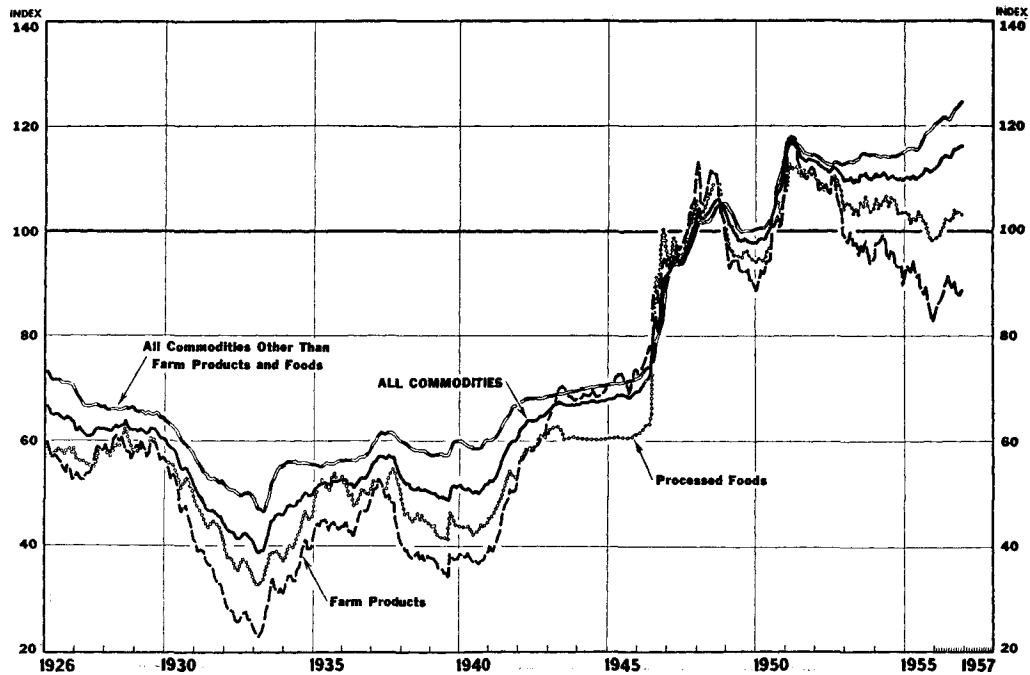


UNITED STATES DEPARTMENT OF LABOR
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* MONEY EARNINGS ADJUSTED FOR CHANGES IN COST OF LIVING

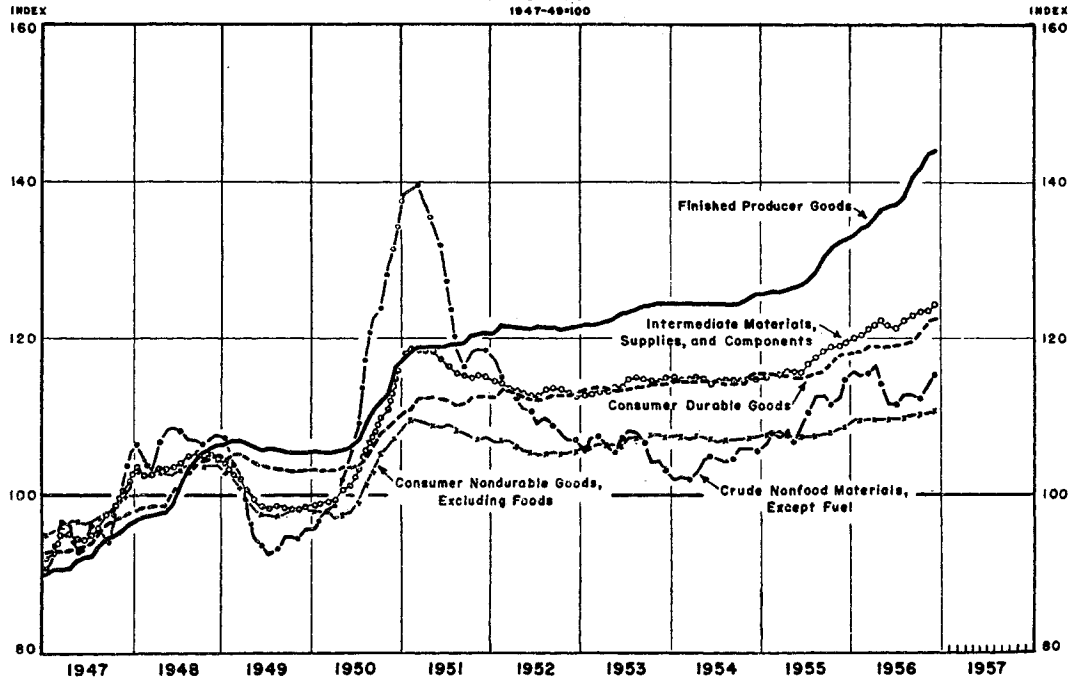
WHOLESALE PRICES

1947-49=100

UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

LATEST DATA: DECEMBER 1956

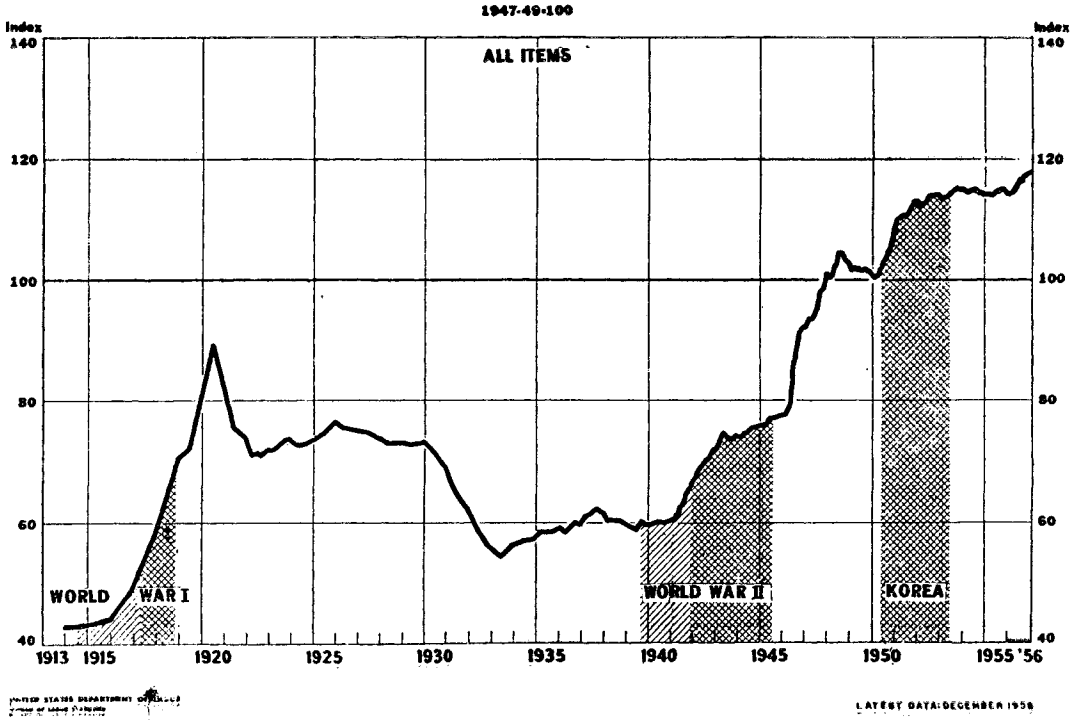
**WHOLESALE PRICE INDEX
ECONOMIC SECTOR INDEXES
SELECTED GROUPS
1947=100**



UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

LATEST DATA: DECEMBER 1956

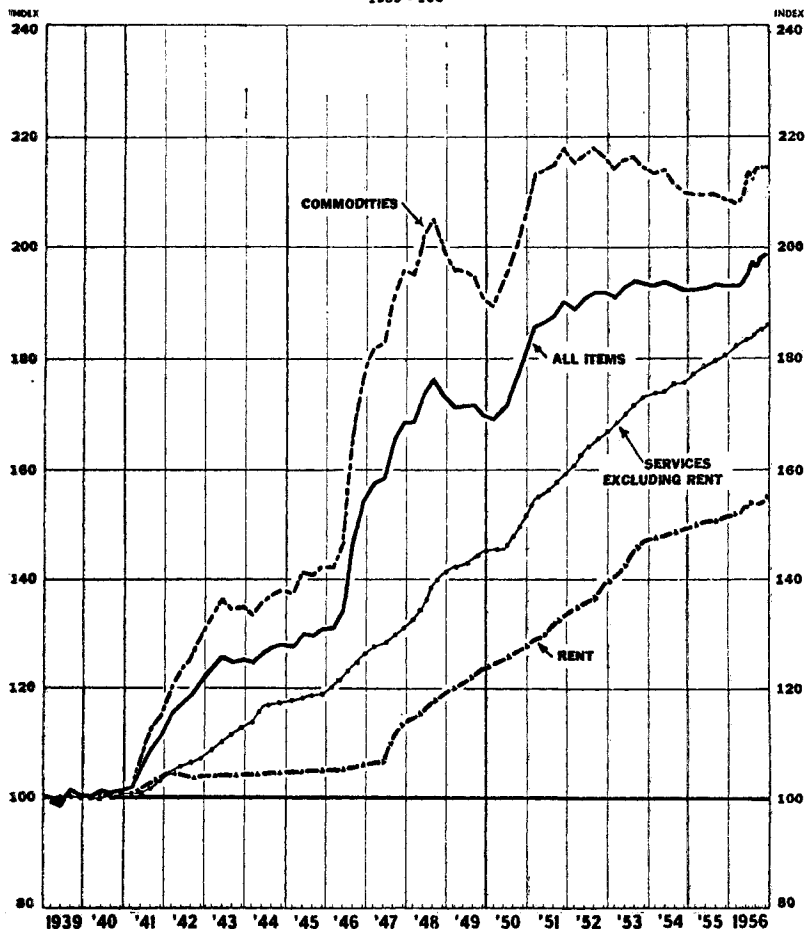
CONSUMER PRICE INDEX FOR WAGE-EARNER AND CLERICAL-WORKER FAMILIES IN U.S. CITIES



CONSUMER PRICE INDEX

SPECIAL GROUPINGS

1939 = 100



UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

LATEST DATA: DECEMBER 1956

The CHAIRMAN. Without objection, we will ask each one of our witnesses to proceed with his 8-minute statement, and in that way we will make sure that no one is slighted. If we were to stop now I am apprehensive that we would possibly take up too much of the time with one witness.

Mr. TALLE. May I make an explanatory statement? I must appear before the Rules Committee at 10:30. If that committee does not detain me long I will return before this morning's hearing is completed.

Chairman PATMAN. We understand your situation, and thank you, Dr. Talle.

Mr. Paradiso.

STATEMENT OF LOUIS J. PARADISO, ASSISTANT DIRECTOR, AND CHIEF STATISTICIAN, OFFICE OF BUSINESS ECONOMICS, DEPARTMENT OF COMMERCE

Mr. PARADISO. I am Louis J. Paradiso, Assistant Director, of the Office of Business Economics of the Department of Commerce. I have been asked to present a translation of the Government budgets into national income and product account basis.

I want to discuss first the Federal budget expenditures and their translation into the national income and product account.

In 1956 the total governments, Federal, State, and local, purchased goods and services which amounted to about one-fifth of the total production of all goods and services in the Nation. The Federal Government alone purchased goods and services amounting to about 11½ percent.

In order to get some idea as to what the Government take is likely to be of the total output of this country in 1957, it is necessary to translate the Government budgets into the national income and product account. Therefore it is this kind of a statement which I will try to present so that we may be able to get an idea as to what the Government's total take would be of the output of the Nation.

First, I will deal with the Federal Government, and it will be in connection with the purchases of goods and services. These purchases are derived by a rearrangement of the items given in the budget, eliminating expenditures which do not represent purchases of goods and services. These excluded items involving such major types of expenditures as transfer payments, grants-in-aid, and interest payments, are not part of our estimates of purchases of goods and services.

In the calendar year 1956, Federal purchases of goods and services amounted to \$47 billion. The rate of purchasing increased after the middle of the year to reach an annual rate of \$48.3 billion in the fourth quarter. The budget implies that in calendar year 1957 Government purchases of goods and services would be \$49.5 billion or \$2.5 billion more than the total of calendar year 1956 and \$1 billion above the fourth quarter rate. Thus it is clear that the implication of the budget on Government purchases of goods and services is for a very modest increase from the fourth quarter 1956 rate.

Practically the entire 1957 rise in purchases of goods and services is in the items encompassed in the national security expenditures. In calendar 1956 these expenditures totaled \$41.6 billion and in the

fourth quarter of that year the rate was \$43 billion. The budget programs call for an estimate of national-security purchases of over \$44 billion in calendar year 1957. Other purchases are expected to show relatively small changes.

Now, with respect to the total Federal expenditures, here again I am talking about these expenditures in relation to the national income and product accounts. If we add the other type of expenditures to purchases of goods and services, the result represents the total expenditures of the Federal Government on the basis of these accounts. These expenditures by the way closely approximate those in the cash budget except for certain conceptual adjustments involving mainly capital transactions and all loans except those related to CCC operations.

Total Federal expenditures on the income and product account in the fiscal year 1956 were \$70 billion. In fiscal year 1957, they are estimated at nearly \$75 billion. In fiscal year 1958, the estimate is close to \$80 billion. These compare for the respective fiscal years with cash budget expenditures of \$72.5 billion in fiscal year 1956, and \$78 billion in fiscal 1957, and nearly \$83 billion in fiscal year 1958.

Now let us move over to the Federal receipts, and here again we go through a translation of these receipts into the national income and product basis. These are estimated on the basis of the budget presentation which implied a personal income of \$340 billion in calendar year 1957 compared with an estimated total of \$325 billion in calendar year 1956 and a rate of \$333 billion in the fourth quarter of 1956. Also implied in these receipts is the fact that corporate profits before taxes were assumed at \$44 billion in calendar 1957, compared with about \$43 billion in calendar 1956.

On the income and product basis, Federal receipts amounted to \$75.5 billion in fiscal year 1956. They are estimated at a little over \$80 billion in fiscal 1957, and \$84 billion in fiscal year 1958. These receipts also approximate those on a cash budget basis.

The main difference between the two sets of accounts is that on the income and product account, corporate taxes are included on a liability basis rather than on a collection basis as is done in estimating cash receipts. The major source of increase in the receipts in the current and next fiscal years is expected to arise from personal taxes. Smaller advances are expected in indirect business taxes and in contributions for social insurance. Thus to summarize, on an income and product account, a surplus of \$5.5 billion is estimated for fiscal year 1957 and nearly \$4.5 billion in fiscal year 1958. These may be compared with a surplus of almost \$5.5 billion in the past fiscal year, namely 1956. These surpluses are somewhat higher than the corresponding surpluses on a cash basis and substantially above those on the administrative budget basis.

Now, let me turn to the State and local governments and just a word on the expectations of these bodies.

For State and local governments we had data developed through fiscal year 1957. Basing the estimates for calendar year 1957 on the data for the fiscal year and the recent trends, we have the following results:

(1) Purchases of goods and services by all State and local governments have been rising at a fairly constant rate in the past few years.

In calendar 1956 they amounted to \$32.8 billion and we estimate that in calendar 1957 they will total about \$35.5 billion, namely about \$2.7 billion more than last year.

The increase will be about equally divided between expenditures for construction activity and for employee compensation.

(2) For other expenditures, such as transfer payments and net interest paid, not much change is expected from current rates. In calendar 1956 total expenditures on an income and product basis amounted to \$35.3 billion. We are estimating that in calendar 1957, these will amount to \$38 billion.

(3) The receipts of State and local governments on an income and product basis amounted to \$33.6 billion in calendar year 1956. As with the Federal receipts, the major adjustment from the cash receipts is placing corporate profit taxes on an accrual basis instead of a collections basis. In calendar 1957, the total receipts of State and local governments are estimated at about \$36 billion.

These estimates imply a deficit in calendar 1957 for State and local governments on income and product account of slightly more than the deficit in calendar 1956, which was about \$1.5 billion.

Finally, I want to make a few comments with respect to the recent trend of prices.

A record output of goods and services in 1956 lifted the value of the gross national product to \$412 billion, more than \$21 billion, or 5½ percent above 1955. In the last half of 1956, the rise in business activity accelerated, resulting in an increase in the gross national product to a seasonably adjusted rate of \$424 billion in the fourth quarter. About half of the 1956 increase in the gross national product reflected higher prices so that the gain in real output amounted to slightly more than 2½ percent.

The composite of gross national product prices reflects price movements in relative proportion to the gross national product expenditure groups and therefore is heavily weighted by consumer price changes. Following 3 years of relative stability, this composite price increased nearly 3 percent last year. Consumer prices which have been stable since early 1953 increased beginning in April of last year and by December of 1956 had risen nearly 3 percent above a year earlier. All major components contributed to this advance. The rise in consumer prices in the latter part of 1956 was moderated to a degree by relative stability in the prices of food products. Wholesale prices in December of last year were 4 percent above a year earlier, following a fairly steady rise throughout 1956. There was substantial variation, however, in the relative pressure on different components during the year.

Wholesale farm and food prices rose rather sharply in the first 6 months of 1956, and thereafter either stabilized or tended downward. Industrial prices tended to rise somewhat faster in the latter part of 1956. An important factor in these increases was the general strong demand for goods which persisted throughout the year, and advances in the cost of production.

Thank you.

(Letter from Department of Commerce, Office of Business Economics, dated January 18, 1957, to chairman, Joint Economic Committee, follows:)

DEPARTMENT OF COMMERCE,
OFFICE OF BUSINESS ECONOMICS,
Washington, D. C., January 18, 1957.

Hon. PAUL H. DOUGLAS,
Chairman, Joint Economic Committee,
United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: The enclosed table showing Federal Government receipts and expenditures is furnished in accordance with the letter of January 16 by the Secretary of Commerce in reply to your letter of January 7.

The table shows three measures of the budget. The top two are the administrative and cash budgets, taken directly from the budget of the United States Government for the Fiscal Year ending June 30, 1958. The last measure represents a translation of receipts and expenditures given in the budget to the national income and product account basis.

In accordance with your request for State and local government receipts and expenditures, the Governments Division of the Bureau of the Census has provided data which indicate the following on a national income and product basis: for fiscal year 1956, receipts of \$32.5 billion and expenditures of \$33.7 billion; for fiscal year 1957, receipts of \$35.2 billion and expenditures of \$36.3 billion.

The amount of detail furnished has been worked out in consultation by technicians of our staff with Mr. Knowles.

If we can be of further help to you, please let us know.

Sincerely yours,

M. JOSEPH MEEHAN, Director.

Federal Government receipts and expenditures: Administrative budget, cash budget, and national income and product account: 1956-58

[Billions of dollars]

	Fiscal years		
	Actual 1956	Estimated	
		1957	1958
Administrative budget:			
Receipts.....	68.1	70.6	73.6
Expenditures.....	66.5	68.9	71.8
Surplus.....	1.6	1.7	1.8
Cash budget:			
Receipts.....	77.1	81.7	85.9
Expenditures.....	72.6	78.2	82.9
Surplus.....	4.5	3.5	3.0
National income and product account:			
Receipts.....	75.4	80.3	84.0
Expenditures.....	70.0	74.8	79.7
Surplus.....	5.4	5.5	4.3

Source: Administrative and cash budgets from the Budget of the United States Government for the Fiscal Year Ending June 30, 1958; national income and product account data from the U. S. Department of Commerce, Office of Business Economics, statistics for 1957 and 1958 based on estimates in the budget, U. S. Department of Commerce, Office of Business Economics, Jan. 18, 1957.

Chairman PATMAN. Thank you, sir.

Next we have Mr. Martin Gainsbrugh, chief economist of the National Industrial Conference Board.

STATEMENT OF MARTIN R. GAINSBROUGH, CHIEF ECONOMIST OF THE NATIONAL INDUSTRIAL CONFERENCE BOARD

MR. GAINSBROUGH. I am Martin Gainsbrugh, chief economist of the National Industrial Conference Board, and I am honored to be back with you again for, I believe, the eighth time.

I have a long statement, but I would like to concentrate my oral comments on possibly the most controversial aspect of the outlook for 1957; namely, the trend for private business investment. I have some additional comments on residential construction, inventories, and net foreign investment in my full statement which is submitted for the record.

To give you my conclusions first—particularly in the light of the uncertainties of the opening weeks of 1957—the outlook for business spending for plant and equipment for 1957 is good. At least this is how all three existing barometers of private capital formation now read in early 1957. These three barometers are the Department of Commerce and the SEC survey of expected capital expenditures for the first quarter of 1957, the McGraw-Hill survey of expected capital expenditures for the full year of 1957, and the latest innovation touched off by the research of your own task forces several years ago, the newly initiated National Industrial Conference Board's quarterly survey of capital appropriations for the 1,000 largest manufacturing companies. All three surveys point in one direction: A good year for plant and equipment.

In the current quarter, private industry expects to spend some \$38 billion for plant and equipment, a new high. This is indicated on page 10 of your Economic Indicators if you would like to look at that series.

In view of the rapid advance in such spending during 1956, we are already at a higher level than the average of last year, which was only \$35 billion. The first quarter rate this year is \$38 billion. The current quarterly average for all industry is 8 percent above the 1956 rate. In manufacturing, the current quarter is 9 percent above last year's average; in public utilities 13 percent, and in railroads, 23 percent. Almost all along the line American business is now spending record amounts in adding to, replacing, and modernizing their plant and equipment.

The McGraw-Hill survey furthermore suggests that these dollar amounts may be exceeded—though modestly—later during the year. As compared with the 8-percent gain over 1956, already experienced in the first quarter, business plans to increase its spending for the year as a whole by some 11 percent.

It is important to see this in perspective.

In 1956, however, capital outlays rose by 22 percent above the 1955 rate. Thus, even the 11-percent figure signifies a tendency toward a levelling out of capital expenditures, at a record rate.

An immediate area of concern in early 1957—and that may be too strong a word since I do not mean to be too alarming about the year as a whole—relates to capital expenditures by durables manufacturing companies. These expenditures in the current quarter are expected to be below the fourth-quarter rate, the first such decline in the past 2 years.

Each of the three surveys on capital spending serves a distinct and significant purpose. First, the Commerce-SEC survey obtains the initial estimate of business programs from 5 to 6 weeks before the quarter actually begins. These are the figures I was quoting above, in discussing the first quarter of 1957. At this stage of business planning, most of the decisions have been made, so that the expenditures can reasonably be expected to be met. I believe they will be.

Secondly, the McGraw-Hill survey, which provides the earliest available annual expectations data, is a compilation of business plans. Some of these may already have been formalized in annual capital budgets; some may be close to such formularization; and some may be of a more speculative nature.

The conference board's new quarterly series on capital appropriations represents a translation of these annual capital budgets. Each specific project has to be approved by top management before the company can place the order and start to spend. Our survey sponsored by Newsweek magazine covers only manufacturing companies, by the way. It indicated a broad upsurge in capital appropriation approvals in the first half of 1956, portending a rise in capital outlays this year. Backlogs of approved appropriations also rose. However, in the third quarter, the durables manufacturing companies indicated a decline in new appropriation approvals; the soft-goods sector continued to post gains. That is the first such decline in our series, which spans 2 years.

It was this decline that raised some question in our mind several months ago, whether during the second half of 1957 capital spending by the durables group might not be facing a reversal in trend. Since then, the first signs of this reversal, very faint to be sure and subject to revision, have already shown up in the governmental estimates of first quarter spending rate.

At the present time, we are engaged in processing our returns for the fourth quarter. Based on replies from only a handful, and of these mostly the smaller and medium sized companies in our group, there has been a rise in new appropriation approvals from the third to the fourth quarter, but probably of no more than seasonal dimensions. There usually is an increase in appropriations from the third to fourth quarter. From all indications it would appear that the fourth-quarter data will support the barometric readings of the third: a plateau or decline in the appropriations process viewed seasonally.

The conference board's survey thus ties in by and large with the other surveys. Capital outlays by manufacturing industry may level off at a high rate later this year. But that is only 43 percent of all capital outlays. Such nonmanufacturing sectors as public utilities and communications are still planning significant hikes in capital outlay.

Translating these surveys of business plans for 1957 into the gross national product account, it would appear that for the year as a whole producers' durable equipment and nonresidential construction outlay in 1957 would be somewhat above (\$1 billion to \$2 billion) the fourth-quarter rate.

Generally overlooked in the discussion of rising prices during the past year has been the advance of plant and equipment prices. This is no surprise in the face of the surging demands by business for plant and equipment. Apparently, it is a fact of life for businessmen too. They report in the McGraw-Hill survey that they expect to pay 6 percent higher prices this year than last. Since the fourth-quarter average of capital goods prices is already considerably above the annual average, it would appear that business expects these prices to continue to rise, but at a much slower rate. As the Economic Report indicates on page 32, the prices of producers equipment in December of 1956 were already 13 percent above mid-1955.

On balance, it would appear that very little if any of the modest rise expected in 1957 for capital outlays above the present rates will represent a gain in volume. For purposes of appraising 1957 as a whole, I believe the most practical assumption for the capital goods sector is a continuation of the current level of physical activity.

On the basis of the available foreshadowing statistics, little or no improvement in residential home construction can be expected in 1957. Housing starts, FHA applications, VA-appraisal requests, mortgage recordings, and contract awards were weaker in the second half of 1956 than in the first, and this slippage will apparently be reflected in new residential spending at least until June of this year.

Housing starts were running at about a 1,135,000 annual rate—seasonally adjusted—in the first 6 months of 1956. In the last 6 months starts were down to a 1,060,000 rate. The number of mortgage recordings of \$20,000 or less was 7 percent behind 1955 in the first 6 months of last year. In the 5 months through November, the decline was 9 percent.

Contract awards for new residential construction for 37 States east of the Rockies, as reported by F. W. Dodge, show an even sharper drop. Dollar award figures for the last 6 months of 1956 were 13 percent behind the volume recorded in the same months of 1955.

The annual joint Bureau of Labor Statistics-Department of Commerce forecast of construction activity calls for 5 percent less dollar spending in home building in 1957 than in 1956, but assumes about 9 percent fewer homes will be built. Dollar spending has fallen less than the number of starts since 1955 because more houses built to sell for over \$10,000 are going up. The average proposed selling price of a 1-family house rose about \$800 in 1956. This trend is expected to carry over into 1957. All of this suggests about 1 million homes in 1957. Some private forecasters would put the figure higher—something over 1.1 million. Some home builders, however, are talking of a figure as low as 850,000 for 1957. It is the consensus in the building trade that the precise level of housing starts in 1957 will depend substantially on conditions in the mortgage market.

There are no serious material shortages in sight. Home builders were able to erect 1.3 million units as recently as 1955. Despite the 12 million new housing units erected since 1945, builders feel the need and desire for new housing is far from satiated. The essence is that the outlook is for a lower level of housing starts for 1957 from 1956.

In the fourth quarter of 1956, the physical volume of business inventories rose, for the eighth successive quarter. Net additions to inventory in 1956 amounted to about \$3.5 billion—significantly above a rate that could be considered normal secular growth. Because of rising prices, the book value of business inventories evidently rose between \$6 billion and \$7 billion.

Operating rates and sales volume in most industries have also risen, relative to a year ago, and it is apparently agreed by most analysts that the current level of inventory-sales ratios, while ample, is not excessive. Inventory growth in 1956 was substantial, but it was well proportioned to need: a large part of the total additions to inventory book values occurred in those industries where orders and backlogs were rising sharply.

The condition of inventory statistics at the end of 1956 was certainly not alarming. However, there appears to be good reason to think that the present rate of accumulation—which amounts to perhaps over \$4 billion on a gross national product basis, and about \$8 billion in terms of book value—is likely to dwindle by midyear. And there remains the somewhat less pleasant possibility that if accumulation continues at its present rate for the next two quarters a certain amount of liquidation may occur late in 1957.

The reasons for expecting at least some decline in the present rate of inventory accumulation are—

(1) Considerably lower liquidity on the part of corporations, and relatively high borrowing costs, both of which are dissuading business from substantial further net investment in inventory;

(2) The fact that in capital goods industries, where a substantial part of recent accumulation has occurred, the rate of ordering is evidently slowing down, reducing the requirements for forward inventory coverage; and

(3) Growing capacity in most industries is progressively eliminating the supply uncertainties which provided some of the incentive for accumulation in late 1955 and 1956.

Surveys of expectations with respect to inventory policy contain a rather wide margin of error, for the obvious reason that inventory policy itself is volatile. However, a survey of over 200 industrial companies conducted by the conference board in late 1956 found that while in 1956 about 70 percent of the companies increased dollar inventories, and about 15 percent reduced their dollar inventories, only 40 percent expect to continue to increase inventories in the first half of 1957, while 30 percent expect a reduction. Granting the difficulties of expectations data in this area, I believe these percentages correctly reflect a declining interest, on the part of business, in further inventory investment. The inventory outlook for all of 1957 seems to point to a moderately higher book value at the end of the year, but no appreciable change in physical level, and hence something approaching zero in the gross national product inventory component.

A continuation of the increase in net foreign investment is likely in 1957. The past year saw net foreign investment reach \$1.1 billion (this excludes economic and military aid shipments, which do not give rise to foreign investment as usually defined in our national accounts), the first time since 1951 that the net foreign investment of the United States has been positive. Probably developments in 1957 make it appear unlikely that a like increase will take place in this year, but it does seem likely that foreign investment will continue to increase substantially.

The National Foreign Trade Council balance of payments group (consisting of a large and representative number of individuals serving generally in the role of economists with manufacturers, exporters, importers, banks, transportation companies, and other concerns directly engaged in international trade and investment) expects that net foreign investment will come to about \$2.2 billion in 1957, about double the 1956 rate, but the increase is still below that which took place in 1956.

Their expectation is for commercial merchandise exports, the largest component of the current account, to be \$18 billion in 1957 against

\$17 billion last year. The latter figure represents nearly a 20-percent increase over 1955.

Imports, according to the NFTC, will approximate \$13 billion, up only \$300 million from 1956. The rise in imports has evidently slowed down, since the increase from 1955 to 1956 was \$1.2 billion.

Among the factors that are expected to lead to this situation are the following:

First, there is the general broad expectation that business activity within the United States will continue on a high plane. The closeness of high business activity and high imports has been established and will continue.

Second, the unsettled situation in the Middle East will tend to make Europe turn to the Western Hemisphere for its supply of fuel. Coal exports are already high and can be expected to remain high or actually increase as a result of Europe's needs. Europe will have to turn to the United States and Venezuela to meet its petroleum needs as long as operations and transportation from the Middle East are disrupted.

Third, there may be a need for increased imports of other goods, particularly consumer goods, from the United States. Some slowdown of industrial activity in Western Europe is already reported. At present, the letdown has been mainly in private investment, but should the crisis continue, a twofold impact may be felt in the consumer-goods field. The shortage of fuel may operate directly to cut consumer-goods output immediately. Should private investment be curtailed for any substantial period of time, an indirect effect may emerge in the inability of industry to meet the growth in consumer demand.

Fourth, the large gold and dollar balances of foreign countries, particularly continental European countries, puts them in a position to increase their purchases from the United States immediately without having to export immediately in order to pay for the imports. Continental OEEC countries have more than doubled their gold and dollar holdings since 1950.

The United Kingdom has not experienced a similar growth, but it has recently arranged with the International Monetary Fund to draw on its full quota of \$1.3 billion if needed.

A fifth consideration is the extent to which price increases will affect the value of our imports and consequently necessitate our spending more to meet our needs. Some price increases are already evident, and more can be expected. A related question is the extent to which internal prices will rise in the United States and consequently contribute to our attractiveness as a market for imports.

United States exports and imports of goods and services and net foreign investments, 1952-57

[Billions of dollars]

	1952	1953	1954	1955	1956	1957 (estimate)
Export surplus of goods and services ¹	2.4	0.4	1.8	2.0	3.4	4.7
Total unilateral transfers, except military.....	2.5	2.5	2.3	2.5	2.3	2.5
Net foreign investment.....	-1	-2.0	-4	-5	1.1	2.2

¹ Excluding transfers under military aid program.

Sources: Council of Economic Advisers; National Foreign Trade Council.

My final comments are devoted to financial aspects which underlie the picture for private business investment.

Turning next to financial aspects of these investment possibilities, the basic issue here is the level of liquidity. In 1956 the record outlays for plant and equipment and the largest boost to inventory book values experienced during the past 5 years combined to bring considerable pressure on business financing. As a partial offset to these pressures depreciation allowances increased sizably, continuing the postwar trend; lending increased, as did the volume of security issues. Retained earnings were down somewhat significantly. The biggest change, however, was the decline in cash and United States Governments. In other words, the pressure was relieved by a decline in corporate liquidity. This provided a safety valve for business investments in 1956. Retained earnings were down significantly. That is the key point. There was a decline of some \$5 billion in cash and United States Government holdings. The figures are in the Economic Report.

As already indicated, the presently available surveys suggest that 1957 plant and equipment outlays will be up considerably less this year than in 1956. The rise in inventories, too, should be somewhat less than it was last year.

The demand for funds in 1957, therefore, should not rise as much as in 1956. In fact, it is conceivable that the use of funds for capital and inventory purposes combined may be no higher in 1957 than in 1956.

On the other hand, depreciation allowances will undoubtedly increase as much, if not more than, in the previous year, while corporate profits available for internal use may be about the same as in 1956.

The leveling of capital outlays, together with a diminution in the rate of inventory buildup, could make financing problems less acute in 1957 than in 1956. This may even serve to bring to a halt the decline in corporate liquidity.

It is worth emphasizing, however, that the attainment of the 1956 rate of capital outlay was largely possible as a consequence of this lessened liquidity. In fact, the current leveling off of plant and equipment and the liquidity decline may well be associated.

Finally a word about profit margins. They are now narrowing. This may mean that even after assuming a higher average level of activity in 1957, corporate profit totals may well be around 1956 average level. They have been steadily narrowing throughout 1956. Profits were not responsible for the bulge in prices in 1956. If this narrowing of profit margins is continued, it could have a significant impact on future plant and equipment outlays. It is in this area that we find the key problem of 1957: the direction of trend in business investment in the closing half of this year.

In summary, I view business investment as a strong sustaining force throughout the year, mildly expansionary in the opening months, but not the explosive force in 1957 that it was in 1956.

Chairman PATMAN. Thank you very kindly, sir.

Now, Mr. George Katona, program director of the survey research center of the University of Michigan.

STATEMENT OF GEORGE KATONA, DIRECTOR OF ECONOMIC PROGRAM, SURVEY RESEARCH CENTER, AND PROFESSOR OF ECONOMICS AND OF PSYCHOLOGY, UNIVERSITY OF MICHIGAN

Mr. KATONA. I am George Katona, from the University of Michigan.

Large consumer purchases will help make 1957 a good year. It appears probable that in 1957 consumers will devote a slightly higher proportion of their income than in 1956 to discretionary expenditures, especially to purchases of durable goods. Yet the consumer outlook is not without some soft spots. Those who expect that consumers will provide a substantial new impetus to the economy are likely to be disappointed.

For the past 10 years the survey research center of the University of Michigan has been conducting nationwide sample interview surveys in which particular attention has been given to the study of the psychological factors influencing consumer spending and saving. Consumer spending depends both on ability to buy and on willingness to buy. Little need be said at present about consumers' ability to buy: incomes and liquid reserves are growing at a slow rate and consumer debt, for most people, is not unduly burdensome. Therefore, I shall turn to an analysis of consumer sentiment which greatly influences the short-range prospects. My remarks are based on the results of a survey completed in December 1956.

The American consumer is satisfied with his financial situation and confident regarding the future. A slight deterioration in consumer sentiment which occurred early in 1956 has now been halted. People's satisfaction with their financial welfare is maintained close to peak levels, and favorable expectations about personal finances continue to far outweigh pessimistic expectations. Confidence that good times lie ahead for the Nation's economy during the next year, as well as during the next several years, is as widespread today as at any time during the postwar period.

Signs that consumer inclinations to buy are improving may be found primarily in expressed buying intentions. Plans to buy new cars are substantially more frequent than they have been earlier in 1956, before the introduction of the new models. However, they remain well below the very high level attained in the fall of 1954. Intentions to buy used cars are at a peak for the 1954-56 period. That probably is an effect of price increases. Intentions to buy homes have increased in frequency in recent months. They now compare favorably with house-buying plans expressed at other times during the past 2 years. However, there are indications that some people who expressed house-buying plans this November and December may have been unaware of the present credit stringency and may be forced to postpone their plans. Plans to make home improvement or repairs are unchanged from a year ago. Plans to buy major household goods give little or no indication of recovery from their earlier decline.

Yet consumer attitudes and buying plans are not as buoyant as in late 1954 and in 1955. At that time optimism was growing rapidly. Since then people's expectations about their own welfare and national business conditions have been stable at a high level of satisfaction. The stimulus of growth in optimism has been lacking. During the last few months there was a further leveling off. The proportion of

families who said that their financial situation was the same as a year earlier and who expected no change was somewhat higher in December 1956 than it had been earlier in 1956 or in 1955.

Similarly regarding people's general economic outlook, no significant improvement has occurred during the last few months. The crisis in the Near East caused only a very slight increase in uncertainty. The results of the presidential election were most commonly viewed as having no effect on business conditions.

Another major reason for the lack of buoyancy in inclinations to spend lies in the price situation. Most people are aware of rising costs of living and consider price increases an unfavorable development. The feeling that good buys are available is much less common than 2 years ago. The belief that prices have risen and will rise in the future began to spread in the spring of 1955 and was still growing in summer 1956. Yet between August and December 1956, no further increase has occurred in the proportion of consumers who see an upward trend in the price level. As of now, concern with prices and fear of inflation have not reached the point at which they would either reduce discretionary spending substantially or impair people's desire and willingness to save.

People on the whole are intent on improving their standard of living. Needs as well as demand have been upgraded over the last 10 years. Even though today the American people own more and newer houses, automobiles, and other durable goods than ever before, they are not saturated and desire more and newer and better goods. At the same time, however, people are also anxious to accumulate liquid reserves, that is, to save. Despite the popularity of installment buying, the will to save and the importance attributed to saving have not declined. Many people feel that their reserve funds or savings are not large enough.

In 1956 liquid saving by consumers increased. (The present tight money is due primarily to demand rather than to supply factors.) The supply has grown but not proportionately to the increase in demand for money.

According to current indications we may expect that the rate of liquid saving will remain at least as high in 1957 as in 1956, while at the same time borrowing (installment buying) may increase.

We expect a better automobile year in the next 9 months than we had a year ago, and we expect that installment buying will likewise increase.

As you know, in the Federal savings statistics, borrowing is considered a negative saving, and therefore the prospects for total savings as published in the Federal statistics is for lesser savings. But we must separate the accumulation of liquid reserves, for instance in savings and loan shares which are now the most popular form of liquid savings in this country, from borrowing which has other functions.

If I may summarize my remarks, 1957 promises to be a good year for the consumer sector. But in contrast to 1954 and 1955, the consumer is not likely to lead. In 1955, the explosive factor was the consumer. In 1956, as Mr. Gainsbrugh just indicated, it was the capital expenditures of business. 1957, I believe, neither will provide a new stimulus. Thus we are in a leveling off situation, and consumers cannot be relied upon to swim contrary to trends.

In other words, should in some other sectors recession or a small decline originate, it is unlikely that the consumers would step in and change the direction in which the economy is moving.

Chairman PATMAN. Thank you very much.

We will now hear from Mr. Wells, Administrator of the Agricultural Marketing Service of the United States Department of Agriculture.

STATEMENT OF ORIS V. WELLS, ADMINISTRATOR OF THE AGRICULTURAL MARKETING SERVICE, DEPARTMENT OF AGRICULTURE

Mr. WELLS. Mr. Chairman, I am Oris V. Wells, Administrator of the Agricultural Marketing Service of the Department of Agriculture.

The first question on which I have been asked to concentrate is the outlook for farm production, prices, and income in 1957.

At our annual outlook conference held about 2 months ago, we concluded that prices received by farmers in 1957 should average some higher than in 1956, and that this would also be true of net income realized by farm operators. We expect that domestic demand for farm products will continue strong, that exports will hold at a high level, and that there will be some cut in farm marketings as a result of smaller hog production and the soil bank. Developments during the last 2 months have generally reinforced the appraisal made last fall.

We expect some further increase in economic activity and consumer incomes during 1957. Under these conditions, expenditures for food probably will increase at about the same rate as disposable consumer income. However, with the rising demand for services along with continuing increases in marketing costs, only part of the rise in food expenditures will be passed through to farm markets. Currently, farmers are receiving only about 40 cents out of the average dollar spent for food at retail.

The value of farm exports for 1955-56 fiscal year rose about 11 percent over the preceding year, even though cotton exports dropped to only 2.2 million bales. Meanwhile, exports have been moving out very rapidly since last June, with the total value for the last half of 1956 now estimated at about 39 percent above the last half of 1955. Wheat exports are up sharply, while sales of cotton by the Commodity Credit Corporation for export during the current marketing year total 6.3 million bales through January 8. We may have both a record volume and record value of farm exports in fiscal 1956-57.

The soil-bank program will be in full operation in 1957. Announced goals call for 20 to 25 million acres from basic crops to be placed in the acreage reserve, and about 20 million acres of cropland in the conservation reserve. This should reduce total crop production **this year unless yields are unusually high.**

The reduction in last fall's pig crop, together with the small cut in prospect for this spring are expected to hold hog slaughter below a year earlier through most of 1957.

The combined effects of the soil-bank program and the decline in hog numbers should mean some reduction in total farm output in 1957. However, the reduction in total farm marketings is not likely to be large. Crop rotation in 1956, part of which will be marketed

this year, was at a record level, and the production of poultry, eggs, and dairy is likely to increase further. In addition, record stocks of corn, wheat, cotton, and rice were on hand at the beginning of the 1956-57 marketing year. Increased exports are reducing stocks of wheat, cotton, and rice, but corn stocks are increasing as a result of last year's big crop.

In summary, some increase in average prices for 1957, together with payments under the soil-bank program, are likely to raise farm incomes above 1956, even though the volume of marketings may decline somewhat. We do not look for an increase in total expenses of farm production. Consequently, we expect the realized net income of farm operators to increase, perhaps about 5 percent. The 5-percent gain from 1955 to 1956 was the first since 1951.

The second question which I have been asked to concentrate on is the effect of farmers' spending in 1957 on new construction and farm machinery. We do not have data which will permit a very precise answer to this question, but I will try to summarize what we know.

The decline in farm income in recent years has had an impact on farm purchases from nonfarm industries. Nevertheless, farmers have attempted to maintain purchases of machinery, equipment, and other industrial goods. To some extent, this appears to have been accomplished by going further into debt. Total farm indebtedness, excluding CCC loans, increased by \$2½ billion in 1955 and 1956, to reach a total of about \$18 billion at the beginning of this year. However, this is not large compared to total farm assets estimated at \$176 billion as of January 1, 1957.

Farm production expenses reached a peak of almost \$22.5 billion in 1952. Although they have eased off slightly since then, the decline has been small compared with the drop in gross income. Largely in response to declining incomes, farm purchases of machinery and equipment in 1956 are estimated to be around 15 percent smaller than in 1955, and more than one-fourth below the heavy purchases in 1951. Farm construction outlays for 1956 were down about 3 percent from 1955, about one-sixth lower than in 1951.

The farm market for construction and new equipment represented around 13 to 15 percent of total business spending for new plant and equipment in 1950-52, but declined to something less than one-tenth in 1956. Farm expenditures for new equipment and construction are expected to increase slightly this year due primarily to the effects of higher farm income in both 1956 and 1957. Purchases of some other production items may be reduced as more acreage moves under the soil bank.

Mr. Chairman, I have supplied Mr. Ensley with a supplementary table on capital expenditures by farmers, which indicates a rough estimate of \$3,815,000 for 1956, and if I had to set down a specific figure for 1957, I would put it about \$4 billion.

In addition to these direct answers to the 2 questions, let me say that I always hesitate, even though I am a statistician, to simply cut a slice of 12 months of calendar time out of the farm business and say, "This is the farm outlook." So I would, if you will allow me, like to say a few words about some medium-run trends which have to be kept in mind looking at the farm picture. They affected farm income last year, they will affect farm income in 1957 and they will still be operating in 1958 and, I suspect, until about 1960.

(The chart referred to is as follows:)

Farm capital expenditures, 1939 and 1946-56

[Millions of dollars]

Year	Gross capital expenditures on:								All items
	Buildings ¹			Motor vehicles				Other machinery and equipment ⁴	
	Farm operators' dwellings	Service buildings and other structures ²	Total	Tractors	Trucks	Automobiles ³	Total		
1939	110	103	213	151	73	122	346	215	774
1946	409	621	1,030	241	216	104	561	444	2,035
1947	560	768	1,328	449	463	194	1,106	795	3,229
1948	712	885	1,597	661	535	307	1,503	1,159	4,259
1949	695	793	1,488	766	540	484	1,790	1,256	4,534
1950	750	857	1,607	715	542	432	1,689	1,242	4,538
1951	863	983	1,846	861	508	414	1,783	1,409	5,038
1952	885	1,006	1,891	718	472	263	1,453	1,315	4,659
1953	841	957	1,798	733	431	540	1,709	1,152	4,659
1954	769	876	1,645	621	463	393	1,477	1,172	4,294
1955	749	852	1,601	676	484	467	1,627	1,113	4,341
1956 ⁵			1,560	515	500	380	1,395	860	3,815

¹ Includes new construction, additions, and major improvements.² Includes fences, windmills, wells, and dwellings not occupied by the farm operator.³ For farm business use (40 percent of total farm purchases of automobiles, 50 percent in 1942-45).⁴ Excludes harness and saddlery and other minor types of equipment charged to current expense.⁵ Preliminary estimates based on incomplete information.

Source: The Farm Income Situation, July 1956.

Mr. WELLS. Following the Korean inflation, prices received by farmers entered a period of decline which extended to the latter part of 1955. Since then a gradual improvement has taken place, with the result that the index of prices received by farmers during the last 3 months of 1956 averaged 235 percent of the 1910-14 base, compared with 225 in the last 3 months of 1955. Meanwhile, prices and cost rates paid by farmers have continued to increase as evidenced by a parity ratio averaging 82 in the last quarter of 1956, compared with 81 a year earlier.

In other words, prices paid by farmers have been going up at almost the same rate as prices received by farmers.

Underlying trends in domestic demand have been favorable. Our population of about 168 million persons in 1956 was 15 percent higher than in 1947-49. This increase in the number of consumers has been augmented by continued increases in consumer incomes to new record levels. Although these increases in income have been accompanied by only relatively small increases in per capita purchases of farm food products, the rise of 4 percent in the index of average per capita food consumption from 1947-49 to 1956 has been a significant factor in the expansion of total domestic demand. When combined with the increase in the number of consumers, the result has been an increase of about one-fifth in total United States food consumption since 1947-49.

Recent trends in the exports of farm commodities have been favorable. After reaching a record level of \$4.1 billion in 1951-52, they dropped about one-third in the next fiscal year. Since then, total farm exports have increased steadily. The expansion in exports in

the current marketing year has been especially important for wheat, cotton, rice, and fats and oils. However, it needs to be emphasized that the recent expansion has been largely the result of Government programs, particularly those carried out under title I of Public Law 480.

There is in the President's Economic Report a most interesting chart which breaks total farm exports down into those financed by normal transactions and those financed by foreign currency and other transactions where the dollar currency really rises within our own Government.

We also need to bear in mind that the underlying trend in farm production is up, and that carryover stocks of many important farm commodities are still very large. Farm output in 1956 is currently estimated at 114 percent of the 1947-49 average, which is about equal to the population increase. It is comprised of a 6-percent increase in crops and a 23-percent increase in livestock and livestock products. Although the soil-bank program should help to check uneconomic expansion, advances in farm technology and increased mechanization also mean that farm-production expenditures will continue at a relatively high level.

I have a summary and three illustrated charts that I hope can also be included in the record.

Chairman PATMAN. Without objection, they may be included.

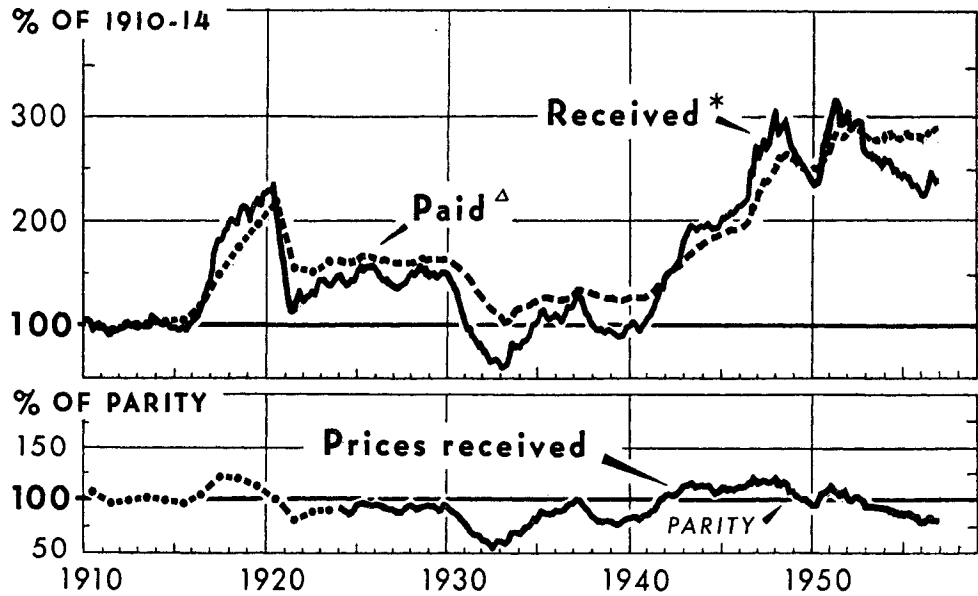
(The material referred to follows:)

Selected data relating to agriculture, United States, 1939 and 1946-56

Year	Prices received by farmers	Parity index	Parity ratio	Farm output			Food consumption per capita	Agricultural exports	Cash receipts from farm marketings ¹	Production expenses ¹	Net income of farm operators	
	Index numbers, 1910-14=100			Total	Livestock and products	Crops					Realized ¹	Total, including change in net inventories ¹
				Index numbers, 1947-49=100								
			<i>Percent</i>					<i>Millions</i>	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>
1939	95	123	77	80	85	82	94	\$655	\$7,872	\$6,162	\$4,394	\$4,489
1946	236	208	113	98	101	98	104	3,173	24,770	14,324	15,000	14,923
1947	276	240	115	95	100	93	102	3,957	29,664	16,831	17,191	15,458
1948	287	260	110	104	97	106	99	3,472	30,253	18,643	15,943	17,695
1949	250	251	100	101	103	101	99	3,578	27,864	17,909	13,673	12,866
1950	258	256	101	100	106	97	100	2,873	28,405	19,248	12,857	13,716
1951	302	282	107	103	111	99	98	4,040	32,909	22,258	14,802	16,111
1952	288	287	100	107	112	103	100	3,431	32,538	22,476	14,256	15,120
1953	258	279	92	108	114	103	102	2,847	31,169	21,246	13,880	13,263
1954	249	281	89	108	117	101	101	3,054	29,714	21,442	12,021	12,487
1955	236	281	84	113	121	106	103	3,195	29,264	21,599	11,340	11,680
1956	236	286	83	114	123	106	104	* 3,620	29,806	21,900	11,900	11,700
1955-4th quarter	225	279	81					894	28,900	21,300	11,200	11,400
1956-1st quarter	227	281	81					829	29,600	21,600	11,600	11,500
2d quarter	241	285	85					1,031	29,700	21,800	11,600	11,800
3d quarter	239	287	83						29,700	21,800	11,900	11,600
4th quarter	235	288	82						978	29,700	21,800	11,900
									30,200	22,300	12,500	12,400

¹ Quarterly data are seasonally adjusted annual rates.² 1st 11 months.

FARMERS' PRICES

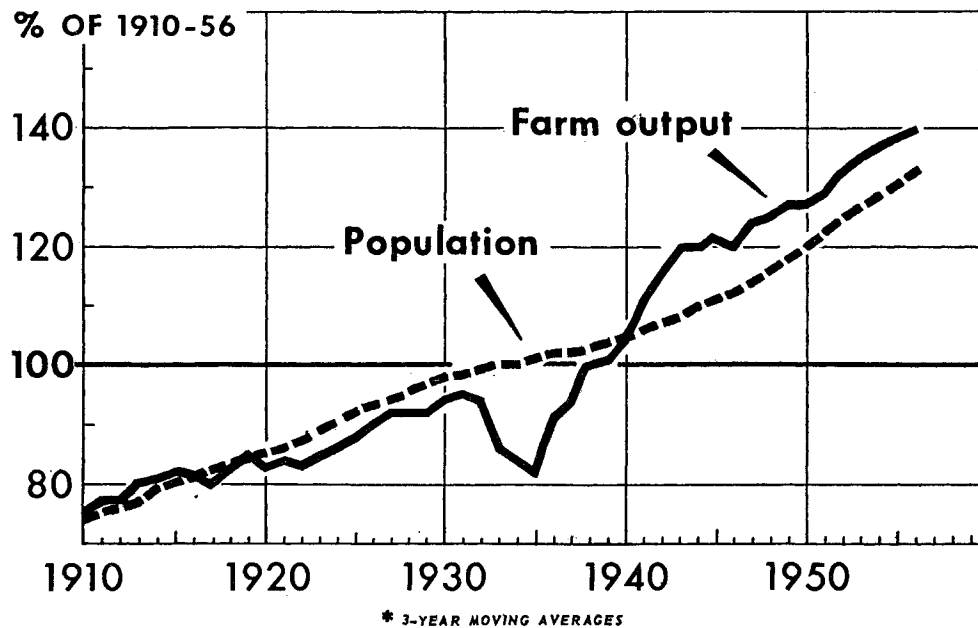


* MONTHLY DATA
 Δ INCLUDES INTEREST, TAXES, AND WAGE RATES. ANNUAL AV. DATA, 1910-23;
 BY QUARTERS, 1924-36, BY MONTHS, 1937 TO DATE

U. S. DEPARTMENT OF AGRICULTURE

NEG. 98-57 (1) AGRICULTURAL MARKETING SERVICE

FARM OUTPUT AND POPULATION *

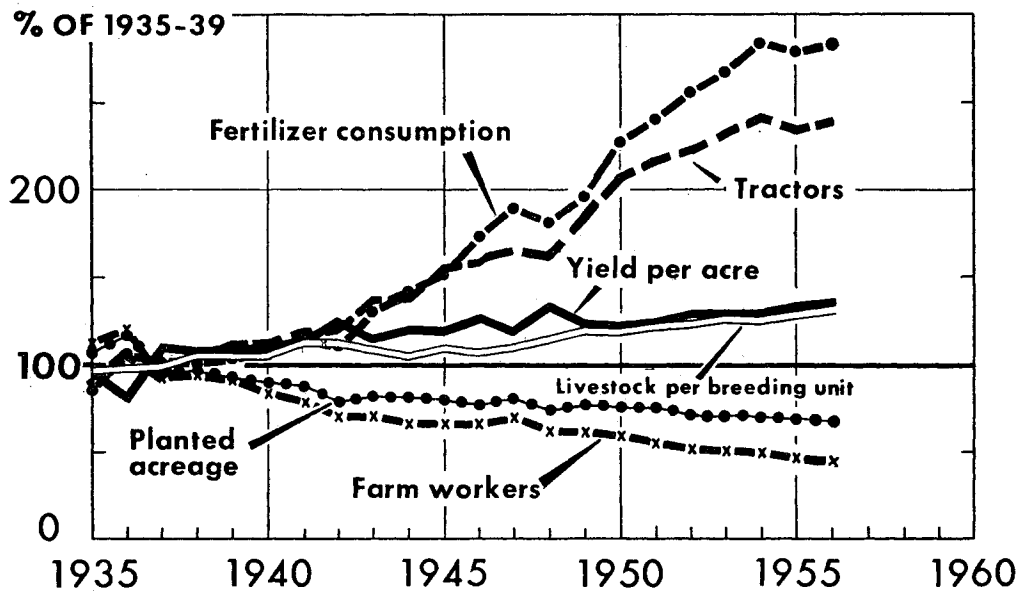


U. S. DEPARTMENT OF AGRICULTURE

NEG. 1912-57 (1) AGRICULTURAL MARKETING SERVICE

FACTORS IN FARM PRODUCTION

Per Unit of Farm Output



U. S. DEPARTMENT OF AGRICULTURE

NEG. 222A-57 (1) AGRICULTURAL MARKETING SERVICE

Chairman PATMAN. I would like to ask a few questions, and I will ask the staff director to make sure I am advised when the 10 minutes have expired.

Mr. CLAGUE, in preparing the cost of living index, do you include the cost of interest?

Mr. CLAGUE. Yes, we do. In the case of homeownership which is included in our index, we count the rate of interest as one of the costs.

Chairman PATMAN. How significant is it?

Mr. CLAGUE. It would not be a very large item in the homeownership picture. The first item is, of course, the price of the house itself. We also include maintenance and repair costs to keep the house up, and then interest would be another cost. I cannot give you the exact weight of that interest, or how much influence it has on the index, but I could supply that if you would like to have it.

Chairman PATMAN. Since it is divided over a long period of years, it would probably be insignificant or at least not large for 1 year, I assume.

Mr. CLAGUE. That is right; it is cumulative, of course. It lasts a long time, and it will stay at that rate until and unless the owner can refinance the house at a more favorable time later.

Chairman PATMAN. Mr. Paradiso, do you in your interesting statement assume the tight money situation as continuing during 1957?

Mr. PARADISO. I did not make that statement, Mr. Chairman.

Chairman PATMAN. I know you did not make the statement, but you did say something along that line. Did you consider the money situation for 1957?

Mr. PARADISO. Yes, I did. I considered that situation to be pretty much a continuation of what we are now going through. I did not envisage an alteration from the present situation.

Chairman PATMAN. Mr. Gainsbrugh, you discussed the retained earnings, and the fact that capital expenditures for plant and equipment are expected to be up for 1957. Last year I believe 67 percent of the capital expenditures came from retained earnings and depreciation. How will that figure compare with 1957, assuming that the 67 percent is approximately correct?

Mr. GAINSBROUGH. That sounds a little low to me.

Chairman PATMAN. Is it about 70 percent?

Mr. GAINSBROUGH. It is about that. In 1956, retained profits and depreciation allowances accounted for more than 80 percent of plant and equipment outlays by nonfinancial corporations. I would expect the flow of cash funds from depreciation to be higher in 1957 than in 1956 because the asset base is larger again as we enter 1957 than it was in 1956. If the profits figures are about the same in 1957 as they were in 1956, and that was implied in Mr. Paradiso's statement, among others, I think there will be a recognition by industry of the need for funds for internal purposes to a greater extent this year than there was last year. Last year dividends went up by 8 percent. I would think that in the light of requirements in 1957, dividends might hold about where they are, which would mean that retained earnings plus depreciation would give a higher cash throwoff in 1957 than in 1956. So there should be more internal funds for investment purposes in 1957 than in 1956.

Chairman PATMAN. In your statement, did you also assume that the money situation would remain about the same as it is now, which, I

believe is generally considered tight? Did you consider it would ease or get tighter?

Mr. GAINSBROUGH. I am hopeful that if the tapering off process that is envisioned by our capital appropriations does transpire toward the middle of 1957 or thereafter, there will be some easing off in the tight-credit policy. For purposes of warranted economic growth, we would need more of an expansion in our monetary supply than we have had in the past 12 or 18 months. But that is only if the tapering off does occur.

Chairman PATMAN. Mr. Katona, how do you consider that the increased interest that the consumer must pay will affect his savings?

Mr. KATONA. I do not believe that the increased interest affects consumer savings. Most consumers save in order to have reserve funds and not for the sake of interest return.

Chairman PATMAN. You do not think it affects consumer savings?

Mr. KATONA. I do not believe so.

Chairman PATMAN. That is, the consumer is not interested so much in the actual interest he receives on his investment as the security of the investment and the capital? The interest rate itself, whether it is 2½ percent or 3½ percent is not so important as the safety of the security, is that right?

Mr. KATONA. We are pretty sure, Mr. Chairman, that for the great majority of American savers, interest rate or changes of interest rate by 1 or 1½ percent do not amount to much. If I may say one more sentence. For some very rich people whose savings may be substantial, it may amount to something. Even in installment buying, consumers are not concerned, perhaps it is their fault, with the charges. In mortgages and in buying houses, they are concerned, and so in residential building I do expect an effect.

Chairman PATMAN. Mr. Wells, suppose that the farm prices had gone up in 1956 the same percentage as industrial prices went up. How would that have affected the cost of living?

Mr. WELLS. Well, that is a little difficult for me to answer. Farm prices in 1956 actually averaged the same level as 1955. How much did industrial prices go up?

Mr. GAINSBROUGH. They went up as much as industrial prices, and they were 7 percent higher at the year end.

Mr. WELLS. From December of 1955 to December of 1956, farm prices did go up 7 percent.

Chairman PATMAN. I am looking back over a period of years and wondering how the price index could remain about the same without somebody giving up something when we know that industrial prices have gone up considerably, that is, steel, automobiles, and many things like that. Was it not a lot of it as a result of the losses the farmers took, Mr. Wells?

Mr. WELLS. There was a period of 59 months, from February of 1951 to December of 1955, in which farm prices fell by 30 percent. There is no question but what this fall in farm prices did result in masking the effect of what was happening quite a bit of the time to the rest of the economy and give us a stable price level made up of the falling farm sector and the rising prices of other products.

Chairman PATMAN. The stable prices, in other words, were at the cost of the farmer?

Mr. WELLS. Certainly, if we had not falling farm prices, the price level would not have been stable.

Chairman PATMAN. During that 59 months, suppose that farm prices had gone up in the same percentage as industrial prices, the index would probably have been considerably different?

Mr. WELLS. I think so, yes.

Chairman PATMAN. Mr. Curtis, do you wish to inquire?

Mr. CURTIS. I will pick up with Mr. Wells. I am first interested in knowing the percentage of Government support in relation to the total farm income. I think our total farm income was \$11.9 billion in 1956. I have some figures on this and I understand that about 10 percent of net farm income in recent years is due to Government payments plus Government loans. But I notice our budget includes about \$5 billion of farm supports. How is that reconciled?

It would look to me that probably that is pretty much an annual figure and I am interested in knowing whether it is 10 percent of the farm income derived from Federal supports or as much as about 40 percent.

Mr. WELLS. This is a difficult question for me to give a short answer to, but let me call your attention to several things:

First, the budget for agriculture for this year, and I think I should say last year, and probably for next year, tends to cumulate the cost of agricultural price supports over a number of years because we are disposing of stocks of agricultural commodities that have been built up since we came out of the Korean inflation period. That is first.

Second, I question comparing the size of the fiscal 1958 agricultural budget, about \$4½ billion excluding loan advances which I do not think belong in this discussion, with the net realized income of farm operators, of about \$11 billion. The cash sales of farm products runs about \$30 billion and the cash expenses of farm production ran \$21 billion or \$22 billion. I would suggest that these budget expenditures support not the net realized farm income, but rather cash receipts from the sale of farm commodities, a large block of which goes back—twenty-odd million dollars—back into the purchase of farm production goods.

So I think the comparison should be against either cash sales or gross value of farm production. Cash sales would have been substantially lower without supports. Farmer purchases of both production and farm family living goods would have been substantially lower without the support-price program.

Mr. CURTIS. I appreciate your comments. In trying to evaluate our farm economy on whether it is 10 percent or 40 percent or what, such a big factor is involved that it becomes important.

Now you state that you are rather optimistic that we will be able to continue the export rate and in fact improve the export of our farm products. Yet, from a little experience I had in talking with a few people in Western Europe, and also listening to some of the gripes at the Geneva Conference of the GATT countries, there was a lot of talk about the fact that the United States was dumping farm products, and there seems to be a growing resistance on their part perhaps to disposing of our farm products in that fashion.

Did you take that possible factor into consideration in estimating an increase of disposing of our surpluses?

Mr. WELLS. Yes, sir. You will remember that I have addressed myself here in this first section to precisely the 12 months' slice of time, the calendar year 1957. I think we do have commitments already underway and prospects which indicate to me that calendar 1957 is going to be a very high year.

Mr. CURTIS. If this psychology did exist, it would be a factor at a later time.

Mr. WELLS. I suppose I am probably also assuming that the Congress will agree with the President in extending Public Law 480 for an additional 12 months and by an additional \$1 billion.

I think the kind of questions you are raising have to do with the longer run outlook for farm exports, and there we must take into account not only this feeling you mention but also the increase in production of agricultural commodities as against the increase in population over the world and the desire of many countries to get a low-priced commodity wherever they can buy it.

Mr. CURTIS. Mr. Clague, in your discussion of part-time work, I was wondering if you had included in that the farm economy? I have been quite interested in the figures over a period of years of the percentage of farm income that comes from nonagricultural work, which is largely in this area of part-time industrial work or nonfarm work. Was that calculated in your studies?

Mr. CLAGUE. Yes, Mr. Congressman, it was. These are census figures which I was quoting and they are derived from the census, the monthly census of population and labor force which the census takes.

I called attention to the large increase in 1956 in the number of these part-time workers. Undoubtedly some of them were on the farm. I am sorry to say I do not have before me the extent to which that is true. I might also add that I am sure a good many of them were also in industry and trade to some extent, too, as shown by the large numbers of women who seem to be coming into the labor force on a part-time basis.

Mr. CURTIS. Of course, in the farm economy, a lot of that is the farmer's wife or daughter. You did not have a breakdown of that?

Mr. CLAGUE. No, but I think I could supply that to you. I do not have it with me but I could put it in the record, if you like.

Mr. CURTIS. Yes.

(The information is as follows:)

PART-TIME EMPLOYMENT

The extent of part-time work has increased in recent years in both farm and nonfarm employment. In 1956, 18 percent of all persons at work were employed less than 35 hours a week, compared with 14 percent in 1947.

Part-time employment in nonagricultural industries has increased sharply for both men and women. The number on part-time work has jumped from about 6 million in 1947 to almost 9½ million average in 1956. Part-time workers comprised 17 percent of nonfarm employment in 1956, as compared with 13 percent in 1947.

While the proportion on the part-time work has also increased for agriculture—from less than 24 percent in 1947 to over 28 percent in 1956—the number of part-time farmworkers has not actually increased, because there has been a decline over the period in the total number of farmworkers.

Full-time and part-time workers in nonagricultural industries and in agriculture, by sex, annual average, 1956, 1955, and 1947

Sex, industry, and hours worked during survey week	Number (in thousands)			Percent distribution		
	1956	1955	1947	1956	1955	1947
Both sexes:						
Total at work ¹	61,818	60,261	55,554	100.0	100.0	100.0
35 hours or more.....	50,640	49,933	47,635	81.9	82.9	85.7
1 to 34 hours.....	11,178	10,329	7,919	18.1	17.1	14.3
Nonagricultural industries.....	55,425	53,728	47,573	100.0	100.0	100.0
35 hours or more.....	46,062	45,046	41,538	83.1	83.8	87.3
1 to 34 hours.....	9,363	8,683	6,034	16.9	16.2	12.7
Agriculture.....	6,393	6,534	7,981	100.0	100.0	100.0
35 hours or more.....	4,577	4,887	6,097	71.6	74.8	76.4
1 to 34 hours.....	1,815	1,646	1,885	28.4	25.2	23.6
Males:						
Total at work ¹	42,166	41,432	39,953	100.0	100.0	100.0
35 hours or more.....	36,529	36,196	35,781	86.6	87.4	89.5
1 to 34 hours.....	5,637	5,234	4,201	13.4	12.6	10.5
Nonagricultural industries.....	37,060	36,122	33,276	100.0	100.0	100.0
35 hours or more.....	32,536	31,897	30,239	87.8	88.3	90.9
1 to 34 hours.....	4,523	4,224	3,037	12.2	11.7	9.1
Agriculture.....	5,107	5,310	6,707	100.0	100.0	100.0
35 hours or more.....	3,993	4,298	5,542	78.2	80.9	82.6
1 to 34 hours.....	1,114	1,010	1,164	21.8	19.0	17.4
Females:						
Total at work ¹	19,652	18,831	15,570	100.0	100.0	100.0
35 hours or more.....	14,111	13,736	11,853	71.8	72.9	76.1
1 to 34 hours.....	5,541	5,093	3,716	28.2	27.0	23.9
Nonagricultural industries.....	18,366	17,606	14,296	100.0	100.0	100.0
35 hours or more.....	13,528	13,147	11,299	73.6	74.7	79.0
1 to 34 hours.....	4,840	4,458	2,997	26.4	25.3	21.0
Agriculture.....	1,286	1,224	1,274	100.0	100.0	100.0
35 hours or more.....	585	589	554	45.5	48.1	43.5
1 to 34 hours.....	702	636	719	54.6	52.0	56.4

¹ Excludes persons with a job but not at work.

Note.—Figures may not add to totals because of rounding.

Source: U. S. Department of Commerce, Bureau of the Census.

Prepared by U. S. Department of Labor, Bureau of Labor Statistics, Division of Manpower and Employment Statistics, Feb. 1, 1957.

Mr. CURTIS. How much do your figures reflect the possibility of double jobs, where with this shortage of hours there seems to be a number of people at any rate that hold two jobs. How much of that data do you have?

Mr. CLAGUE. That is entirely eliminated in the figures I supplied you, which come from the census, because they get these data from the homes of people. They call on the family, and there the fact that a person held 1, 2, or 3 jobs would not make any difference. In our Bureau of Labor Statistics reports which come from employers, this double jobholding does exist or would be included. We would find a man on two different payrolls and he would be counted twice. The census has made some reports on that subject from time to time.

I have the impression, if you will let me correct it later, that there are about 3½ million persons in this country who hold more than one job at one time.

(Mr. Clague later submitted the following:)

EMPLOYED PERSONS WITH TWO OR MORE JOBS

Preliminary estimates¹ of the number of persons holding two or more jobs are available from a special survey conducted by the Bureau of the Census in July 1956. These figures show that, of the 66.7 million persons employed during the

¹ Detailed data not yet completely prepared for publication.

week ending July 14, 1956, 3.7 million had more than 1 job or business. The 3.7 million included 2.8 million persons whose primary jobs² were in nonagricultural industries and 900,000 whose primary jobs were in agriculture.

Among agricultural workers with additional jobs, 300,000 were wage and salary workers (hired farmhands) and 600,000 were self-employed or unpaid family workers. The secondary jobs of most of the wage and salary farmworkers were also in agriculture but almost 350,000 of the 600,000 farm self-employed or unpaid family workers held additional jobs in nonagricultural industries. This suggests that many of the latter were owners of small farms near urban areas where industrial jobs are available. Many of this group spend most of their time on farmwork during busy seasons like planting and harvesting and are therefore classified by census as agricultural workers. During the rest of the year they spend most of their working time on their industrial jobs and are classified as nonagricultural workers.

Mr. CURTIS. Thank you.

Chairman PATMAN. Mr. Mills.

Mr. MILLS. Mr. Chairman, as I understand the President's economic message and his budget message, the view is expressed that the objectives of the Employment Act will be carried out and accomplished in the calendar year 1957.

In other words, there will occur on the basis of fixed or relatively stable prices an increase in gross national product of 3 or 3½ percent which is the figure that we normally say represents the growth from year to year necessary to carry out the objectives of the Employment Act. Am I right in concluding from the statements that each and all of you have made this morning that there is some serious doubt that gross national product will increase by 3 or 3½ percent in 1957 over 1956 on the basis of fixed or relatively stable prices?

I have raised the question because I have been concerned over the statements, particularly those that have been made with respect to the increase in the labor force that will be employed, and increase in investments and plant expansion, and inventory accumulations, consumer demand, and prices of farm products and income received by farmers.

You have said that the investment in plant and equipment, Mr. Gainsbrugh, and inventory accumulations, will not supply the impetus which apparently is needed for that degree of growth in gross national product. You have said that the consumers will not react in 1957 as they did in 1955 to supply the lead. That is the expansion that occurred at that time and it was apparently needed at that time to bring about the increase in gross national product.

As I understand, Mr. Wells, even though the situation with respect to farmers may be more favorable in 1957 than 1956 it will not be so favorable as to supply the leadership in attaining a 3- to 3½-percent increase in gross national product.

As I understand from your statement with respect to Federal, State, and local expenditures, perhaps that situation is more favorable than any of the others discussed by these gentlemen. In all probability, then, Mr. Paradiso, I must conclude that if a gross national product increase of 3 or 3½ percent will occur in 1957 over 1956, the expansion generating that increase must come from Federal and State and local expenditures.

Now, am I justified in that conclusion?

² Primary job classification is based on the greatest number of hours worked during the survey week.

Mr. PARADISO. Congressman, I think that you have to keep in mind the developments since the middle of the year. When you talk about comparing 1957 with 1956, we have already exceeded the gross national product for the average of 1956 by something like 3 percent roughly, although in terms of real gain, that is, eliminating the price rise in the fourth quarter of last year compared with the year as a whole, we are up $1\frac{1}{2}$ percent. So let us start with that.

This means that we have to consider, from indications as developed here at this table, how much more gross national product we can expect to result in a 3- or $3\frac{1}{2}$ -percent increase for 1957 as a whole compared with 1956.

All the statements around this table seem to indicate modest increases, small increases from the fourth-quarter rate. The Federal Government purchases, as I have indicated, would show a small rise from the fourth-quarter rate. That is \$1 billion in 1957, compared with the fourth-quarter annual rate.

The consumer purchase statement seems to indicate a small rise. Business-investment programs do not level off in the fourth-quarter rate but indicate a small rise. You do not need too many of these small rises to yield a total for 1957 which would be close to a 3-percent rise over 1956, particularly in view of the fact that we have already gone a good way toward approaching the 3-percent increase.

Mr. MILLS. Is it your thought then that we are reasonably safe in expecting a 3- or $3\frac{1}{2}$ -percent increase in gross national product in 1957 over 1956?

Mr. PARADISO. Reasonably safe, viewing the trend as we see it now.

Mr. MILLS. We very shortly will begin to consider a budget request that in order to be financed on the basis of existing tax rates will require increases in personal income and corporate income that we have translated into a 3- or $3\frac{1}{2}$ -percent increase in gross national product. It becomes very important, as I view the situation, for us to be as certain as we can as we look at the future, and always there are uncertainties, but as certain as we can as to what our revenues may be under existing rates, in making these enormous expenditures for the Federal Government. Just a slight error in our projection of increase in gross national product could cause us to end the fiscal year 1958 in the red rather than in the black. All of us know what that might do at this particular time or under conditions similar to these today to economic stability here at home.

Mr. GAINSBROUGH. I would like to offer one comment if I may on your general question.

I agree thoroughly with the statement that Mr. Paradiso has made that it is the summation of small gains in all sectors of the economy that may very well give us a higher level of national economic activity in 1957 than in 1956. In a sense we do not want a repetition of the explosive forces in 1956 because those explosive forces in 1956 generated inflationary pressures, as Mr. Clague has indicated. However, there was implicit in the line of analysis that was presented, a thesis that possibly we needed increased Government spending to maintain a high level of activity. I wanted to depart from that point of view. I think we have built up a case here this morning which indicates a continuation of high-level activity or the probability of a continuation of high-level activity throughout the year.

I do not believe that greater governmental spending is needed at this particular moment to buttress the economy. And there is always the alternative of fiscal and monetary policies other than governmental spending that can be stimulative in character. We can ease the tightness in the credit stream, if that is required. We can bring more activity into being in the home-building field than we have permitted during the past year. That sector has been affected by monetary policy.

There is also the possibility that if corporate taxes, for example, are oppressive or excessive or inimical to further capital investment, tax reductions can be just as stimulative to the economy as increased governmental spending. I did want to make that reservation of mine clear.

Mr. MILLS. I am merely asking a question for information. Are you saying in part that it is not necessary for the Congress to appropriate more money for fiscal year 1958 than we appropriated in fiscal year 1957 to buttress the economy?

Mr. GAINSBROUGH. If that is the sole purpose of the appropriations, yes, I would say that I am arguing against an expansion of budgetary expenditures for purposes of strengthening or holding up the economy with the thought that there might be tapering off or slowdown in economic activity.

Mr. KATONA. I would like to agree with your initial statement. I believe that from December of 1956 to December of 1957 there is little chance for a 3 percent real increase in gross national product if Federal expenditures do not increase.

Mr. CLAGUE. It is not appropriate for me to talk about Federal expenditures, but I would like to call your attention to one area which I did cover in my statement. That is wages and salaries.

You will notice that deferred wage increases are already written into contracts of 5 million workers. Half of these range from 6 to 8 cents an hour, which is about 3 to 4 percent. In construction, the largest number of increases range about 9 to 11 cents per hour, which would also be about 3 or 4 percent.

It is hard to imagine that the new contracts that will be negotiated in 1957 by unions and management will be any less than that when they come up for renewal this year.

Now, I do recognize, in making this statement, that wages are a cost to the employer, and they may be shaving profits as Mr. Gainsbrugh indicated. But if you start out with the assumption that there will be a businessman's demand that will keep these people at work, I would foresee a consumer demand arising out of this which would be at least sustained along previous levels. Consequently, if these consumers spend, and Mr. Katona indicates they may, they will certainly create a demand of a private character, and nongovernmental character, which will be very important.

This is not a forecast, but this is just an indication of one segment of expansion of demand that is likely to occur.

Mr. MILLS. Your statement generally raised the thought in my mind that you were expecting that we would have some inflationary increases in prices in 1957, as a result of the wage increases. Of course, if we have sufficient inflation in 1957, we can expect that increase in receipts of Government, perhaps, that are needed to finance

these expenditures that are contained in this budget. I had hoped we would be able to do it without the necessity of further inflation.

That is all, Mr. Chairman.

Representative KILBURN. As a new member of this committee I stand in awe of so many eminent economists and I am somewhat hesitant in proposing questions to you.

As I understand the President's state of the union message, he suggested that increases in wages and prices only follow increased productivity. I presume that means not only the individual worker's productivity but the general increases resulting from improvements in plant and equipment.

Do you see any hopes of halting inflation by that method?

Mr. CLAGUE. Would you like me to try that, Mr. Congressman?

Representative KILBURN. Yes, please.

Mr. CLAGUE. The President's statement did indicate that for the economy as a whole, productivity is the one way in which you raise the standard of living. That is to say, if you pay higher wages, or raise prices to the consumer, and that is the sole method of increase in the gross national product, or if there is no productivity to match the wage increases, then obviously wages and raw material costs convert into prices and prices go up.

Now, on the other hand, productivity can mean a cut in the costs because the employer is using less labor to produce the same amount of product. Consequently, we could get a rise in the standard of living due to this productivity. That is a truism.

Now, how this will work out in any one year is not very certain. Our figures on productivity for the most recent years are not very good, as I explained so fully in my statement. They do indicate that 1956 was not a very good year from that point of view. On the other hand, 1954 and 1955 were. What the outlook is for 1957, I am not sure. But it is clear that unless we get a moderately good increase in productivity, answering Mr. Kilburn and Mr. Mills, then of course it might take the form of price increases which would give you the estimated gross national product but not in real terms.

Did I answer your question, Mr. Kilburn?

Representative KILBURN. I am impressed by these figures and the way in which all of you follow these matters so very closely. I am wondering whether any of you think that the recommendations of the President to stop inflation have any chance of really prevailing.

Mr. GAINSBROUGH. I have a different view about the basic causes of the inflationary pressures of the past 12 to 18 months from some of my other colleagues here, apparently. They place their primary emphasis upon the cause of the bulge in prices as being demand. I am inclined to agree that part of it did stem from the demand side. I am of the opinion, however, that the inflationary pressures of the past 12 to 18 months are essentially different from the inflationary pressures of the first postwar decade. Those stem now largely from the pressures of an expanded money supply upon the price structure.

The inflation of the past 12 months came in a period of a balanced budget and of tight money. The pressures came primarily from the cost side in my opinion rather than from the demand side. The basic cause of that cost pressure was wage increases in excess of the gains in output per man-hour.

To come back to your basic question, I think it is a question that concerns the whole Western World and not just the United States alone. Until such time as we do get a recognition that wage increases in excess of productivity are harmful to the national interest, we will not have met the question of sustained inflation arising from the cost rather than from the demand side.

The President has singled out the question of the wage-cost push, or wage inflation if you like, as being a question of dominant concern in 1957.

There is one further corollary to this, if I may develop it. That is that wage inflation may not be long sustained in character. The inflation stemming from the huge deficits of World War II ran a long course. But wage inflation can push huge sectors of our population out of the market place rather quickly. In so doing, the price we pay for wage inflation would not be sustained inflation over a prolonged period of time but increasing unemployment. I do not foresee that as the picture for 1957. I am looking at this over a longer period of time.

Representative KILBURN. I think that is a very clear statement and a very instructive one to me.

It seems to me that the big unions and the big labor leaders are in exactly the same position as the big corporations in that they are competing with each other. Just as soon as one union gets a wage increase, then the next union or the head of the next union wants to make as good a showing, and so he goes after an equal or greater increase. That same thing is true of course of big corporations. They want to make just as good a showing in earnings. It is difficult to see where to stop it.

Mr. KATONA. May I say it is not only the unions. According to consumer surveys, the great majority of the American workers are convinced that they have a right to expect year by year or every 2 years some wage increase. This is today's psychology which contributed to the prosperous times in the last 10 years. I think it will be very difficult to change this very strong demand from the rank and file.

Therefore, I personally expect further wage increases and some further price increases.

Representative KILBURN. Most of the union members expect an increase every year and presumably, then, they want to increase inflation every year.

Mr. KATONA. People are not quite as consistent, Congressman, and they do not realize that.

Mr. GAINSBROUGH. I did not want my comments to be misinterpreted in that respect. I was speaking of the relationship between wage against productivity. If this economy continues to grow more efficient year after year and that seems to be the record, then it is possible, as Mr. Katona has indicated, for wages to rise and living standards to rise. But they must be commensurate in the main, and not in any given year, but in the main with the increased efficiency of the economy. Where we get wages outstripping the gains in productivity, then we begin to get imbalances in the economy which can be harmful to the national interest.

Representative KILBURN. They should get wage increases under those conditions.

Chairman PATMAN. Mr. Gainsbrugh, did you indicate a while ago that you would favor a reduction in taxes this year to stimulate the economy?

Mr. GAINSBROUGH. I did not. I said, however, that in the event stimulation of the economy did become necessary there were various mechanisms that were open to us over and above an increase in governmental spending. One such mechanism might be a review of our whole tax system against this particular framework, if I may develop it.

Chairman PATMAN. Did you notice in the Wall Street Journal this morning that United States Steel declared a quarterly dividend of 75 cents?

Mr. GAINSBROUGH. No; I have not read that.

Chairman PATMAN. I wanted to invite your attention to it for this reason: It has been suggested here that employment cost or wages were such an important factor in inflation. This statement in the Wall Street Journal discloses that for the fourth quarter employment costs aggregated \$434,188,236, and the products and services sold during that same quarter of 1955 was \$1,093,747,000. The employment cost amounted to 40 cents on the dollar.

In the fourth quarter of 1956, a comparable period, the employment cost was \$471,795,000, and the products and services sold was \$1,194,587,925, or still about 40 cents out of the dollar.

How do you reconcile that with the statement that the employment cost was the cause of inflation insofar as United States Steel was concerned?

Mr. GAINSBROUGH. My comments were directed to the national picture rather than to any individual instance. I think at all times, and in every stage of the cycle, you will find some companies that are benefiting and that are above the average, and others that are below the average.

But if you will look at the data that you have in your Economic Indicators you will find that corporate profits in the aggregate in 1956 were if anything, a little bit below where they were in 1955.

Chairman PATMAN. That does not apply to United States Steel.

Mr. GAINSBROUGH. I do not believe it did, from the figures that you have read. I am, however, dealing with the corporate economy as a whole.

Chairman PATMAN. I understand that. I just invited your attention to this one particular case.

Mr. GAINSBROUGH. You will find that national income went up relatively and that wages went up relatively, but that profits after taxes were declining rather than rising in their share of the national income.

Again, in the Economic Report, you will find that the rate of return for the corporate entity both on sales and on equities was lower in 1956 than in 1955.

Chairman PATMAN. I think Mr. Katona made a very important statement a while ago when he said that the small savers were not induced to save by reason of the interest return. As they become larger they may become more interested.

In other words, I assume, however Mr. Katona, that the average saver, being a small saver, is not influenced too much by the interest rate. Is that a fair assumption from what you stated?

Mr. KATONA. I would say so; yes, sir.

Chairman PATMAN. Do you agree with that, Mr. Gainsbrugh?

Mr. GAINSBROUGH. I would have to, on the basis of Mr. Katona's research. I do think, however, that there can be a shift in the character of savings as a result of the change in interest rates. That is, in the composition of savings and movement from one type to the other.

Chairman PATMAN. Let me ask you this question. Suppose interest rates go up to 4 or 5 percent? Will the savers accept that and say, "That is enough for me and I do not want to look around for an opportunity to invest my money and make more out of it"?

Would it be against the national interest to have an interest rate such that the saver would be satisfied with the return he received and thereby have no inducement to look around and try to invest in private enterprise and become a part of the private-enterprise system?

What do you think about that, Mr. Katona?

Mr. KATONA. That is hard to say. I personally would not consider it bad if more medium savers would invest in common stocks. You can provide impetus to our economy by investing in common stocks by savers who had invested in savings and loan shares.

Such shifts may occur. On the whole I would say that even with 4- or 5-percent interest rates, savers would not be induced to have much more, except a few people, and the bad effects of such an increase, especially on mortgage financing, would outweigh the advantages obtained from increased saving.

Chairman PATMAN. You think the increases are detrimental to the economy rather than helpful?

Mr. KATONA. An increase of interest rates on savings to 5 percent would definitely, in my opinion, be detrimental; yes.

Chairman PATMAN. What about 4 percent?

Mr. KATONA. I believe that we should have low interest rates and I personally think, though I cannot base it on scientific findings, that a 4-percent savings rate is likewise higher than I would like to see it.

Chairman PATMAN. It is higher than you would like to see it?

Mr. KATONA. That is right.

Chairman PATMAN. This is consistent with your belief that the average saver, who, of course, is a small saver, is not attracted by the interest rate?

Mr. KATONA. He is not sufficiently attracted to save more because saving has primarily other purposes, namely, to put away money into safe reserve funds for future spending or for emergencies and not to provide him with additional income.

Representative KILBURN. When you say savings, do you mean interest on savings accounts?

Chairman PATMAN. Yes; I do.

Mr. KATONA. That is what I meant, too.

Chairman PATMAN. Mr. Paradiso, do you agree with these gentlemen on what they said about savings and interest rates on savings?

Mr. PARADISO. Well, I do not have any other evidence than some of the information developed by Mr. Katona in his own surveys. On the basis of that, and from my own personal observation, it does appear that the consumer is not unduly affected by changes in interest rates. There are certain groups that are. I will agree, generally, with the foregoing statements.

Chairman PATMAN. What about you, Mr. Clague? Do you agree with Mr. Katona and Mr. Gainsbrugh?

MR. CLAGUE. This question does not grow out of any of my present work, but I do recognize the way in which interest payments enter into the average consumer's budget; for example, when he buys a house he commits himself to pay an interest rate in borrowing the money.

Now, a certain amount of the saving that occurs in the country is a kind of compulsory saving. I am saving compulsorily every month when I have to pay back a certain amount of money which includes the interest I am paying on a loan from the mortgage company.

In that sense, I think economists have long recognized that the small saver is generally a person who saves partly because he wants a house or he wants a car or other specific things, and some of his savings consist in committing himself for those purchases. Then he pays back money which becomes relouable later on.

Now, I think in that sense Mr. Katona is right. The small saver does not quit buying a house because the interest rates change. He would like to get the house and he will try to get it if any money becomes available to him.

Chairman PATMAN. I am afraid we do not have our definitions straight. You are talking about the saver whom I would consider more or less of a captive saver. He is compelled to save.

MR. CLAGUE. That is right. It is compulsory.

Chairman PATMAN. We are talking about the person who voluntarily saves. The question is: Will the voluntary saver be induced to save more by reason of a little higher interest rate, or does the interest rate enter into the question a great deal?

MR. CLAGUE. I think I agree with Mr. Katona on that. If he did not borrow the money to buy a house he would set it aside to buy a house. If he has the objective of buying a house, the answer is that the rate of interest does not influence him too much in that decision. I think most economists agree with that.

Chairman PATMAN. Would you like to comment on that, Mr. Wells?

MR. WELLS. I really should not, because you people have simplified this too much for me. You are talking here mostly about the ordinary American who feels he does well to make a living and put aside a certain minimum amount for security. There, I agree with everything that has been said about the fact that small changes in interest rates are of secondary importance.

However, I also feel, without being a savings statistician, that the amount of savings in the United States that accrue from this source are very small relative to the amount that accrues from other sources.

If you are talking about the average saver in terms of numbers, which we are now talking about, that is one thing. If you are talking about those individuals and institutions who account for the larger amount of dollars actually saved, I would suggest that profit and interest rates are extremely important.

Chairman PATMAN. Mr. Curtis, would you like to ask a question?

Representative CURTIS. I did not intend to enter this savings argument, but I must make this comment. I know, as I serve as a director in a savings and loan company and have done so for many years, that we have had to increase our interest rates in order to get the money in.

I also suggest that one reason savings and loan associations have become such a repository for the small man's savings in place of the

savings bank has been to a large degree the interest rate. So in that respect, at any rate, looking at it from the institutional standpoint, we are pretty much convinced that the interest rate does make a difference.

I have one other comment on that too. I think you would agree that the worst thing that can happen to a small saver is inflation. I wanted to pick up a question that was posed to Mr. Gainsbrugh and I know he wanted to make a further answer. I want to anticipate what the answer might be so that he can comment on that. In this business of tax reduction, if I get to the point that you were making, if the actual funds would be free from tax reduction and went into investment capital as opposed to consumer spending, then it would be deflationary or it would resist the inflationary trends. Is that about right or am I wrong?

MR. GAINSBROUGH. The point I was on the verge of developing was that we are shifting from the highly stimulative economy of the first postwar decade to the highly competitive economy of the second postwar decade.

I felt it was relatively easy for all forms of business, small business and large, to obtain funds for expansion during the first postwar decade. In part it was because the banks were largely depositories for Government bonds and welcomed all borrowers; partly because they had built up reserves during World War II, and in part because excess-profits taxes were eliminated and that eased their problem somewhat.

But this is completely different environment now. The banks are loaned up and credit is difficult rather than easy to secure. It may very well be that corporations in the years ahead will have to look far more to internal sources for expansion purposes and to the traditional sources of long-term capital, the equity markets, than they did in the first postwar decade.

That leads me to the basic point that I wanted to stress. Corporate taxes, high as they were, may not have been oppressive in the stimulative environment of the first postwar decade, but at some future period of time they may be. They may be the chief restraining factor in that there is not sufficient funds available for plow-back purposes within the corporate entities.

Representative CURTIS. I happen to share your views on that and I would like to make this other comment: You said "for expansion." I would pose this situation; that it is to a large extent to maintain our present position due to the fact that our depreciation accounts do not have enough in them at the inflated cost to even replace the capital outlays of plant and machinery.

As I see it, we have been in a period when these companies have had to do a lot of replacing. They find that their reserve funds are just not adequate under inflationary costs. So they have to get additional capital somewhere else. Would you say that is a fair statement?

MR. GAINSBROUGH. That point is well taken and again I think, to further elaborate on it, through recourse to certificates of necessity, some of the inadequacies of the treatment of the depreciation were corrected.

Now, we are getting less and less of the accelerated amortization through the certificates of necessity. We have had some changes in tax law that are favorable to a more realistic treatment of depreciation. But I still think that it remains true for the small- and medium-sized firm with a heavy fixed investment per dollar of sales.

That is particularly so because of the large price rises of the past 12 or 18 months in equipment and construction costs. They find their depreciation reserve inadequate when it comes to replacement time.

Representative CURTIS. I personally dislike the use of the certificates of necessity because of the inequities that exist there and also the Government actually can direct the course of where the investment capital will go.

Although, as you say, it has eased it. It has done it, in my judgment at any rate, in a very inequitable way, particularly with relation to small- and medium-sized businesses.

Mr. GAINSBROUGH. That was not meant to be an endorsement of certificates of necessity. It was rather a review of the factors at work. One of those was accelerated amortization under certificates of necessity which did ease the problem of inadequacies of depreciation for the steel industry, among others.

Representative CURTIS. I have one other comment. It seems to me that the President's Economic Report and the comments of the panel emphasize that the shortage in credit is not in the consumer dollar as much as it is in the investment dollar.

I would say that is so. This is the thing I wanted to pose in the home-building field. Although we see a consumer dollar tightening, it has been tightened because of the shortage of building materials and glass and cement and steel and so forth, which are short, in turn, because there has not been enough investment capital for the expansion of production for those basic materials. Would anyone care to comment on that, either agree or disagree?

Mr. GAINSBROUGH. I do not think it was the shortage of materials that held back the home-building industry in past months. I think it was primarily the deterioration in their competitive position so far as available funds were concerned.

The housing starts figures suggest the weaknesses are in the FHA and GI area rather than in the conventional mortgage area where we did have a free interest rate at work.

Representative CURTIS. I know that the Government actually did put a clamp on home financing. But I am suggesting that one reason they did that, and one of the few reasons I could go along with it although I worried about it, was the fact that there seemed to be the shortage in these basic materials. If they had allowed that credit to continue, the prices of these basic materials would have gone up beyond the point they did go up.

That is the syllogism I was trying to pose.

Mr. GAINSBROUGH. I accept that. I think the picture is quite different now from the picture of 12 to 18 months ago. I am hopeful that in the light of what has been said this morning about some of the forces that will be tapering off as 1957 moves along, that housing can become a sustaining if not expansionary force in terms of timing.

It would be most desirable in terms of timing if that curve turned upward in the closing half of 1957.

Representative CURTIS. Certainly the demand is there, as Mr. Katona pointed out. Thank you.

Chairman PATMAN. Mr. Ensley, would you like to ask any questions?

Mr. ENSLEY. I have a couple of questions on which I would like to see if I can get some clarification.

Mr. Clague, with respect to the various indexes that you publish, particularly the Consumer Price Index and the wholesale index, do you believe that they are accurate measures of price movements?

To put it another way, are they a good measure of inflation?

Mr. CLAGUE. We make these figures, both the wholesale prices which are business prices and the Consumer Price Index which is consumer prices at retail; and we try in every way possible to make those indexes accurate.

I have published a number of statements this year calling attention to the steps we take to do that. Now, I would have to add that there are certain kinds of changes in value which we have a hard time taking into account.

However, we do price automobiles for the consumer at the discount that the consumer gets and not at the list price.

Mr. ENSLEY. You are pricing what is actually paid, rather than some list prices?

Mr. CLAGUE. That is right. We get from the automobile dealers a report on what they are actually selling the cars for. We try to take into account special sales also if they extend over a reasonable period. We do not capture all of the spectacular discounts that are available to consumers through special discount shops and stores of that sort, but generally we pick those discounts up a little later because the department stores compete.

We are now finding that for household appliances we are getting plenty of discounts from list prices right in our department stores. We include specialty stores, radio, television shops, and other specialty appliance stores in our sample in order to find places where discounts are taking place.

I would say in general that we get a very close approximation of actual price changes. If you will allow a few months to go by while the competitive situation takes care of it, I would say that we catch up.

Mr. ENSLEY. To what extent do you believe the recent price increases are the result of pent-up inflationary pressures that were built up during World War II and Korea which are only now finding their way into the indexes for one reason or another?

Mr. CLAGUE. I say to a small extent that would be true. Our rent index comprises about 5 or 6 percent of our Consumer Price Index. Homeownership is a bigger item because roughly half of the wage earners and salaried earners own their homes. But taking rent, for example, there is still rent control in New York City and there are still a few places in which rent is held down. Rent is still trying to catch up. As controls are relaxed, that small segment of our index would reflect that rise.

Now, look in our chart No. 11—the last chart I presented to you—which sketches these. The services have a definite lag also. That is partly streetcar fares and public-utility prices which are regulated by Government.

On the other hand, I would say that in 1956 the major change in the index and the reason we moved away from stability was that food prices no longer helped us.

For 4 years food prices declined and that offset the rises in these rents and services and other factors on the industrial side. Then, in

1956, food prices turned around and joined the others, and so our index went up.

Mr. ENSLEY. Could I, Mr. Chairman, see if I can get the consensus of the five men on the panel here with respect to the outlook for 1957? If I understand your testimony correctly, I believe you would all agree that 1957 in real terms would probably be better, without being too precise as to percentages, than calendar year 1956.

Would anyone dissent from that? Apparently there is no dissent from that. The second question is this: Would you not all agree, from your testimony and the testimony presented, that we could anticipate a moderate price increase in calendar 1957 over calendar 1956?

I gather that is agreed. What would you anticipate the price increase would be from the present levels and over the calendar year 1956 as a whole? Are we safe in saying that you would anticipate some further price increase from present levels as well as from the calendar year 1956?

Would anyone dissent from that generalization?

Mr. CLAGUE. Let me say a word about our Consumer Price Index. It is very much influenced by what happens to farm prices because foods make up 30 percent of the weight of the average family budget. So what Mr. Wells says about agriculture and agricultural prices will have a great bearing on what will happen to our index. I am quite sure that we will have continued rises in rents and services, but what will happen to commodities is the question.

That, of course, includes all kinds of commodities, including clothing and things of that sort. But the one that will have the most influence on our index in 1957 is probably food prices. If they remain stable we will not do at all badly.

Mr. ENSLEY. In the light of this prediction or forecast I want now to refer to the President's report where he said that of particular importance in the maintenance of a prosperous economy is the responsibility of leaders of business and labor to reach agreements on wages and other labor benefits that are consistent with productivity prospects and with the maintenance of a stable dollar.

My question is, How can we develop a mechanism by which leaders of business and labor assume this responsibility? I wonder if Mr. Gainsbrugh would like to comment on that?

Mr. GAINSBROUGH. Let me go back to your first question while I think about the second one. I think we have backed up price pressures already in the hopper as we enter 1957 that will be at work upon the price structure in 1957.

There are increases at the wholesale price level that have not yet materialized in the retail price index which will show up a 2-, 3-, or 4-month time lag.

I think again, the basic reason for the price pressures over and above those that Mr. Clague has cited, is the fact that wages went up faster than did productivity and, as a result, unit labor costs rose.

Over a long period of time, we find a very tight correlation between the rise in unit labor cost of manufactured products and the subsequent prices of those manufactured products.

There is one further comment: We have already been told about the emerging wage pattern for 1957. These are almost always given

in terms of major contracts that call for further increases in wages in 1957. I have forgotten the figures that Mr. Clague gave us but let us say they center around 8 cents more or less.

Mr. CLAGUE. 6 to 8 cents.

Mr. GAINSBROUGH. If that is the pattern just these wage increases alone are again on the verge above the probable gain in productivity, if not at that particular point. Let us assume a 2 to 3 percent increase in national productivity and no new breakthrough in the wage pattern for 1957.

We already have banked up wage increases that will be about equal to the gains in productivity in 1957 unless the gains in productivity are exceptional.

I do not think we have found an answer yet to how you deal with this particular problem anywhere in the Western World. That is, the problem of rendering our full-employment goals compatible with price stability.

I am perfectly willing to concede that hortatory measures may be no more successful in the future than they have been in the past. The course of the economy reflects these pressures in the face of the desires of the employer to hold down prices or of the employee to keep wage increases consistent with productivity. At least this has been the pattern so far.

If I were asked to single out one approach that might be productive, I would suspect it would have to be the educational process, singling out this particular phenomenon for national attention, holding hearings as you are now doing in connection with the cost patterns, the wage patterns, and the price patterns of our major industries, and perhaps through that mechanism, exercising some degree of restraint.

The other approach that is hinted at in the President's message is through direct controls of one type or another—and these are not specified or developed—as compared with the voluntary mechanism. I am hopeful that through the educational process we can restore a better balance between wages, costs, and prices than we now have.

Mr. ENSLEY. It is one of the most difficult problems currently facing us.

Mr. GAINSBROUGH. Yes, sir.

Mr. ENSLEY. Would it be permissible to insert at the end of Mr. Paradiso's statement some correspondence with the Secretary of Commerce with respect to data underlying the President's Economic Report?

Chairman PATMAN. Without objection, that is so ordered.

The bankers use an expression, "moral suasion." Do you go that far or do you just say "education"?

Mr. GAINSBROUGH. I would use both.

Representative CURTIS. Mr. Ensley's line of questioning, particularly about these pent-up forces, raises some question in my own mind on that agricultural picture.

I have not thought it out but I will be interested in your reply, Mr. Wells, in regard to the relationship of Government subsidies in our agricultural economy. It was pointed out that we are experiencing what amounts to pent-up forces that are now coming out in our national expenditures.

Realizing that the price of agricultural goods does make up 30 percent of the budget, would you think that that is a type of pent-up

force that is exhibiting itself as having inflationary effects now? I have not thought it through and I am wondering if it has any bearing.

Mr. WELLS. There are several observations I would like to make partly to your question and partly to Mr. Clague's comments. I did try to make the point that the agricultural budget last year, this year, and next year is partly paying the cost of pressures which were built up during 5 years of decline in prices, that is, averaging it out.

Representative CURTIS. That is what I am directing my question to.

Mr. WELLS. It is a fact that over those years, for about 59 months, prices were falling and they did give stability to the cost-of-living index. Mr. Clague suggests that perhaps what happens to the cost-of-living index during this year is more closely tied with farm prices than with anything else.

I, of course, would have to differ with Mr. Clague. In the first place, although about 30 percent of his budget is food, about 60 percent of that is not farm prices. The farmer gets about 40 percent of the food dollar and that means that 18 percent of the consumer price index is goods and services beyond the farm level that are associated with food.

Representative CURTIS. I have just a word of caution. I, of course, have heard that presentation but I have also noticed that a great deal of the processing of foods is now being done on the farm, more particularly in our large mechanized farms, or right nearby. This actually gets directly into the farm economy itself. But essentially your point is well taken.

Mr. WELLS. I personally think that the rise in the price of the farm-food commodities from the level that was prevailing in December will be quite modest indeed. I think we have had most of our rise in farm prices during the last 12 months.

I would place more emphasis than Mr. Clague does on this automatic round of wage increases plus the negotiated wage increases which will accompany it as an inflationary factor during the coming year.

I am also more interested, I think, than our discussion here has so far led us, in the kind of consumer and business psychology that is going to prevail at the end of this year than I am with the actual level of averages for the year.

I do not know whether I make myself clear or not. We live through time and what I am interested in is, How are we going into 1958? I think there a great deal depends on Mr. Katona's consumer.

Now, I happen to believe that Mr. Clague's index is an excellent index, but there is one type of inflationary pressure that Mr. Clague's index does not measure and that is the desire of the American consumer to upgrade his standard of living. If American consumers all decide they want pushbutton, two-tone automobiles with tubeless tires instead of secondhand cars, and if half of them decide to buy deep freezes or color televisions, the increase in buying pressures which flow from such optimistic consumer and business attitudes is, I think, one of the chief factors in such situations as developed in 1955 and 1956.

Now, in 1954, for the first time American business spent more money advertising in a year of falling consumer demand than they had spent the previous year. They conditioned the American consumer to want more, or so my advertising friends claim. These questions as to what

influences consumer psychology interest me just as much as what influences the businessman's expectations and capital expenditures. What kind of a frame of mine are the American consumer and the American businessmen going to have going out of 1957 into 1958?

Representative CURTIS. Thank you.

Mr. CLAGUE. I have just two points. Mr. Wells and I are not in basic disagreement at all. I would like to clarify what I meant when I said food was important in our index. Food happens to move seasonally and it swings up and down during the year. We will have rising food prices until we get the summer markets and then those prices fall.

In the meantime, however, food may be the one factor that will make our index move more in the short run, that is, in the spring of 1957. I have assumed all along that the other factors, rents and the services and perhaps certain other commodities, will increase slowly as they have been doing.

But he did not give me that assurance. I have one last point. I want to make sure that I get it clear to the committee. Mr. Wells said it correctly but I want to emphasize it so there will be no misunderstanding.

Our index does not put into the price of an automobile the rising standard of living that Mr. Wells was talking about. He said it correctly; we factor that out. A rising standard of living means more purchasing power by consumers, but our index does not show what that is.

We have not designed it to do that. We designed it to show the rising costs of the same kind of market basket and, as far as possible, the same quality of goods.

Mr. KATONA. Mr. Chairman, may I make a short remark on interest rates? Mr. Curtis has correctly pointed out that the savings and loan associations have profited substantially from the fact that they paid higher interest rates than other savings mediums.

Now, that is a differential effect and does not change the fact that the average saver does not save more if interest rates go up. We have at the present time a rather unfavorable differential effect.

For most Americans the most popular and most favored savings medium is still United States Government savings bonds. United States savings bonds, which had a relatively favorable interest rate over 10 years, are now in an unfavorable position as compared to other savings mediums.

Secondly, what is missing there is "upgrading." People want something new and something added, and savings bonds have not changed over the past few years. I personally believe that some people save less because their favorite medium is less attractive than, differentially speaking, it had been 5 years ago.

One question for the Congress of the United States, I believe, is whether that should continue or whether some changes in the interest structure or tax privileges of United States Government savings bonds should not be introduced.

Chairman PATMAN. I just want to ask you, Mr. Wells, to place in your testimony, if you please, the month-by-month figures for farm prices during the 59 months that you mentioned farm prices went down, from February of 1951.

Mr. WELLS. I would be glad to do that.
(The material referred to follows:)

Prices received by farmers, prices paid or parity index, and parity ratio, United States, by months, February 1951—January 1957

[1910-14=100]

Date	Prices received index ¹	Parity index ²	Parity ratio ³	Date	Prices received index ¹	Parity index ²	Parity ratio ³
1951—February	313	277	113	1954—January	258	282	91
March	311	281	111	February	258	282	91
April	312	284	110	March	255	283	90
May	306	284	108	April	257	282	91
June	300	283	106	May	255	284	90
July	294	283	104	June	247	282	88
August	291	283	103	July	246	280	88
September	292	283	103	August	248	281	88
October	297	284	105	September	246	280	88
November	303	285	106	October	242	279	87
December	306	285	107	November	242	279	87
1952—January	299	288	104	December	239	279	86
February	293	290	101	1955—January	243	283	86
March	291	289	101	February	244	283	86
April	292	290	101	March	242	284	85
May	291	290	100	April	246	284	87
June	290	288	101	May	242	282	86
July	292	287	102	June	241	282	85
August	294	288	102	July	236	281	84
September	288	286	101	August	232	280	83
October	281	284	99	September	235	279	84
November	275	282	98	October	229	280	82
December	269	281	96	November	224	279	80
1953—January	267	284	94	December	222	278	80
February	263	281	94	1956—January	226	281	80
March	263	282	93	February	227	280	81
April	260	280	93	March	228	282	81
May	263	280	94	April	235	284	83
June	267	277	93	May	242	286	85
July	268	278	93	June	247	286	86
August	265	279	91	July	244	287	85
September	266	277	92	August	237	288	82
October	249	276	90	September	236	287	82
November	249	277	90	October	234	287	82
December	255	278	92	November	234	289	81
				December	237	290	82
				1957—January	238	292	82

¹ Index of prices received by farmers.

² Index of prices paid by farmers for commodities used in farm production and farm family living, including allowances for wage rates paid hired farm labor and interest and taxes per acre of farm real estate.

³ Ratio of index of prices received to index of prices and cost rates paid by farmers.

Source: Agricultural Marketing Service.

Chairman PATMAN. Would it be asking too much of you or should I ask Mr. Clague to do this: To take the information that you have and ascertain what the cost of living index would have been had farm prices gone up during that period of time as industrial prices went up. (See p. 598.)

Mr. WELLS. I think Mr. Clague and I could come to an agreement on that. That is on the assumption, Mr. Chairman, that nothing else would have changed.

Chairman PATMAN. Without objection, the committee will stand in recess until tomorrow morning at 10 o'clock in this room.

(Whereupon, at 12:20 p. m., the hearing in the above-entitled matter was recessed to reconvene at 10 a. m. Thursday, January 31, 1957.)

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 31, 1957

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

The committee met at 10 a. m., pursuant to recess, in room P-63 of the Capitol, Hon. Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Bolling, Mills, Talle, Curtis, and Kilburn; Senators Sparkman, O'Mahoney, and Watkins.

Present also: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Chairman PATMAN. The meeting will come to order.

We are all aware of the upward trend in prices. A panel of distinguished economists told this committee yesterday that prices are likely to continue upward during the coming year.

The Economic Report expresses concern about this situation. The President indicated the limitations of Federal monetary and fiscal policy in maintaining economic stability under present circumstances. Much of the President's report is in the form of exhortation to leaders of business and labor to exhibit statesmanship in their wage negotiations and pricing policies.

Today we have assembled a panel of economists to discuss price changes and policy implications. We have submitted to them questions as to the amount and nature of recent price changes, factors in price changes, and implications for policy. Every attempt has been made to secure a well-balanced group of witnesses.

In order to expedite the discussion the Chair will recognize each of the 8 panel members for purposes of making an opening statement of 8 minutes, summarizing the views of the witness. We will proceed without interruption through the opening statements, following which there will be general discussion by members of the committee and the panel. The committee staff will notify each speaker when his 8 minutes has expired.

Our first witness this morning is Mr. Leon H. Keyserling, economic consultant, and former Chairman of the President's Council of Economic Advisers.

Mr. Keyserling, you are recognized for 8 minutes.

STATEMENT OF LEON H. KEYSERLING, CONSULTING ECONOMIST

Mr. KEYSERLING. Mr. Chairman and members of the committee, we should all be concerned about price rises which, during the past 12 months, have been more than 4 percent for industrial prices, about 3

percent for consumer prices, and in the case of such items as steel more than twice as much. At the same time, we should not confuse this situation with the wartime overall inflationary situation; and because the two situations are being confused, we are doing the wrong things in the wrong places in our national economic policies. We are inflating the parts of the economy that are inflated, deflating the parts that are deflated, sacrificing our great national objectives which we must achieve for world security, and neglecting to fight inflation in reasonable ways.

In an overall economic inflation such as during World War II there were shortages of everything. The economy was growing at more than a normal rate. Because there were shortages of everything, all prices were going up. The proper approach in those times was to use the classic anti-inflationary weapons all along the line.

The situation today is entirely different. There are some shortages, but there are lots of surpluses. Some prices and incomes are going up too fast, other prices and incomes are going down much too fast. We have mixed inflationary and deflationary forces operating at the same time.

To illustrate, the rate of our economic growth is slowing down, and, as underscored by the Symington report of 2 days ago on airpower and by the statement in the New York Times today that the Russians in recent years have expanded their industrial output by 10 to 11 percent, the slowdown of our rate of economic growth is real and serious. We grew by more than 4½ percent annually in real terms during the first few years after World War II. We slowed down to 2.6 percent annually during the last 4 years. During the past 12 months we have grown only by 2.5 percent. The consensus or unanimity of witnesses yesterday was that our real rate of growth would be even slower in the next 12 months. Therefore, we are faced with this dilemma: If we apply to the economy the repressive measures which are desirable in an overall inflationary situation, we are saying that we can afford and should try to grow only one-fifth or one-fourth as fast as the Russians.

Second, the selective inflationary trends of today represent distortions, rather than overall inflation. I have on page 6 of my statement the details of this. I don't have the time to give all the facts in my opening statement.

In summary, the essence of the recent situation has been an expansion of an investment boom in plant and equipment at more than a sustainable rate relative to the growth of consumption. This has been underpinned during the last 4 years by an increase in certain types of incomes, big business profits, dividend income, interest income, at a more than sustainable rate, and a progressive falling behind in the underpinning of consumption which rests primarily in wage payments and farm income. We cannot cure these distortions by pouring oil on the flames of inflation where it exists and water on the embers of deflationary sectors. Yet current national economic policies are directed toward these purposes.

For example, first of all there is the hard money policy. The hard money policy has practically no effect whatsoever upon the relatively excessive rate of growth of investment, or the relatively excessive growth of prices and incomes in some parts of the economy. The very large companies which have been contributing to the investment boom,

which has been relatively too fast, are not affected by the hard money policy. They finance out of their own resources, out of depreciation reserves, and out of the price structure. They finance in advance out of the consumer before they build their plants, and after they build their plants they use the increased productivity to be paid again for the same plants, and then they use the fact that wage increases come along at that time as a justification for still further price increases.

In contrast, the hard money policy is pouring water on the embers. It is deflating farm income further by making the financing of crops harder. It is forcing out the marginal small-business man. It is decreasing the ability of consumers to buy durable goods. As a matter of fact, during the past 12 months, consumer buying has increased only by 2 percent in real terms, or even less than the extremely low $2\frac{1}{2}$ percent rate of growth in the overall economy. This has not been due to excessive saving. It has been due to inadequate consumer income, as I can elaborate when I have more time.

Third, the budgetary policies of the Federal Government have also poured water on the fuels of inflation and failed to deal with the bottlenecks and shortages which are inflationary in the short run, and deflationary in the long run. We hear that the new budget is the biggest budget in peacetime. Realistically measured, it is the smallest. Since 1953, the budget of the Federal Government has shrunk from 20 percent to 16 percent of the size of the national economy represented by gross national product. If we could afford this so-called economy now, in terms of our international needs and our domestic deficiencies, I would be for it. But it certainly throws a lot of doubt on the traditional classical palaverings about the causes of inflation to have the kind of price inflation we have now when we have been running a nice budgetary surplus, and when Federal budgetary outlays have decreased by 20 percent relative to the size of the economy.

Actually, the Federal budgetary outlays are not directing themselves to the specific bottleneck situations, such as the inadequacy of resource development. This is inflationary. And infinitely more important, they are not directing themselves to the world situation. Let us remember that even during World War II, when we had an infinitely more inflationary situation, we did not throw out the baby with the bath. Even then, we did not, as the theoretical economists would have had us do, collect in taxes all that we spent. Because while theoretically that would have been anti-inflationary, we also had to remember that it was even more important not to disrupt our productive system. Nor did we during World War II decide that, because we were fighting inflation, we should fight Hitler at half speed. We put first things first, and that is the purpose of a Federal budget. I do not mean that we should run a Federal deficit now. But we could spend more to meet basic needs, stimulate a more adequate rate of growth, and still run a budget surplus. The Federal budget of today is defective from the viewpoint of fighting inflation, defective from the viewpoint of our national needs, and the hard money policy is even more upside down.

Now, the current inflation is not caused by an overall excess of demand. You certainly do not have an overall excess of demand, when your economy is slowing down more and more below its normal rate of growth. But some people say that the current inflation is

being caused by cost pressures operating against the price structure, namely and specifically by wages. This is erroneous.

Let us take the steel industry as an example. Is our business management so lacking in judgment that they will pay out more and more in dividends every year when they do not have ample funds for plant expansion? The answer is obviously no. Why are dividends rising more and more month by month and year by year if profits, the function of which are to finance expansion, are inadequate? As I have said before, they have had ample funds to finance expansion, and yet they have been financing largely out of the consumer, out of the price structure, out of the retained earnings, and out of tax favors from the Government. There has not been the kind of pressure upon costs which could justify these kinds of price increases. In fact, we are faced with a situation which national economic policy has not come abreast of. It is not an overall inflationary situation. It is not an overall deflationary situation. It is a mixed situation. In a mixed situation, we have to solve this conundrum: How can we maintain a high enough level of economic activity to use our resources effectively and to meet the world threat confronting us, and do justice to the underserved portions of our population, and at the same time avoid a price inflation which in the current situation is not resulting from general overstrain, is not resulting from general shortages, but instead is resulting from the tendency of an administered price system to get what it can while it can? So long as we have our kind of economic system, and I believe we are going to have this kind of system, and I am for this kind of system, then we must find ways to combat this particular kind of selective and administered price inflation.

May I say what kind of selective inflation is now combined with selective deflation? It is in part the cause of the inadequate rate of economic growth, because the same restrictionary policies which are contributing to the price inflation are not expanding capacity enough. It is in part the result of an inadequate rate of economic growth. It is causing deflationary tendencies in other parts of the economy. We now have not a problem of general inflation, but a problem of bad balance. We have to adjust our national economic policies to restore a better balance, and I recommend the following policies.

My 8 minutes are up. My prepared statement covers the subject in detail, and includes my recommendations. Thank you very much.

(The statement follows:)

SUMMARY OF FULL STATEMENT OF MR. KEYSERLING

There is proper concern about combating the inflationary price trends in various parts of the economy. But current national economic policies and programs are seriously tending to fight the wrong enemies in the wrong battles at the wrong time and in the wrong places. This is because these policies and programs are utilizing, though to a lesser degree, some of the broadside weapons which were appropriate to the type of overall inflationary situation characteristic of wartime, when the total resources of the economy were overstrained, when total demand far exceeded total supply, when the overall growth rate of the economy was abnormally high, and when commodity shortages almost everywhere were pushing up prices almost everywhere. The situation today is entirely different, and calls for highly selective treatment. The economy as a whole is not overstrained; the rate of economic growth has fallen to seriously low levels; shortages in a few selective areas are accompanied by surpluses or ample supplies in most areas; and excessive price, income, and investment trends in some parts of the economy are accompanied by excessively low price, income, and production trends in other parts of the economy.

We are now in a mixed situation, where there is not general inflation caused by an overstrained general economy, but rather a selective and distorted inflation, and a selective deflation, which are in part the result of and in part the cause of our economy's lagging far behind an optimum rate of economic activity and real growth. Yet the Federal budgetary policy is in the overall on the repressive rather than the expansionary side. It is designed to short-change the national security which we need most for our national survival, and to short-change the development of natural and human resources which we need for adequate economic growth. Yet it is not designed in detail to break some of the specific bottlenecks or remove some specific shortages which are contributing to the immediate inflationary pressures. The credit and monetary policies, including the hard money policy, are repressing the rate of overall economic growth, and adding to the distortions in the economy by pouring oil on the flames of selective inflation and water on the embers of selective deflation.

A Federal budget which has been reduced from 20.8 percent of our total national production in fiscal 1953 to about 16 percent now is cramping the things that we need most as a Nation. A hard money policy which is making it harder to build schools is having the same effect. An exhortation to labor to be more restrained with respect to wages fundamentally misreads the current economic situation, which is characterized in the overall by a nonsustainable investment boom getting more out of line with inadequate consumption. Price increases which largely represent the administered judgments of business, without basic economic justification, are attributed to the wrong causes and assailed with paper swords. The problem of building our world strength, and the problem of combating vigorously the first lurking signs of deflationary forces, are being relegated to the sidelines, while attention is being concentrated upon inveighing against an overall inflationary situation that does not exist while ignoring or neglecting both the selective inflationary dangers and the selective deflationary dangers which do exist and interact upon each other.

Instead of this, we need a more vigorous effort to expand production, and to elevate our rate of overall economic growth to attainable and desirable levels. To meet our full needs, we must have maximum production. We need a Federal budgetary policy which carries forward the things we need most, and if this should in fact cause inflationary pressures, we should be prepared to restrain the superfluous rather than the essential. We need specific programs or incentives to break some of the bottlenecks—such as steel capacity—which are cramping the whole economy, instead of trying to force the economy into the bottle through the narrow neck. We need a comprehensive congressional investigation, from top to bottom, of why some prices are rising so much when the economy as a whole is lagging, and when there is no intrinsic justification for many of these price rises. We need a reversal of the hard money policy, which hits the economy where it is most vulnerable, and aids those who need no stimulus. We need, from the Council of Economic Advisers through the Economic Report of the President, a far more alert responsiveness to the mandates of the Employment Act of 1946. Currently, the Council is not setting forth needed levels of employment, production, and purchasing power, and thus it is providing no concrete guides to economic adjustments, programs or policies.

FULL STATEMENT OF MR. KEYSERLING

Mr. Chairman and members of the committee, your inquiry into the many signs of price inflation is vital and urgent. It is my hope that your general examination of this subject may shed light upon and be followed shortly by a detailed investigation of the whole price situation by the appropriate committees of the Congress. During the past 12 months, the consumer price index has risen about 3 percent, the wholesale price index for all commodities has risen about 4 percent, and some prices in critical areas have risen far more. It would be dangerous if these inflationary trends were ignored or neglected. But the far greater actual danger today is that, substituting excitement for clear analysis, we are applying some national economic policies and programs which intensify rather than reduce the current inflationary dangers; misread the nature of the economic situation and therefore contain ultimate threat of a deflationary spiral; and, above all, throw out the baby with the bath by neglecting national security and domestic needs which are more imperative than absolute price stability, although the more adequate servicing of these needs would also contribute to

price stability. Due to the lag in economic thinking and its practical application, we are in process of fighting the wrong enemies, in the wrong battles, at the wrong time, and in the wrong places.

The economic problems of depression and wartime inflation created approaches which were not completely effective when used, and which in any event now lead to gross oversimplification and misdirection of effort when applied to the current situation. An examination of some history is essential to an understanding of the current situation.

During the great depression, we suffered from tremendous underutilization of our total resources, accompanied by a negative rate of economic growth from year to year. This was reflected in surpluses of goods or of productive capacities almost all along the line, accompanied by sharply falling prices almost all along the line. To reverse these trends, the formula was developed that Government spending and deficit financing should be greatly increased, and that credit should be made very abundant and very cheap. There is now common acceptance that this approach was correct. But it nonetheless was an oversimplification, because it did not sufficiently stress that the causes and cures of our economic difficulties are complex and manifold. Not enough attention was paid, for example, to the quasi-independent factor of business investment. Not enough attention was paid to the fact that Government spending and deficit financing could not be increased rapidly enough, nor credit availability expanded enough, to do the whole job. To have attempted the whole job through these devices would have involved the Government in a range and scope of activities far beyond the very nature of our economic system in peacetime. Consequently, full prosperity was not restored until World War II, which is another way of saying that the lifting of the economy from unusual depths through prime reliance upon the spending power of government involved operations of a size tolerable only in wartime.

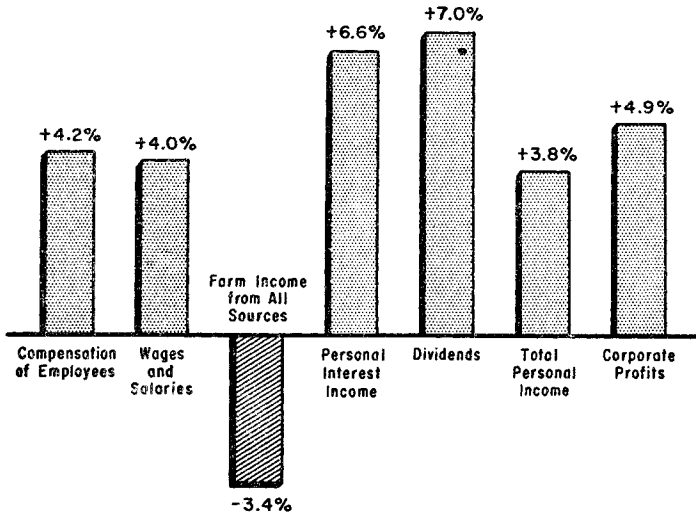
There is common acceptance today of the proposition that there was much inadequacy and oversimplification in the idea that severe deflation could be fought successfully by enlarged government spending, deficit financing, and easy credit. Yet, today, we are applying this oversimplification in reverse. We are running into the serious error of trying to fight so-called inflationary dangers by excessive reliance on a tight control of government spending, budgetary surpluses, tight credit, and hard money. This would be too narrow an approach, even if we were confronted with general and overall inflationary pressures of the wartime type. But it is a doubly dangerous approach today, when the so-called inflationary pressures are of an entirely different type, indicative of entirely different fundamental economic conditions, and fraught with entirely different types of perils. To illustrate this, we must compare the wartime inflationary situation with the enormously contrasting conditions of today.

In the early stages of World War II, for example, the total private and public demand for goods and services far exceeded the Nation's total productive power, even when the economy was operating at top levels and expanding at an unusually fast rate of real economic growth. There were shortages all along the line, for farm products as well as for industrial products. These conditions generated sharply upward price movements all along the line. To prevent price inflation from rationing goods in the wrong direction under such conditions, there was need for the classic anti-inflationary weapons: very high taxes, drastic restraints of credit, and even price and wage controls. There was need also to defer civilian housing, school and hospital construction, road building, and a wide range of consumer goods including automobiles. But even during World War II, we did not let the theoretical economists run away with us and substitute theory for sound policy. Despite the need to fight inflation, we did not lift taxes enough to achieve a budgetary surplus, because to do so would have distorted the whole process of productive expansion through the use of our enterprise system. Nor did we, through preoccupation with the fight against inflation, decide to fight Hitler at half speed. We redoubled our efforts with respect to the things we needed most, and put aside the superfluous instead of foregoing the essential. Above all, although it created some additional inflationary strains, we concentrated upon the expansion of total production at far above the normal rate, so as to get closer to a situation where we could enjoy without inflationary strains some of the things we needed less.

In the Korean war situation, we faced the same types of problems in smaller size. There were some who wanted to fight inflation solely by cutbacks of civilian production, and by freezing all prices, profits, and wages. Believing that this would be a highly undesirable approach, I took the contrary view that we should combine appropriate anti-inflationary measures with vast efforts to ex-

LABOR AND FARM INCOMES, 1953-'56 GREW TOO SLOWLY RELATIVE TO OTHER INCOMES TO SUSTAIN FULL PROSPERITY

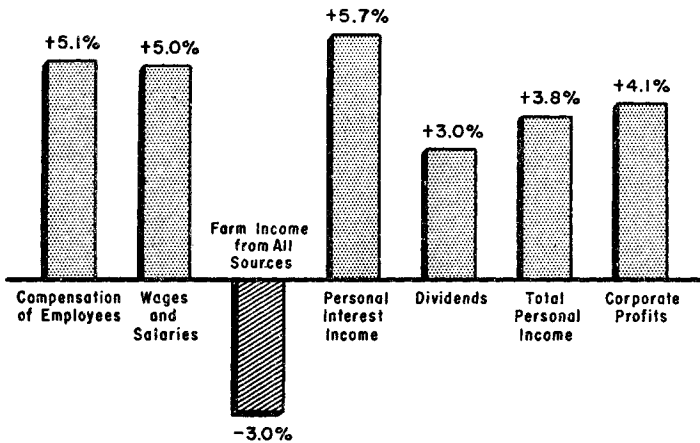
Average Annual Rates of Change in 1955 Dollars



THE BALANCE WAS BETTER IN 1947-'53

(Farm Income Did Decline, but Less Than in 1953-'56)

Average Annual Rates of Change in 1955 Dollars



Data: 1947-1955, Dept. of Commerce; 1956 estimated by Conference on Economic Progress on basis of first half year and Outlook.

pand production, and particularly the industrial base of production, as the most fundamental solution to many foreseeable years of high national security efforts in a critical world situation. This broader approach was successful, to the degree that by the middle of 1951 and for several years thereafter we enjoyed relative price stability because we had brought our productive genius to bear upon the problems confronting us. If we had not done this, we not only would have failed to put first things first, but we would also have had more inflation—first suppressed and then overt—for a longer period of time.

These experiences have some bearing upon the economic situation today, and some implications for current policy which I shall come to shortly. But first of all, we must grasp firmly the supremely important fact that the so-called inflationary pressures of today are entirely different in all respects from those during World War II or during the early stages of the Korean war. The inflationary trends of today are occurring, not when the economy as a whole is overtaxed or growing at an excessively fast rate, but rather when the total private and public demand for goods and services is far short of the Nation's productive potential, and when the overall rates of economic activity and expansion have for some time been much too low. The so-called inflation of today is not general but highly selective, and reflects increasing distortions in the whole economic structure. While some prices and incomes and lines of activity have been advancing too fast in absolute or relative terms, other types of prices or incomes or lines of activity have been advancing too slowly in absolute or relative terms, or standing still, or falling dangerously backward. Under such circumstances, inflationary and deflationary forces are commingled; and the inflationary trends, instead of reflecting an excessive overall rate of economic activity or growth, are in fact the types of distortions which are holding overall economic activity and growth far below normal or desirable levels and are threatening the emergence of a deflationary spiral. Meanwhile, Government policies and programs have tended to slow down the things we need more of, stimulate some of the things we need less of, and add both to the inflationary and deflationary dangers by accentuating the distortions. Let us now examine the facts supporting these propositions.

(1) *The overall growth rate of the economy has been slowing down dangerously.* During the seven-year period 1947-53, the total economy expanded at an average annual rate of about 4.7 percent, measured in uniform 1955 dollars; during 1953-56, the rate fell to about 2.6 percent; and from fourth quarter 1955 to fourth quarter 1956, the expansion was only about 2.5 percent. The average annual rate of our real growth during the past 40 years has been about 3 percent, and since World War II much higher.

Thus, it is clear that recent developments have swung far below the rates of growth consistent with full and efficient use without inflation of a growing labor force and a rapidly advancing technology. The majority judgment of business analysts today is that, at best, the economy will continue to exhibit only about this excessively low rate of real growth in the coming year. This unsatisfactory outlook is due primarily to the inability of the investment boom in plant and equipment to continue to expand so much more rapidly than general consumption, and due correspondingly to the inadequate expansion of consumer demand for residential construction, other durables, and some soft goods. On the domestic front, this means that the central economic problem of today is to enlarge the overall rate of economic growth, lest the insufficient absorption of a rapidly growing labor force and a rapidly growing technology result in the emergence of powerful deflationary forces. However, the world situation is the overwhelmingly urgent reason why we need greatly to accelerate our rate of economic growth. The Soviets are now expanding four to five times as fast as we are in real terms, and allocating a much larger part of their total production to the military and economic aspects of the world struggle.

Our own long-range experience makes it preposterous to assert that we cannot grow much faster than 2.5 percent a year without general inflationary pressures. And the world situation makes it imperative that we grow faster, even if this generated some selective inflationary pressures, which should then be counteracted by effective measures. In fact, the low rate of economic growth itself contributes to current inflationary pressures. It discourages adequate expansion of productive facilities, and thus creates bottlenecks. It encourages the tendency to substitute higher prices for bigger sales. It reflects shortages in some resource areas, which we say we cannot afford to overcome because the economy is not growing rapidly enough to support the needed programs, while in fact these shortages are cramping the rate of growth and thus will be highly inflationary in the long run.

And as already indicated, the excessively low rate of economic growth is the product of existing inflationary distortions, even while the low rate of growth contributes to further distortions.

- (2) *The selective inflationary trends of today reflect and create serious imbalances and distortions within the general economy, which do not result from an excessive overall rate of economic activity and growth, but instead stunt overall economic growth and threaten economic stability.*

During the 1953-56 period as a whole, farm income from all sources has dropped 8.3 percent, in constant dollars, while national income has increased 11.5 percent; and farm prices have dropped 8.5 percent while industrial prices have risen 7.2 percent, consumer prices 1.6 percent, and retail food prices dropped only 1.0 percent. During the same period as a whole, personal interest income has been advancing about 65 percent faster than wages, and dividend income has been advancing about 75 percent faster than wages. Corporate profits have been advancing about 29 percent faster than the personal income of the people as a whole, even while the ratio of small business profits after taxes to big business profits after taxes has declined from about 70 percent in 1952 to about 50 percent in 1955; some improvement appeared in this ratio in 1956. These disparate trends have been both cause and effect of the growth in our productive facilities at a much more rapid rate than the growth in consumption, which in the long term view has deflationary rather than inflationary implications. From fourth quarter 1955 to fourth quarter 1956, while investment in plant and equipment grew about 10 percent in real terms, consumption grew only about 2 percent. And because disposable personal income in real terms has grown even more slowly than consumption, even this inadequate growth in consumption has needed support from a nonsustainable credit boom. Under these circumstances, it is a complete misreading of the situation to complain that wages have been advancing too fast, or to assert that this is the central cause of price inflation. While there is a real problem of unevenness in the wage structure, and of lifting low-income families relatively faster than others, consumer incomes, of which wages are the major portion, have been advancing much too slowly to maintain balance between investment and consumption at a satisfactory rate of economic growth. Nor in the main have the wage increases as a cost factor necessitated the price increases; the excessive relative rate of investment, and the constant lifting of dividend payments to new heights, indicate that profits in the overall have been more than adequate to support their investment and income functions.

- (3) *Most of the specific price increases, under these circumstances, have not been due generally to an inflationary strain on resources.*

Consumer prices and even food prices have been advancing. But this has not been due to an undersupply of clothing or of food; both of these areas are in surplus. Some of the price advances have been due to the power of an administered price system, under semi-monopolistic conditions, to advance prices even when productive capacities are by no means strained. Some have been caused by the predilection of an administered price system to utilize legitimate wage increases as an excuse for pyramided price increases and excessive profit margins. Of these tendencies, the steel industry is a good example. The industry raised its prices even during the economic recessions of 1949 and 1953-54, when operating far below capacity. The industry sought to justify its large price increases in 1956, which were several times the computed cost of the wage increases, on the ground that it needed more money to finance plant expansion. But plant expansion should be paid for out of the improved productivity and efficiency which results from the new plants; when it is paid for by the consumer before the new plants are built, there is an extra and unjustifiable payment. The steel industry has kept its capacity too low, so that it is now operating at more than 100 percent of capacity, and has operated too close to capacity in all fully prosperous years. Today, there is a steel shortage which operates as a bottleneck on the whole economy. Compared with 1953 as a whole, wholesale industrial prices by the fourth quarter of 1956 had risen only about 9 percent, while steel prices had risen more than 22 percent. Comparing fourth quarter 1956 with 1955 as a whole, industrial prices rose only 6 percent while steel prices rose about 12 percent. The disparities in fact are greater, because the index of industrial prices includes steel prices. We are now confronted with a situation where most of the price rises are due, not to genuine inflationary pressures, but

rather to concentrated economic power unwisely exercised. This threatens deflation more than it threatens inflation, and this is the problem with which we need predominantly to deal.

- (4) *The budgetary policies of the Government have not been responsible for these selective inflationary trends; they have been responsible for the inadequate rate of overall economic growth and for some of the distortions in the structure*

Federal budgetary outlays for national security have declined from 14.1 percent of our total national production in fiscal 1953 to an estimated 9.6 percent in the current fiscal year 1957. Thus, the proportion of our total annual production being channeled into this priority purpose has decreased by 32 percent within 4 years. Federal budgetary outlays for all purposes other than national security have declined from an annual average of 8.3 percent of total national production during the fiscal years 1947-53 to only an estimated 6.6 percent in the current fiscal year. The total Federal Budget, which represented a ratio of 20.8 percent to our total national production in the fiscal year 1953, has fallen to a ratio of about 16.2 percent in the current fiscal year 1957. These trends may also be shown in terms of outlays for goods and services, which relate more closely to gross national product.

The President's new Budget, which is mistakenly called "the biggest ever in peacetime," would represent only an estimated 16.1 percent of estimated total national production in the fiscal year 1958. These downward trends in the relationship between the Federal Budget and the national economy, accompanied by nice-looking budgetary surpluses in the most recent years, demonstrate conclusively the error of the notion that inflationary or anti-inflationary price trends can be correlated with the Federal Budget alone. We have recently been following, and seem committed to continue to follow, a Federal budgetary policy which has not grappled properly with the inflationary problem, but instead has succeeded only in giving lowest priority to the things we need most—national defense, international economic exertions, and domestic expansion of such important foundations for economic stability and growth as resource development and schools. Actually, by stunting the rate of economic growth, these Federal budgetary trends are inflationary in the short run and deflationary in the long run. They are not compatible with stable economic growth, and therefore are not compatible with stability in the price structure.

- (5) *The credit and monetary policies of the Government, including the so-called "hard money policy," have even more clearly been based upon a misreading of the overall economic situation; they have contributed to the distortions which mean selective inflation on the one hand and selective deflation on the other hand*

As an aggregative device, the hard money policy has once again demonstrated, as I have insisted on many early occasions, that it cannot stop selective price inflation without being pushed to the point that would threaten a general deflation and rapidly rising unemployment. More specifically, the hard money policy is operating directly conversely to correcting the distortions in the economic structure. It has exercised almost no effective restraint against the parts of the economy which have been booming relatively too rapidly, such as investment in plant and equipment. The very large companies which are responsible for most of this investment boom finance themselves by methods which leave them relatively unaffected by such restraints. But the hard money policy is operating severely against the very parts of the economy which are relatively depressed and underutilized—the small businessman, the farmer, the homebuilder, and the low-income consumer purchaser of durables. In addition, the hard money policy is holding back the most needed public improvements at the State and local level, and increasing by one-half to three-fourths of a billion dollars a year the cost to the Federal Government of doing the very things that we are not doing enough of. The hard money policy, in short, by handing out income bonanzas and incentives to some who do not need them, and reducing the incomes and activities of others who are in real trouble, is pouring fuel on the fires of inflation in some parts of the economy and water on the embers in other parts of the economy.

RECOMMENDED PROGRAMS

The lines of approach which we need to deal with the current economic situation and outlook, in the context of a world situation which we are told is becoming more perilous, are in summary these:

(1) First and foremost, we need to maximize production and economic growth. We cannot do enough of anything—and we need to do more of many things—if we keep half-hidden the productive genius which is the great non-secret weapon of the American economy. The Economic Report of the President and his budget message, instead of overemphasizing the things that we must do without, should elevate to central importance the things that we must do. Of course, we cannot do everything at once, but we must achieve the necessary before we enjoy the superfluous; and the full production we can have, in a situation short of total war, can provide both the necessary and the superfluous.

(2) We need to utilize the Federal budget to provide the American people with an adequate level of national security, plus a level of basic domestic programs, with respect to our material and human resources, sufficient to reduce inflationary pressures by breaking bottlenecks and by overcoming shortages, and sufficient also to underpin an optimum rate of economic production and growth from year to year. The strongest Federal budget is that which helps to make the national economy strongest.

(3) We need, through private and public economic policies combined, to correct the current distortions in the price, income, and production structure, which are increasing inflationary pressures in some areas, increasing deflationary dangers in other areas, and thus threatening us ultimately with a deflationary spiral. On the public side, this means a Federal budget which helps those first who need help most, instead of stimulating those who are out of line on the high side. To prevent the incomes of the people and the necessary outlays of Government from being taxed by selective price inflation, we need a detailed congressional investigation of the whole price situation from top to bottom. A large proportion of the recent price increases have been due, not to economic necessity, but rather to economic misbehavior. Direct controls of prices are undesirable in these times, but the watchful eye of an informed Congress and an informed public is highly desirable.

(4) We need to abandon the so-called hard-money policy, which in the interest of special groups is rationing incomes and goods in the wrong direction, and holding the overall rate of economic growth to dangerously low levels. In place of this hard-money policy, we may need some more specific and selective restraints which fight selective inflationary dangers instead of injuring the economy and the people.

(5) We cannot intelligently nor effectively apply segmental aspects of economic policy, unless we have the whole perspective of the economy in operation and what we are seeking to do. The most recent material prepared by the Council of Economic Advisers, for transmission by the President in his Economic Report to the Congress, has completely disregarded the statutory requirement to state needed levels of employment, production, and purchasing power. Without these targets as benchmarks, there is no way of appraising the validity of proposed economic policies and programs, and this explains the vacuity of the attempts by the Council to set forth or discuss forward-looking policies or programs.

Mr. KEYSERLING. Additional charts bearing on the matters discussed in this statement were presented in my testimony before the Senate Subcommittee on Disarmament on January 17, 1957, and are available in the printed hearings of that subcommittee.

Chairman PATMAN. Professor Backman, professor of the school of commerce, New York University.

STATEMENT OF DR. JULES BACKMAN, PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY

Mr. BACKMAN. Mr. Chairman and members of the committee, I have a more complete statement which I would like to file with the reporter, and would just like to summarize the highlights.

Chairman PATMAN. That is agreeable.

Mr. BACKMAN. The outlook is for a price rise of several percent in 1957. However, we do not face an explosive inflation spiral. The rise in prices has reflected the cost push exerted by increases in labor costs in excess of gains in productivity in a business boom which has made it relatively easy to pass these cost increases on to the buyer. There is an understandable concern with the problem of inflation. However, we are not in a period of classic inflation reflecting either Federal Government budgetary deficits or large expansions in money supply. So long as the Federal budget remains in the black and monetary policy prevents a sharp expansion in money supply, there is little likelihood of a runaway price inflation. Unless the wage-price spiral is fed by an expanding money supply, it is more likely to lead to unemployment of resources as they are "priced out of the market" than to a major price inflation.

To the extent that monetary and fiscal policy are used to blunt the boom, one of the major factors contributing to price advances will be modified or eliminated. But there will still remain the problem of excessive increases in labor costs. Little can be done in the wage area in 1957 because "key wage bargains" already have been reached. But we must look to the future if we are to prevent a repetition of the current situation. President Eisenhower has pointed squarely to the proper goal in this area in his statement that:

Negotiated wage increases and benefits should be consistent with productivity prospects and with the maintenance of a stable dollar (p. 3).

But this objective will only be achieved if management in major industries firmly refuses to agree to labor cost increases in excess of national productivity gains and if the public is educated to understand the dangers which arise when labor cost increases exceed these amounts.

What factors explain the creeping price rise which has been taking place during the past year and a half? It is important to keep in mind that this price does not result from large Government budgetary deficits with an accompanying expansion in bank credit or from a large increase in money supply, including deposits and currency. The rise does reflect a combination of the business boom and increases in labor costs in excess of the gains in productivity.

During the fiscal years 1955-56 and 1956-57, the Federal budget is estimated to be in the black. The cash surplus is in excess of \$3 billion in each year. During this period the Federal debt is being reduced by modest amounts. This is clearly a picture of a Federal budget which is deflationary, not inflationary. This is a budgetary situation which is in sharp contrast to the huge deficits and accompanying tremendous rise in public debt which characterized World War II and the first postwar year with the accompanying large inflation in prices.

The total money supply was increased by only about 1 percent in 1956. Under conditions of capacity operations in key sectors of the economy, a larger rise in currency and demand deposits could only have meant further pressures on the price level.

The period since mid-1955 has been marked by a further rise in labor costs of substantial proportions. Total hourly labor payments including fringes have increased by more than 10 percent on the average and in many industries by considerably more. Since mid-

1955, it appears that increases in labor costs have far outstripped the gains in productivity in manufacturing industries. The result appears to have been a rise in unit labor costs in excess of 5 percent.

The largest increases in prices were recorded for metal and metal products (14.9 percent) and machinery and motive products (12.9 percent). It is interesting to note that within the machinery group, the rise for agricultural machinery which deals with a lagging sector of the economy was 7.7 percent while the increases in prices of construction machinery and electrical machinery, both areas of dynamic expansion, approximated 15 percent. The overall rise for fuel, power and lighting materials was only 5.9 per cent. However, one component, coal prices, rose 22.8 percent under the combined influence of sharply expanding demand and large increases in wage rates. Petroleum products rose 8.4 percent reflecting in part the Middle East situation.

At the other extreme, small net declines were shown for processed foods, lumber and wood products, and farm products.

The areas with the major increases in prices have been largely those in which the pressures of the boom have been greatest while the areas in which prices have lagged have been the areas in which economic activity has not been stimulated significantly. These data also suggest that a slowing down of the boom will be the most potent force to stop the price rise.

It is interesting to note that sensitive prices like copper scrap, lead scrap, and rubber have actually declined during the past year despite the general rise in the price level. This is not the behavior one would expect under conditions of general price inflation. These declines are explainable, however, in terms of the reduced level of activity which characterized the automobile industry and residential building in 1955. It is the pattern of behavior that would be expected during a boom which has an uneven impact on the economy.

It is important to keep in mind that a price rise attributable to these factors will not have the same spiraling effect of an inflation flowing from monetary and fiscal factors. This is not the background for an explosive inflation. It is the background for a further modest price rise so long as the boom persists.

There can be little quarrel with the President's objective of voluntary restraint. However, we must recognize that many key sectors in the economy are not free to apply this proposed standard in 1957. For many important industries, including automobile, steel, electrical equipment, railroads, meat packing, agricultural implements, and coal, wage increases for 1957 and in some cases for 1958 have already been incorporated in contracts.

In many of these industries, the negotiated wage increases are scheduled to be 6 or 7 cents an hour. In addition, provision usually is made for further adjustment in wages if the cost of living should rise. If the rise in the consumers' price index should be two points, it will mean a wage increase of an additional 4 cents an hour in most of the industries listed.

In light of these contract provisions, we already seem assured of an increase in wage rates of 4 percent to 5 percent in 1957. Past experience indicates that the wage adjustments in these key areas will be a very potent force in determining wage increases in other sectors

of the economy where contracts still remain to be negotiated. Under these conditions, it is impossible for industry and labor to exercise the restraint called for by the President unless they were to reopen the existing agreements and negotiate smaller wage increases. Since the probability of such an action is completely nonexistent, it is clear that there is not much that can be done through voluntary restraint insofar as wages and other labor costs are concerned during 1957.

The President warns that the failure of voluntary restraints could lead to wage-fixing and price-fixing by Government. I would like to state categorically that I am completely opposed to any such program to limit price rises in peacetime. Such a program is foredoomed to failure and can only result in disruptions to production, impairment of incentives, and an ever-widening area of controls which will create worse evils than the control program would be designed to overcome.

The effort to limit price and wage increases by exhortation has never succeeded in the past and will be no more successful under current conditions.

I believe that better results can be obtained through monetary and fiscal policy. Any restraint exercised through monetary or fiscal policy, however modest, will inevitably hurt some groups. This is unavoidable regardless of what policies are adopted. But to state the problem in these terms is to give only a partial picture. What happens if these restraints are not imposed and prices are permitted to spiral? Then the burden falls on the large groups who live on fixed incomes and on those whose incomes do not and cannot keep pace with an inflationary price rise.

Unfortunately, there is no best policy in the sense that no one will feel its effects. There is only a "least worst" policy in the sense that its adverse effects will be kept to a minimum. In these terms, the alternative to hurting some groups who do not contribute to the inflation is to hurt still larger groups who do not contribute to the inflationary pressures.

Do we seriously believe that we are making every effort to combat inflation on the monetary front when mortgage credit, consumer credit, and bank credit continue to expand at near record rates? And is mortgage credit excessively restrictive with the present low down payments and 30-year maturities for mortgages? The Federal Reserve Board "has leaned against the wind," to use Mr. Martin's descriptive phrase, but it certainly has not leaned far enough to be in danger of falling over.

If stronger fiscal and monetary restraints are required to halt an inflation they should be imposed. The evils attending inflation are more serious than those attending strong anti-inflation policies.

Thank you.

(Mr. Backman's prepared statement follows:)

STATEMENT OF DR. JULES BACKMAN
PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY
THE ANATOMY OF THE PRICE RISE

Since June 1955, the wholesale price index has risen by 5.3 percent. However, there has been a wide variation in the behavior of individual prices and groups of prices. It is instructive to determine the areas of the economy which have experienced the greatest price rises as a background against which to evaluate the causal forces and the adequacy of proposed policies. I have prepared sev-

eral tables which show the changes in wholesale prices since June 1955 and since December 1955.

Because of the seasonal price movement for many food and farm products, comparisons between June and December inevitably involve some distortion, when allowance is not made for seasonal factors. When comparisons are made between the same months of successive years, this problem of seasonal price movements is overcome.

Table 1 shows the changes in wholesale prices by major industry groups from June 1955 to December 1956. The changes are arrayed in order of magnitude. The overall rise was 5.3 percent in the wholesale price index and 7.8 percent in the index for commodities other than farm products and foods during this period. The largest increases were recorded for metal and metal products (14.9 percent) and machinery and motive products (12.9 percent). It is interesting to note that within the machinery group, the rise for agricultural machinery, which deals with a lagging sector of the economy, was 7.7 percent while the increases in prices of construction machinery and electrical machinery, both areas of dynamic expansion, approximated 15 percent. The overall rise for fuel power and lighting materials was only 5.9 percent.

This smaller than average rise resulted from the fact that one component, electricity, showed a small decline and another component, gas, was about unchanged. In contrast, coal prices rose 22.8 percent under the combined influence of sharply expanding demand and large increases in wage rates. Petroleum products rose 8.4 percent, reflecting in part the Middle East situation.

At the other extreme, small net declines were shown for processed foods, lumber and wood products, and farm products.

An examination of table 1 indicates that the major increases have taken place in those sectors of the economy which have been most stimulated by the boom or in industries in which labor costs are of greatest relative importance. On the other hand, in industries which have not done too well during the past year and a half, price rises have been nominal or nonexistent. These include tobacco manufactures, textile products and apparel, and the three areas of declining prices previously noted. This table underlines the importance of expanding demand and boom time conditions in the overall price rise which has taken place.

A similar picture is shown in table 2 which arrays the changes in major groups of wholesale prices between December 1955 and December 1956. We find the major increases in machinery and motive products, metals and metal products, and structural nonmetallic minerals. Also included among the larger increases in 1956 were farm products and processed foods, which advanced from the depressed levels of December 1955. Lumber and wood products (which were adversely affected by the decline of nonresidential building), rubber and rubber products (which were adversely affected by the large decline in automobile sales), and textile products and apparel (which have experienced lagging markets) reported no change or declining prices in 1956. Another area with relatively small increases in prices was tobacco manufactures, which has been affected by the lagging sales of cigarettes partly as a result of the cancer scare. This is also an area of relatively low labor costs. Chemicals and allied products also involve relatively low labor costs.

By economic sector.—Table 3 shows the breakdown of the wholesale price index by economic sectors. Between June 1955 and December 1956, the overall index for crude materials showed no change. However, when the important components of that index are examined, it is found that foodstuffs and feedstuffs declined 5½ percent in contrast to the rise of 7.2 percent for nonfood materials except fuel and a 13.9 percent rise in fuel. This latter increase reflected primarily the sharp rise which has taken place in coal prices.

The overall index for intermediate materials supplies and components rose by 7.3 percent in the past year and a half. The table shows that there was practically no change for food manufactures and that materials for nondurable goods manufactures rose only 2½ percent. The major rises in prices occurred in materials used in durable goods manufactures (10.1 percent) and for components for manufacturing (15.4 percent). Intermediate materials used for construction rose 7.1 percent.

The pattern for the finished goods was similar. There has been little change for foods and a rise of only 3.1 percent for other nondurable goods; in contrast, finished durable goods prices rose 6.4 percent and prices of producers finished goods rose 13.2 percent. This tabulation again indicates the relatively small price changes for the nondurable consumers goods in contrast to the sharp rises

which have taken place in producers goods and for consumers durable goods. As the President has noted, "Prices of investment goods and semimanufactured materials and components rose quite rapidly, reflecting heavy pressure of demand relative to supply" (pp. 30, 32). A little later in the report, reference is made to the continued rise in prices of producer finished equipment, "the demand for which was especially insistent" (p. 32). It seems clear that the areas which have been most stimulated by the boom show the largest price rises in contrast to the relatively modest price changes in other sectors of the economy.

It must be recognized that economic data of this type rarely yield a picture of perfect relationships. Nevertheless, it appears to me to be significant that the areas with the major increases in prices have been largely those in which the pressures of the boom have been greatest while the areas in which prices have lagged have been the areas in which economic activity has not been stimulated significantly. These data also suggest that a slowing down of the boom will be the most potent force to stop the price rise. To the extent that fiscal and monetary policies act to blunt the rate of advance in the boom areas, the overall rise in prices can be slowed down and then brought to a halt.

Sensitive price index.—Table 4 shows the changes in the Bureau of Labor Statistics spot primary index for three selected dates. The changes for each of the specific commodities is also shown. Such prices usually reflect inflationary pressures in our economy very promptly. At the slightest hint of inflation, they move upward sharply. Past experience has shown that the general wholesale price index and the consumer price index generally follow the movements of the sensitive wholesale price index, though not as sharply.

From 1939 through August 1945, the sensitive price index almost doubled as compared with increases of about one-third in the general level of wholesale prices and in retail prices. By 1948, the sensitive price index had increased to a level 264 percent above prewar as compared with an increase of 112 percent in the wholesale price level and 76 percent in retail prices.

From June 1950 to February 1951, the sensitive price index rose more than 50 percent as compared with an increase of only 16 percent in the general wholesale price index and 8 percent in retail prices. When the substantial inflationary pressures anticipated as a result of the Korean war failed to take place, sensitive prices began to reverse their rise. In fact, currently, the index is only moderately higher than in 1950.

What has happened to these prices in the past year and a half? Since May 31, 1955, the overall index has risen only 3.5 percent. In the past year, the rise has been 2.6 percent. Table 4 shows the wide diversity in price changes for the individual products. Of the 24 products shown in the tabulation, nine were lower in January 1957 than in May 1955 and one was unchanged in price; 14 commodities had increased in price. The largest increase was for steel scrap which advanced 90.6 percent; it has since declined a little. At the other extreme, cocoa beans recorded a decline of 35.3 percent. Half of the commodities showed changes within a range of plus and minus 6 percent.

A similar pattern of diversity of price behavior is shown for the past year. From January 10, 1956, to January 10, 1957, 10 commodities declined and one was unchanged in price. The extreme changes were a price increase of 50.6 percent for hogs and a price decline of 28.2 percent for copper scrap. It is interesting to note that sensitive prices like copper scrap, lead scrap, and rubber have actually declined during the past year despite the general rise in the price level. This is not the behavior one would expect under conditions of general price inflation. These declines are explainable, however, in terms of the reduced level of activity which characterized the automobile industry and residential building in 1956. It is the pattern of behavior that would be expected during a boom which has an uneven impact upon the economy.

FACTORS CONTRIBUTING TO PRICE RISES

What factors explain the creeping price rise which has been taking place during the past year and a half? Is this a rise which is due to the same type of factors which resulted in the explosive rise of World War II and the early post-war years? How does it differ from that earlier rise and do these differences have any significance in the outlook for prices? It is important to keep in mind that this price rise does not result from large Government budgetary deficits with an accompanying expansion in bank credit or from a large increase in money supply, including deposits and currency. The rise does reflect a combination of

the business boom and increases in labor costs in excess of the gains in productivity.

I should like to review each of these factors briefly. It is important to understand the nature of the price rise and the basic pressures which are operating, if we are to formulate proper public policy.

The Federal budget

During the fiscal years 1955-56 and 1956-57, the Federal budget is estimated to be in the black. The regular budget will show a surplus of a little less than \$2 billion for each year. The cash surplus is in excess of \$3 billion in each year. During this period the Federal debt is being reduced by modest amounts. This is clearly a picture of a Federal budget which is deflationary, not inflationary. This is a budgetary situation which is in sharp contrast to the huge deficits and accompanying tremendous rise in public debt which characterized World War II and the first postwar year with the accompanying large inflation in prices. The President has properly pointed out that the budgetary surplus "prevented additional strains on the economy" (p. 40).

Money supply

The total money supply was increased by only about 1 percent in 1956. Total demand deposits showed little change despite an \$8 billion increase in commercial bank loans because this was offset in part by a liquidation of investments, particularly Government securities, and because of the rise in time deposits. Under conditions of capacity operations in key sectors of the economy, a larger rise in currency and demand deposits could only have meant further pressures on the price level. The report emphasizes the heart of the problem when it concludes: "A large overall expansion of bank credit would not have resulted in a significantly higher national output, but would instead have led to a greater rise in prices" (p. 40).

Again we have a sharp contrast with the World War II situation. From the end of 1940 to the end of 1945, total demand deposits and currency outside the banks rose by 141.8 percent (from \$42.3 billion to \$102.3 billion). This tremendous increase in money supply was a potent factor in the large war and postwar rise in prices. It is encouraging that we are not experiencing any significant rise in money supply in the current situation. This is due in large measure to tighter monetary policy which the Federal Reserve Board has appropriately instituted.

Money has been passing from hand to hand at a faster rate. According to data compiled for demand deposit turnover by the Federal Reserve Board, there was an increase of 6.6 percent in New York City, 5.7 percent in 6 other large cities, and 6.8 percent in 337 other reporting centers in 1956 as compared with 1955. Since the New York City totals are influenced by the volume of security trading, the totals outside New York City are usually considered a better guide to turnover related to general business activity. This greater turnover of bank deposits has reflected first, the growth of bank loans which usually create very active deposits and second, the business boom with the accompanying spirit of confidence. While the total supply of demand deposits has shown little change, that total has been used more intensively.

The business boom

One characteristic of a boom is the shortages which develop in some sectors of the economy. The 1956 boom in plant and equipment expenditures created pressure on many of the durable-goods industries. One evidence of this pressure is the large backlog of unfilled orders which accumulated in the durable-goods industries as the affected industries operating at capacity could not fill all orders promptly. Unfilled orders in the durable-goods industries increased from \$52 billion at the end of 1955 to about \$59 billion at the end of 1956 despite the rising volume of deliveries during the year. In the latter part of the year, the steel industry operated at capacity and could not meet all demands. As I noted earlier, these areas of shortage experienced the largest price rises during the past year and a half. In fact, the price rise reflects largely the pressures generated by a business boom.

Increases in labor costs greater than the gains in productivity

Increases in average hourly earnings and various fringe benefits have been of major magnitude during the war and postwar years. The increases in labor costs have exceeded by a wide margin the gains in output per manhour. The result has been a sharp rise in unit labor costs throughout the economy during

the war and postwar years. The period since mid-1955 has been marked by a further rise in hourly earnings of substantial proportions.

In the 18 months following June 1955, average hourly earnings in all manufacturing industries rose by 9.6 percent; the increases for durable- and nondurable-goods industries were about the same.

Average hourly earnings

	June 1955	December 1956	Percent change—June 1955–December 1956
All manufacturing.....	\$1.87	\$2.05	+9.6
Durable goods.....	1.99	2.18	+9.5
Nondurable goods.....	1.70	1.86	+9.4

The increase of 18 cents an hour in earnings does not measure the entire rise in labor costs. In addition, there has been a considerable increase in the so-called fringes during this period. Overall estimates of the magnitude of these higher fringe costs are not available. Illustrations include supplementary unemployment benefit plans which cost 3 to 5 cents an hour and liberalization of pension and welfare provisions. Clearly, total hourly labor payments including fringes have increased by more than 10 percent—and in many industries by considerably more—during this year and a half of price rises.

During the past 12 months, average hourly earnings have risen by 6.2 percent in manufacturing industries and total labor costs per hour by an even larger proportion because of the increase in fringe benefits.

Average hourly earnings

	December 1955	December 1956	Percent change—December 1955–December 1956
All manufacturing.....	\$1.93	\$2.05	+6.2
Durable goods.....	2.06	2.18	+5.8
Nondurable goods.....	1.74	1.86	+6.9

To the extent that output per man-hour has risen, the unit labor costs of a company or industry have risen less than indicated when attention is devoted to labor payments alone. How much has productivity risen during this period of a year and a half? Although precise estimates are not yet available, a rough approximation may be made on the basis of available data for production and man-hours.

In manufacturing, a man-hours in 1956 appear to have increased fractionally for production workers and a little more for nonproduction workers. During the same period, the Federal Reserve Board index of production of manufactures increased by 2.8 percent. These data suggest a rise in productivity in manufacturing industries of no more than 2 percent in 1956. Average hourly earnings were 5.3 percent higher in 1956 than in 1955 (\$1.98 compared with \$1.88). In addition, fringe costs rose. Labor Commissioner Ewan Clague reported at a National Industrial Conference Board meeting last year that "Insofar as later quarters in 1955 were concerned, there was some indication of leveling out [in productivity] in the latter part of the year." Thus, since mid-1955, it appears that increases in labor costs, including wages and fringes, have far outstripped the gain in productivity in manufacturing industries. The result appears to have been a rise in unit labor costs in excess of 5 percent.

Gross national product rose from \$387.4 billion at annual rates in the second quarter of 1955 to \$413.8 billion in the third quarter of 1956, an increase of 6.8 percent. In real terms, the rise was about 3 percent. During the same period, total employment increased by about 2 percent. Thus, for the entire economy, the rise in productivity appears to have been less than the long term annual rate of gain of 2 percent.

On the basis of these data, it appears that during the past year and a half of creeping price advance, wage increases plus fringe benefits outstripped significantly the gains in productivity. The President emphasizes this point on page

34 of the Report where he concludes that for 1956, "only a very small gain in overall productivity is indicated * * * the smallness of the 1956 gain contributed to the rise in unit labor costs and, in turn, to the increase in prices."

There is virtually unanimous agreement among economists that labor cost increases in excess of gains in productivity will result in pressure for higher prices as the President has pointed out.

This brief review of the forces affecting prices during the past year or more indicates that the President is on sound ground in his conclusion that:

"The combination of heavy demands from the investment goods sector of the economy, rising labor costs, and renewed advances in prices of many raw materials resulted in price increases for a broad range of semimanufactured materials, components, and supplies. And these price increases became cost increases to producers of finished goods, many of whom were also experiencing rising labor costs" (p. 32).

It is important to keep in mind that a price rise attributable to these factors will not have the same spiraling effect as an inflation flowing from monetary and fiscal factors. This is not the background for an explosive inflation. It is the background for a further modest price rise so long as the boom persists.

POLICIES PROPOSED TO LIMIT FURTHER INFLATION

To limit further inflation, the President emphasizes three areas of attack.

1. Voluntary limitation of wage and price increases by labor and business leaders.
2. Monetary policy.
3. Fiscal policy.

1. Voluntary limitation of wage and price increases

In his Report, the President suggests that, "Specifically, business and labor leadership have the responsibility to reach agreements on wages and other labor benefits that are fair to the rest of the community as well as to those persons immediately involved. Negotiated wage increases and benefits should be consistent with productivity prospects and with the maintenance of a stable dollar." There can be little quarrel with this objective. Wage increases in excess of gains in productivity result in higher unit labor costs, which create pressure for price rises.

Nevertheless, we must recognize that many key sectors in the economy are not free to apply this proposed standard in 1957. For many important industries, including automobile, steel, electrical equipment, railroads, meat packing, agricultural implements, and coal, wage increases for 1957 and in some cases for 1958 have already been incorporated in contracts. BLS reports that 5 million workers are covered by long term contracts which were negotiated in 1955 or 1956. While this is but a small proportion of the labor force, it does cover most of the "key wage bargains."

In many of these industries, the negotiated wage increases are scheduled to be 6 or 7 cents an hour. In addition, provision usually is made for further adjustment in wages if the cost of living should rise. The cost of living adjustments are made quarterly in some industries, such as automobiles, and semiannually in other industries like iron and steel. In most instances, the contracts provide for an increase of one cent an hour for every half point increase in the consumers' price index. Further advances in the consumers' price index seem probable in 1957. If the rise in the index should be two points, it will mean a wage increase of four cents an hour in most of the industries I have listed. If the increases in living costs are larger, the wage increases will be correspondingly greater. In addition to these contract provisions for wage changes, some contracts provide for additional fringe benefits to become effective in 1957.

In light of these contract provisions, we already seem assured of an increase in wage rates of 4 percent to 5 percent in 1957. Past experience indicates that the wage adjustments in these key areas will be a very potent force in determining wage increases in other sectors of the economy where contracts still remain to be negotiated. Under these conditions, it is impossible for industry and labor to exercise the restraint called for by the President unless they were to reopen the existing agreements and negotiate smaller wage increases. Since the probability of such an action is completely nonexistent, it is clear that not much can be done through voluntary restraint insofar as wages and other labor costs are concerned during 1957.

The Report also emphasizes that "businesses must recognize the broad public interest in the prices set on their products and services." (p. 3) The ability of industry to hold down its prices is not unrelated to what happens to labor costs. With an average wage increase of 4 or 5 percent likely in 1957 and the probability that productivity will increase by a much smaller percentage, many industries will be subject to a further rise in unit labor costs this year. Under these conditions, I question whether the President's appeal for voluntary restraint to hold down prices can be attended by much success.

I suspect that we will experience a further price rise of several percent in 1957 largely as a result of the rise in labor costs and a continuation of boom time conditions. If the boom subsides later in the year, as some anticipate, then the pressure on prices should also subside.

The President warns that " * * * failure to accept the responsibilities inherent in a free economy could lead to demands that they be assumed by Government, with the increasing intervention and loss of freedom that such an approach inevitably entails" (p. 3). In other words, the failure of voluntary restraints could lead to wage fixing and price fixing by Government. I would like to state categorically that I am completely opposed to any such program to limit price and wage rises in peacetime. Such a program is foredoomed to failure and can only result in disruptions to production, impairment of incentives, and an ever widening area of controls which will create worse evils than the control program is designed to overcome.

The effort to limit price and wage increases by exhortation has never succeeded in the past and will be no more successful under current conditions.

I believe that better results can be obtained through monetary and fiscal policy.

2. *Monetary policy and fiscal policy*

Although the President gives considerable emphasis to monetary and fiscal policy he states that:

"To depend exclusively on monetary and fiscal restraints as a means of containing the upward movement of prices would raise serious obstacles to the maintenance of economic growth and stability. In the face of a continuous upward pressure on costs and prices, moderate restraints would not be sufficient; yet stronger restraints would bear with undue severity on sectors of the economy having little if any responsibility for the movement toward a higher cost-price level and would court the risk of being excessively restrictive for the economy generally" (p. 44).

Any restraint exercised through monetary or fiscal policy, however modest, will inevitably hurt some groups who will be quick to react as we have seen in the past year. This is unavoidable regardless of what policies are adopted. And it is also possible that some groups who have little responsibility for the spiral will be adversely affected by such restraints. But to state the problem in these terms is to give only a partial picture. What happens if these restraints are not imposed and prices are permitted to spiral? Then the burden falls on the large groups who live on fixed incomes (pensioners, dependents of those in the Armed Forces, widows, and similar groups) and on those whose incomes do not and cannot keep pace with an inflationary price rise (Government employees, teachers, ministers, and many white-collar groups).

Unfortunately, there is no best policy in the sense that no one will feel its effects. There is only a "least worst" policy in the sense that its adverse effects will be kept to a minimum. In these terms, the alternative to hurting some groups who do not or may not contribute to the inflation is to hurt still larger groups who do not contribute to the inflationary pressures.

Do we seriously believe that we are really making every effort to combat inflation on the fiscal front when Government spending continues to rise and new programs of spending are being initiated? It is true that it is expected that the Federal budget will be in balance even with the enlarged spending, but isn't this the time when even larger budgetary surpluses should be built up as a compensation for the boom in the private economy?

Do we seriously believe that we are making every effort to combat inflation on the monetary front when mortgage credit, consumer credit, and bank credit continue to expand at near record rates? And is mortgage credit excessively restrictive with the present low downpayments and 30-year maturities for mortgages? The Federal Reserve Board "has leaned against the wind," to use Mr. Martin's descriptive phrase, but it certainly hasn't leaned far enough to be in danger of falling over.

If stronger fiscal and monetary restraints are required to halt an inflation they should be imposed. The evils attending inflation are more serious than those attending strong anti-inflation policies.

CONCLUSION

The rise in prices has reflected the cost push exerted by increases in labor costs in excess of gains in productivity in a business boom which has made it relatively easy to pass these cost increases on to the buyer. There is an understandable concern with the problem of inflation. However, we are not in a period of classic inflation reflecting either Federal Government budgetary deficits or large expansions in money supply. So long as the Federal budget remains in the black and monetary policy prevents a sharp expansion in money supply, there is little likelihood of a runaway price inflation. Unless the wage-price spiral is fed by an expanding money supply, it is more likely to lead to unemployment of resources as they are "priced out of the market" than to a major price inflation.

To the extent that monetary and fiscal policy are used to blunt the boom, one of the major factors contributing to price advances will be modified or eliminated. But there will still remain the problem of excessive increases in labor costs. Little can be done in the wage area in 1957 because "key wage bargains" already have been reached. But we must look to the future if we are to prevent a repetition of the current situation. President Eisenhower has pointed squarely to the proper goal in this area in his statement that: "Negotiated wage increases and benefits should be consistent with productivity prospects and with the maintenance of a stable dollar" (p. 3). But this objective will only be achieved if management in major industries firmly refuses to agree to labor cost increases in excess of national productivity gains and if the public is educated to understand the dangers which arise when labor cost increases exceed these amounts.

TABLE 1.—Changes in the major groups of the wholesale price index, June 1955–December 1956

[1947-48=100]

	June 1955	December 1956	Percent Change
Metals and metal products.....	132.6	152.4	+14.9
Machinery and motive products.....	127.1	143.5	+12.9
Pulp, paper, and allied products.....	118.3	127.9	+8.1
Commodities other than farm products and foods.....	115.6	124.6	+7.8
Hides, skins, and leather products.....	92.9	99.4	+7.0
Nonmetallic minerals, structural.....	123.7	131.3	+6.1
Fuel, power, and lighting materials.....	106.8	113.1	+5.9
Furniture, other household durables.....	115.2	121.4	+5.4
Rubber and products.....	140.3	147.9	+5.4
All commodities.....	110.3	116.2	+5.3
Miscellaneous.....	89.1	91.6	+2.8
Tobacco manufactures and bottled beverages.....	121.6	123.6	+1.6
Chemicals and allied products.....	106.8	108.3	+1.4
Textile products and apparel.....	95.2	95.6	+0.4
Foods, processed.....	103.9	103.1	-0.8
Lumber and wood products.....	123.7	120.9	-2.3
Farm products.....	91.8	88.6	-3.5

Source: U. S. Department of Labor, Bureau of Labor Statistics.

TABLE 2.—Changes in the major groups of the wholesale price index, December 1955–December 1956

[1947–49=100]

	December 1955	December 1956	Percent change
Machinery and motive products.....	133.0	143.5	+7.9
Farm products.....	82.9	88.6	+6.9
Metals and metal products.....	143.9	152.4	+5.9
Foods, processed.....	98.2	103.1	+5.0
Nonmetallic minerals, structural.....	125.4	131.3	+4.7
All commodities.....	111.3	116.2	+4.4
Commodities other than farm products and foods.....	119.8	124.6	+4.0
Fuel, power, and lighting materials.....	109.3	113.1	+3.5
Furniture, other household durables.....	117.3	121.4	+3.5
Pulp, paper, and allied products.....	123.6	127.9	+3.5
Miscellaneous.....	88.8	91.6	+3.2
Hides, skins, and leather products.....	96.7	99.4	+2.8
Chemicals and allied products.....	106.6	108.3	+1.6
Tobacco manufactures and bottled beverages.....	121.7	123.6	+1.6
Textile products and apparel.....	95.6	95.6	0
Rubber and products.....	151.0	147.9	-2.1
Lumber and wood products.....	125.1	120.9	-3.4

Source: U. S. Department of Labor, Bureau of Labor Statistics.

TABLE 3.—Wholesale price indexes by economic sector June 1955, December 1955, and December 1956

[1947–49=100]

	June 1955	December 1955	December 1956	December:1956 from—	
				June 1955	December 1955
All commodities.....	110.3	111.3	116.2	+5.3	+4.4
Crude materials, total.....	96.2	89.9	96.2	0	+7.0
Foodstuffs and feedstuffs.....	89.7	75.8	84.5	-5.5	+11.9
Nonfood materials except fuel.....	107.7	114.9	115.5	+7.2	+0.5
Fuels.....	102.9	110.1	117.2	+13.9	+6.4
Intermediate materials, supplies, and components, total.....	115.7	119.4	124.2	+7.3	+4.0
Total materials and components for manufacturing.....	117.1	120.9	125.9	+7.5	+4.1
Materials for food manufacturing.....	100.0	94.8	100.0	+0.1	+5.6
Materials for non-durable-goods manufacturing.....	102.4	103.7	105.0	+2.5	+1.3
Materials for durable-goods manufacturing.....	137.2	144.7	151.1	+10.1	+4.4
Components for manufacturing.....	128.2	137.5	147.9	+15.4	+7.6
Materials and components for construction.....	124.2	129.0	133.0	+7.1	+3.1
Finished goods, total.....	110.6	111.5	116.0	+4.9	+4.0
Total consumer.....	106.5	106.1	109.2	+2.5	+2.9
Foods.....	102.1	98.3	101.8	-0.3	+3.6
Other nondurables.....	107.4	108.7	110.7	+3.1	+1.8
Durables.....	115.1	118.1	122.5	+6.4	+3.7
Producer.....	127.1	132.9	143.9	+13.2	+8.3

Source: U. S. Bureau of Labor Statistics.

TABLE 4.—Daily index numbers and spot primary market commodity prices, May 31, 1955, Jan. 10, 1956, and Jan. 10, 1957

[1947-49=100]

	May 31, 1955	Jan. 10, 1956	Jan. 10, 1957	Percent change to Jan. 10, 1957, from—	
				May 31, 1955	Jan. 10, 1956
Groups:					
All commodities.....	89.0	89.8	92.1	+3.5	+2.6
Foodstuffs.....	86.2	74.8	83.3	-3.4	+11.4
Raw industrials.....	90.8	101.8	98.6	+8.6	-3.1
Livestock and products.....	62.9	58.5	66.7	+6.0	+14.0
Metals.....	105.4	129.3	122.2	+15.9	-5.5
Textiles and fibers.....	84.2	80.8	85.3	+1.3	+5.6
Fats and oils.....	65.3	62.9	71.8	+10.0	+14.1
Commodities:					
Burlap..... yard	\$0.115	\$0.106	\$0.116	+ .9	+9.4
Butter..... pound	.571	.574	.594	+4.0	+3.5
Cocoa beans..... do	.365	.310	.236	-35.3	-23.9
Copper scrap..... do	.350	.415	.298	-14.9	-28.2
Corn..... bushel	1.461	1.248	1.345	-7.9	+7.8
Cotton, 14-market average..... pound	.336	.339	.334	- .6	-1.5
Cottonseed oil..... do	.141	.119	.144	+2.1	+21.0
Hides..... do	.132	.155	.140	+6.1	-9.7
Hogs..... 100 pounds	18.750	11.750	17.700	-5.6	+50.6
Lard..... pound	.122	.108	.153	+25.4	+41.7
Lead scrap..... do	.082	.092	.085	+3.7	-7.6
Print cloth:					
Spot and nearby..... yard	.187	.206	.186	- .5	-9.7
Most distant contract..... do	.188	.195	.188	0	-3.6
Rosin..... 100 pounds	9.200	9.600	9.700	+5.4	+1.0
Rubber..... pound	.318	.422	.344	+8.2	-18.5
Steel scrap..... ton	32.000	51.000	61.000	+90.6	+19.6
Steers..... 100 pounds	23.000	21.375	22.375	-2.7	+4.7
Sugar..... do	6.000	5.850	6.400	+6.7	+6.4
Tallow..... pound	.062	.072	.069	+11.3	-4.2
Tin..... do	.915	1.064	1.012	+10.6	-4.9
Wheat:					
Kansas City..... bushel	2.462	2.150	2.330	-5.4	+8.4
Minneapolis..... do	2.471	2.325	2.325	-5.5	+ .4
Wool tops..... pound	1.815	1.565	1.960	+7.4	+25.4
Zinc..... do	.125	.140	.140	+12.0	0

Source: U. S. Bureau of Labor Statistics.

Chairman PATMAN. Mr. Brubaker, research director, United Steelworkers of America.

STATEMENT OF OTIS BRUBAKER, RESEARCH DIRECTOR, UNITED STEELWORKERS OF AMERICA

Mr. BRUBAKER. Mr. Patman, members of the committee ladies and gentlemen, the Steelworkers Union is delighted to accept the invitation of the Joint Economic Committee to participate in this panel discussion of the question of the so-called wage-price inflation spiral mentioned prominently in two recent Presidential statements. This panel discussion can be, and we hope it will be, the beginning of a serious investigation by the Joint Economic Committee of the causes of inflation and what can be done about them.

Certainly our union, the United Steelworkers of America, does not now, and never has, favored inflation. The members of our union and the retired former members suffer as much as do other members of the public when pay checks and pension checks buy less and less because of inflation, i. e., higher prices of food, clothing, shelter, and the other necessities of life, is constantly nibbling away at the real buying power of their incomes.

Unfortunately, however, there is much misinformation about inflation and its causes. There is a deliberate, widespread, and systematic attempt in our country by such groups as the National Association of Manufacturers, the chamber of commerce, many newspapers, and other large employers to lay the blame for inflation on the efforts of wage earners and their unions to secure wage and fringe improvements in order to raise the standard of living of the American worker.

Congress can do much in this regard if it will search out the facts concerning wages, prices, and profits, their roles in our economic system, and assess the blame on those who cause and those who profit from inflation. In fact, if the spotlight of congressional publicity is kept focused on those who would like to raise prices and constantly increase profit margins, it may have a salutary effect in curbing price increases.

Our union has prepared some fairly elaborate studies, with the assistance of Mr. Robert Nathan's office, which we are presenting to the committee. We would like to ask that they, along with this shorter statement, be made a part of the record of the hearing.

Chairman PATMAN. The committee will consider it. There is no question about putting in your statement. We do have a problem in printing with respect to those documents, particularly the charts and illustrations.

Mr. BRUBAKER. Standing alone this briefer statement is not an adequate statement. We have made many references to these more elaborate studies.

Chairman PATMAN. Without objection they will be inserted in the record.

(The documents follow:)

UNITED STEELWORKERS OF AMERICA

Pittsburgh 22, Pa.

DEAR SIR: Since midnight of June 30 the basic steel industry has been idle because of the decision of the companies to shut down operations when labor contracts with the United Steelworkers of America terminated.

Instead of engaging in good faith bargaining with the union prior to June 30 to work out new contracts which would meet the needs of the employees and provide them with an adequate share in the tremendous prosperity of the industry, the companies forced 650,000 of their employees and thousands in other industries into unemployment with consequent harm to the economy.

We of the United Steelworkers did not want this shutdown to happen. We did everything in our power to prevent it. We made reasonable proposals for an honorable settlement which would be fair to the employees, the stockholders, and the public. However, we were confronted by a totally inadequate take-it-or-leave-it proposition from the industry.

We are not indulging in wild charges, but stating our sober conviction, when we say that the leaders of the steel industry forced the shutdown—for ulterior reasons which they must be better able to explain than anyone else. You will recall that the Steelworkers Union, just before contract talks with the industry spokesmen were broken off, made a forthright offer to extend our agreements for 15 days with customary retroactivity to provide more time for negotiations. The industry showed its true purpose of forcing a shutdown when it flatly rejected this offer.

Thus we stand at the present impasse—with time ticking away, with a needless great loss in production, in wages, in purchasing power to keep the wheels of our economic machine turning.

I realize that you, as a public-spirited citizen, would like to know more of the facts on this situation than can be found in the newspapers. Ours is a responsible union. We believe that you—and the public in general—have a right to know the facts because all of us have a stake in the outcome. It is in recog-

dition of your right to know that the United Steelworkers of America has prepared two well-documented studies of the facts and real issues involved in our present dispute with the steel industry. For it is only through a study of the clear facts that the issues can be reasonably appraised and intelligent negotiations carried on.

Unfortunately the spokesmen for the industry have not been willing to engage in genuine negotiations based on the irrefutable facts contained in these two studies. Rather, they have substituted press releases, press conferences, and newspaper advertisements for genuine negotiations. Because their inadequate proposals, which they well knew the union could not accept, were handed down with a take-it-or-leave-it attitude which cannot be defended, they have obscured or misrepresented the facts.

So I commend, then, for your judgment, the facts in our two studies here summarized. In the one entitled "Steel and the National Economy 1956," there is a thorough analysis of the current state of the economy and the over-all effect of the steel industry on the national economy, with special emphasis on the question of inflation. In the other study entitled "Facts on Steel: Profits, Productivity, Prices and Wages, 1956," there is a detailed examination of the financial position of the industry, with significant comparisons of the relationship of profits, productivity, prices, and wages.

You recall that steel industry spokesmen have sought to justify their failure to offer a reasonable wage increase by invoking the word "inflation." They said that "no increase in employment costs at this time would be in the Nation's best interests * * *" since it would set off "another ruinous round of inflation." Now, there are very few people indeed who want inflation, but we sharply disagree with the industry's contention that inflation is caused by wage increases—for to say this is tantamount to saying that it is impossible for the living standards of the working population to improve at all. Indeed, any inflationary tendencies that may exist in our economy stem not from wage and salary increases, which are vitally needed, but from pricing policies of industry generally and particularly the steel industry. Let us see what our studies have to say on this and related subjects.

STEEL AND THE NATIONAL ECONOMY

The volume which addresses itself to the problem of inflation and the present state of our economy contains the following facts and essential policies:

Concern is expressed by the union as to the need to safeguard and improve the health of our economy as a whole. Note is taken of the fact that there have been some serious soft spots in the fabric of the economy, which has been on a plateau for some 9 months. Despite precarious inventory accumulations and higher consumer debt, the full employment levels of 1952 and 1953 have not been matched. Prosperity in the last decade has been sustained by wage and salary increases and labor's rising share of the total income. (Though in steel labor's total-income share has fallen in this decade.) But labor's share in the economy, as well as in steel, has fallen in the last year and consumer purchases are lagging. Unless corrected, this could spell trouble.

With confidence in the fundamental strength of our economic system, and with faith in its potential growth, we also in this study take into account the possibilities and challenges of the years ahead. A growing labor force and rising productivity make possible a doubling of our production and our standard of living within the next 20 years. These can be achieved only if there is an active market for the goods and services we can produce.

Consumers buy \$5 of every \$6 worth of goods and services purchased privately. Since consumer purchasing power arises largely from wages and salaries, wages and salaries must increase if economic expansion is to be resumed and a market provided for this doubled production.

Our study refutes any alleged relation between wage increases and inflation and states: "Experience has proved that wage increases have not caused inflation, that wages can be increased without prices being raised, and that rising real wages give us stable prosperity and growth."

Wage increases, says our report, lagged behind price increases in the immediate post-war and Korean inflations and obviously could not have caused inflation. The pattern of inflation is rising prices, rising real profits and lagging real wages. In the stable period since mid-1951, on the other hand, wage rates in manufacturing have risen 23 percent, living costs less than 4 percent and industrial prices 4 percent. Yet total profits before taxes reached record levels in 1955.

Rising real wages, stable prices and sustained high profits, made possible by constantly increasing productivity, are thus the keys to economic stability and perpetuation of prosperity for all segments of our economy. Our study points out:

"Productivity * * * has been increasing more than 3 percent per year. In manufacturing industries, the annual rate has been exceeding 4 percent. Automation will increase the pace. * * * Real hourly earnings in manufacturing fell behind the rise in productivity at the time of the Korean War and have not caught up yet. This disparity must be corrected through rising real wages."

With steel a conspicuous exception, the union's report says, rising volume of business in industry generally has tended to be associated with lower profit margins per unit of production in periods of stability. This policy has yielded prosperity and high total profits. The spurt of industrial prices ahead of wages and the sharp rise in profit margins in 1955, after 4 years of moderate decline, spell danger and must be reversed.

Our study reveals a disturbing irresponsibility in the pricing and profit margin policies of the steel industry. Our study states:

"The contrast between the pricing policies of the steel industry and of all manufacturing industries as a whole is rather startling. Steel prices have increased proportionately with wage rates since 1947 ignoring rapidly rising productivity in its pricing policies. For all manufacturing, industrial prices increased considerably less than half as much as wage rates from 1947 to 1955.

"The steel industry does not follow the principle of higher volume and lower margins. If there is any single industry that has followed inflationary pricing practices; that has shown a disregard for the economic welfare of the country, especially relative to its key role in the economy; that has truly practiced inflation; that has the least right to hide behind the cloak of favoring a sound dollar and to contend that wage increases are inflationary; it is the steel industry."

Before the union commenced negotiations with the industry, several steel company spokesmen had issued public statements calling for higher prices for their products. They based this mainly on the plea that price increases were required to finance expansion. Our study says of this:

"Contentions by leaders of the steel industry and other industries that prices must be increased so that there will be more profits with which to finance expansion are astounding. Raising prices to secure funds for new plant and equipment in effect forces the consumer to put up the money for new plants for the benefit of existing stockholders. The consumer gets nothing for his forced 'investment.' The opportunity for American citizens to participate in the growth of American industry is denied when expansion is financed entirely through exorbitant profits rather than security flotations."

FACTS ON STEEL: PROFITS, PRODUCTIVITY, PRICES AND WAGES

Now let me refer you to the second of our two economic studies, which deals with the financial position of the steel industry in relation to industry as a whole and in relation to profits, wages, prices and—of special significance—productivity in relation to all of these factors.

Our study emphasizes productivity as the key to the entire question of wages, prices, profits and the health of the overall economy.

"It is now commonly accepted that, over long periods, wage gains and rising living standards must come largely from increased productivity, i. e., rising output per man-hour," states our report. "With this concept the union has no quarrel as long as one prior condition is met—namely, that the income shares as between management and investors on the one hand and labor on the other * * * are fair and equitable. There is no such equitable sharing in the steel industry today."

Here is what our analysis of the productivity record of steel reveals:

Taking note of the great, continuing rise in productivity for many years, we observe especially "the sharp acceleration in the productivity rate in the most recent years."

For example, productivity in the steel industry currently has been running at a rate 4.7 percent higher than in 1955. And the rate in 1955 was a phenomenal 11.2 percent above 1954. In short, steelworkers are producing more and more steel per man-hour. Increased productivity in steel has run well in excess of the increase in the economy as a whole and in manufacturing industries.

Yet what does a comparison show us? Taking the years 1939-1956 (more than 16 years), we find the "real" productivity increase in the steel industry to be 68.8

percent. For the same period, the "real" straight time average hourly earnings of the steelworker rose only 47.1 percent.

It is evident that increasing productivity is the key to providing higher wages, higher standards of living, broader and more stable prosperity—and all without the need to boost prices beyond reason and without harm to the rightful profits of the industry and its investors. For if the millions of workers in industry do not receive a fair share of these benefits of increased productivity, then our free enterprise economy cannot continue to function. And it is in this area that the leaders of the steel industry have, so far, been far too backward and shortsighted.

Our study of the industry contains interesting revelations as to steel profits. Far from being in dire straits, profit-wise, the steel corporations under examination have been showing a 1956 profit rate of 15.3 percent higher than last year and, believe it or not, 107.4 percent higher than in 1954! These are profits before taxes, and it should be remembered that wage increases are offset from profits before, not after, taxes. As to profits after taxes, you will find that these companies have been reaping, at the 1956 rate, net profits 13.1 percent higher than in 1955 and 95.6 percent higher than in 1954.

That is not all of the story, however, for any such gain in profits has to be compared to profits in other lines of manufacturing to make real sense out of the comparison. You will find in our study that such a comparison shows that the steel industry has done very well indeed.

Take a look at this, if you will, from the point of view of profits as a share of the "sales dollar," which is a favorite approach of many companies. What we discover is this:

While net profits as a share of the sales dollar in the steel industry went up from 6.2 cents in 1947 to 7.9 cents in 1956, the record shows that net profits for all manufacturing companies went down from 5.7 cents in 1947 to 4.3 cents in 1956.

And these figures, by the way, do not at all mean that companies in other manufacturing lines are in bad condition, profit-wise, or are ill-managed. Rather, it means simply that with increased productivity and higher volume of business these companies are taking less profit per dollar of sales. In contrast to this, the steel industry has been siphoning off more and more profit from each and every sales dollar, instead of passing on more of the benefits of increased productivity and high-level sales to their employees and their customers.

You will find, too, a striking contrast in the rising size of dividend payments by the steel companies, whose dividends more than tripled between 1947 and 1956 while the dividends from all corporations were not quite doubled.

This study discloses, as does our other study, that the pricing policies of the steel industry have shown little concern for the welfare of the public. Traditionally the industry has sought to justify price increases as being necessitated by wage increases, increased materials costs, alleged "too low" profits margins, and more recently, the "need" to finance expansion out of profits. We have already seen from our studies that profit margins certainly are not "too low" and that the concept of financing expansion out of profits is untenable and in contradiction to the traditional system of obtaining expansion capital through flotation of securities.

The facts in our study likewise contradict the industry's assertions that increased wages and materials costs have necessitated price increases. The industry has increased prices out of all proportion to increased costs. For each \$1.00 increase in labor costs since 1945, exorbitant price increases have yielded \$3.19 in additional revenues. The figures on materials costs are equally startling. Materials costs since 1947 have risen about 28 percent, but steel prices in the same period have risen 78.2 percent—an excess of price increases over cost increases of nearly 3 to 1.

A central and overriding fact relative to the current dispute which emerges from our study of the steel industry is the ability of the industry to absorb a truly substantial wage increase without a price increase. This is due to the relatively small portion of total costs represented by wage costs, about one-third only, and to the great profitability of the industry.

Within the framework of its 1956 operations, the steel industry could absorb for a full year a wage "cost" increase which would meet the needs of its employees, forego a price increase, and end up with net profits comparable to the huge profits of prior years. The return on net worth would still be nearly double the fair and reasonable rate of 6 percent, and the return on sales would be well above the 4.3 cents for all manufacturing corporations in 1956.

The picture becomes even more overwhelming when we realize that the fore-

going figures are based on an assumption of no increase in productivity. Clearly, even a modest productivity increase of 4 or 5 percent will facilitate the industry's ability to absorb wage increases without increasing prices and still end up with enormous profits.

What does all of this prove? Certainly not that the industry should not make good profits, nor that the stockholders should not receive good dividends. Rather, what it demonstrates is that the steel companies can well afford, beyond the shadow of a doubt, to meet the Steelworkers' proposals for a substantial wage increase and the other benefits we ask for our members and that they can do so without raising prices.

The Steelworkers Union presented reasonable, practical and justifiable proposals to the steel industry.

We asked for a substantial wage increase which is vitally needed to permit steelworkers to improve their living standards, to share in the industry's record prosperity and productivity which they have greatly helped to fashion, and to provide them with the increased purchasing power needed for a prosperous and expanding economy.

We asked for Sunday premium pay at double time and Saturday premium pay at time and one-half in line with the predominant practice in American industry.

We asked for improvements in "fringe" benefits such as holidays, vacations, shift differentials, and insurance.

These provisions of our contracts have fallen far behind practices now prevalent in American industry as indicated by the following table taken from our report:

	American industry practices	Steel industry practices
Pay for Sunday work.....	Double time.....	Single time.
Pay for Saturday work.....	Time and one-half.....	Single time.
Paid holidays.....	7.....	6.
Premium above holiday: Pay for work on holidays.....	One-half time or better.....	None.
Vacations for:		
3 years of service.....	2 weeks.....	1 week.
10 years of service.....	3 weeks.....	2 weeks.
Over 15 years of service.....	3 or 4 weeks.....	3 weeks.
Shift differentials:		
Evening.....	10 cents.....	6 cents.
Night.....	15 cents.....	9 cents.

We asked for a supplemental unemployment benefits plan to protect steelworkers against the ravages of unemployment which occasionally occurs in this industry.

We asked for improvements in other contract provisions which need modernization.

Our study points out that the steel industry has refused to make a wage offer or an offer on the other contract items which even begins to meet the needs here noted. Customarily, the industry and the union have signed 2-year contracts with provision for wage reopening after 1 year. Now the industry has demanded a closed-term, 5-year contract, the provisions of which are decidedly substandard. The industry has flatly refused to make any wage or contract proposals for the customary 2-year term.

The industry has advertised far and wide that the take-it-or-leave-it package which they have offered us, over the 5-year term, would cost 65 cents an hour.

This industry figure, as our study proves, is propaganda rather than fact. Giving the companies the benefit of any doubt, the ultimate value of the industry's offer, when they all finally go into effect in 1961, would be 45.3 cents per hour. Moreover, the average benefit over the 5-year term amounts only to 28.5 cents per hour since many of the offered benefits would not become effective for several years. This is much less than we have received on the average during the past 10 years under 1- and 2-year contracts.

The industry has alleged that any substantial meeting of the union's demands would (1) represent a cost too great for the industry to bear, (2) force a large hike in steel prices, (3) be highly inflationary in steel and in the economy.

These allegations are, as our studies have shown, wholly unsupported by the facts. They are a deliberate attempt to mislead the public. It is plainly not true that increases in employment costs in steel would set off another round of inflation. Inflation is an increase in prices—and it is the companies' price

policies which have an inflationary effect, not its wage policies. As has been shown above, the steel industry—unlike almost every other American industry—has refused to absorb wage increases in the past and has instead passed on to the consumer three times the cost of each wage increase. The steel industry—unlike almost every other American industry—has increased its profit on each dollar of sales, instead of lowering it, as volume increased. The steel industry—unlike almost every other American industry—has refused to recognize that wages should increase without a price increase when workers produce more steel for each hour they work.

In short, the steel industry can afford to meet the union's proposals without increasing prices, and without setting off any inflationary effect whatsoever.

Not only can they afford it, but they have a responsibility to do so—in order that the benefits of increased productivity and profits shall be shared by their employees and thus keep purchasing power in balance with output to insure a healthy economic situation.

For you will find in our study of the industry that the steel industry's share of the sales dollar in gross profit has risen from 10.9 cents in 1947 to a rate of 16.2 cents in 1956. But in shocking contrast to this, an analysis of the 11 companies on which proper information was available reveals that wages and salaries, as a share of the sales dollar, have been reduced from 40.5 cents in 1939 to 35.5 cents in 1955. In other words, as we state in our report, "the wage earner's portion of the sales dollar has grown smaller and smaller." The facts reveal, for example, that despite the hourly wage increases (plus pension and insurance improvements) in 1954 and 1955, the actual labor cost per ton of steel produced is less in 1956 than it was in 1954.

All this is, indeed, a far cry from the impression created by steel-industry propaganda, with its complaints of rising wage costs and too-small profits. And, of course, the factual record of their pricing policies do not jibe with their piously expressed concern over inflation. The facts, as our two studies prove, are that the industry's profit position has been steadily improving while its wage and salary costs have been substantially reduced.

Obviously, if such a trend as this were prevalent throughout all industry, there would spread such a gap between the output of mass production and the buying power of the consumers as to create a serious danger to the economy. There must be a balanced sharing of the benefits derived from increased productivity to keep the economy going forward.

The steel-industry leaders should face the plain economic facts which are presented in our two studies and which I have outlined to you here.

Adm. Ben Moreell, of Jones & Laughlin Steel Corp., speaking in behalf of the steel industry over a nation-wide television network on June 28, said that agreement could be reached between men of good will. We in the steelworkers concurred in that, and we still concur. Added to good will must, of course, be reason. And reason must operate within the framework of the economic facts.

The union has been willing throughout, and is willing now, to negotiate a fair and honorable settlement based on our proposals, which our studies prove are reasonable, practical, and entirely justifiable. It is the plain duty of the industry, now that it has succeeded in forcing a steel shut-down, to begin—for the first time—the process of give-and-take negotiation which alone can end the present crisis.

Sincerely yours,

DAVID J. McDONALD, *President.*

**FACTS ON STEEL:
PROFITS, PRODUCTIVITY, PRICES
AND WAGES
1956**

UNITED STEELWORKERS OF AMERICA

**1500 COMMONWEALTH BUILDING
PITTSBURGH 22, PENNSYLVANIA**



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Introduction

The Steelworkers Union has presented to the Steel Industry a set of reasonable, practical and justifiable collective bargaining proposals in 1956. The Union has asked for:

1. A wage increase.
2. Improvements in the out-dated "fringe" benefit provisions of the agreements covering such "fringes" as holidays, vacations, shift differentials, and insurance.
3. Premium pay for Saturday and Sunday work, for the first time.
4. Institution of a Supplemental Unemployment Benefits plan.
5. Modernization of many of the non-monetary clauses of the agreements such as union security, seniority, hours of work, safety and health, and others.

These collective bargaining proposals are modest in scope. The justification for the proposals is clear and unequivocal. In fact, the Steel Industry during the negotiations with the Union has pretended that it agreed with the bases on which most of the Union's proposals rest. The bases for the proposals are:

1. A wage increase is obviously necessary in order to accomplish at least four goals:
 - (a) To permit Steelworkers to improve their living standards along with millions of other Americans who likewise are enjoying wage and salary increases in 1956—increases which are averaging at least 10¢ per hour and are ranging as high as 25¢ in some of the more prosperous industries.
 - (b) To permit Steelworkers to share in the prosperity of the Steel Industry which they have greatly helped to fashion.
 - (c) To permit Steelworkers to receive a fair share of the fruits of the large increases in productivity—output per man and per manhour—to which they have so importantly contributed.
 - (d) To provide Steelworkers with that part of the increased purchasing power and income needed among wage and salary workers if our Economy is to prosper and expand.
2. The "fringe" benefit provisions of the contracts with Steel Companies have fallen far behind the practices **now prevalent** in the vast majority of the collective bargaining agreements in American Industry. They must be greatly improved just to "catch up" with the benefits **already** provided by most other industries and major companies.

The Steel Industry's current proposals—some of which would not be effective until July 1, 1960—still fall most significantly short, on nearly every item, of meeting the presently prevailing practices in American Industry.

3. A Supplemental Unemployment Benefits plan to help Steelworkers during the serious layoffs and losses of pay which occasionally occur in this Industry is badly needed. The Industry has conceded this principle, though it has proposed a wholly unacceptable plan.

Sunday Premium Pay at double time and Saturday Premium Pay at time and one-half are also the predominant practice in American Industry. The Steel Companies, however, still refuse to meet this practice. Instead they propose a minor premium for Sunday (**1/25 time**) and **none** for Saturday. Even this insignificant Sunday premium would begin only three years hence.

4. Many of the other contract provisions are also subnormal. Steel is one of the very few major industries which still adamantly refuses to grant a union shop. It still insists on seniority provisions which result in discriminatory layoffs for senior employees. It still refuses to make proper ar-

rangements with the Union to safeguard the safety and health of its employees. It still insists on split work weeks and schedules which disrupt each employee's life each week by rotation from day shift to evening shift to night shift and which force nearly all Steelworkers to work frequently on Sundays and Saturdays, when most of the work could just as readily be scheduled on other days.

The Steel Industry has refused to make a wage offer or an offer on the other contract items which even begins to meet the needs here noted. Customarily, the Industry and the Union have signed 2-year contracts with provision for wage reopening after one year. Now the Industry has demanded a closed-term, 5-year contract, the provisions of which are decidedly substandard. The actual offer, taken together with the conditions made a part thereof, bears little resemblance to the publicized proposal. The Industry has flatly refused to make any wage or contract proposals for the customary 2-year term. It has alleged that any substantial meeting of the Union's demands would:

- (1) represent a cost too great for the Industry to bear,
- (2) force a large hike in Steel Prices,
- (3) be highly inflationary in Steel and in the Economy.

These allegations are, in the Union's opinion, wholly unsupported by the facts. They are a deliberate attempt to mislead the public. It is important and appropriate to check these claims against the facts and data which are available. This the Union has attempted to do in this presentation. In the financial analysis which follows the Union has examined the facts and figures available in the Annual Reports to the stockholders of each of these Companies and in the statistics published by the Government and by various private organizations. This analysis of the Steel Industry examines the data of 25 major Steel Companies and treats these Companies, which account for over 90 percent of all steelmaking capacity in the United States, as being representative of the whole Industry.

These 25 Companies include all firms with annual ingot capacity of 500,000 tons or more as of January 1, 1956, except for Ford Motor Company, International Harvester Co., Timken Roller Bearing Co., and Merritt-Chapman & Scott Corp. (parent of Newport Steel Corp. and Milton Steel Div.) which are primarily engaged in business other than Steel production; and Reeves Steel and Mfg. Co. (parent of Empire Steel Corp.) for which no financial data are published. These 25 Companies are listed in each of the Tables in descending order of ingot capacity. The Companies and their ingot capacities are shown in TABLE 1 and graphically in CHART 1.

Table 1
THE STEEL INDUSTRY
(25 Companies)
Annual Capacity in Tons

U. S. Steel.....	39,215,000	McLouth.....	1,380,000
Bethlehem.....	20,000,000	Pittsburgh.....	1,320,000
Republic.....	10,262,000	Detroit.....	1,290,000
Jones & Laughlin.....	6,166,500	Granite City.....	1,080,000
National.....	6,000,000	Barium.....	898,600
Youngstown S and T.....	5,750,000	Allegheny Ludlum.....	864,200
Inland.....	5,200,000	Northwestern S & W.....	825,000
Armco.....	5,150,000	Lukens.....	750,000
Colorado F and I.....	2,514,500	Alan Wood.....	625,000
Wheeling.....	2,130,000	Copperweld.....	618,880
Sharon.....	1,763,000	Lone Star.....	550,000
Kaiser.....	1,536,000	Laclede.....	500,000
Crucible.....	1,423,400		

TOTAL (25 COMPANIES) 117,811,580

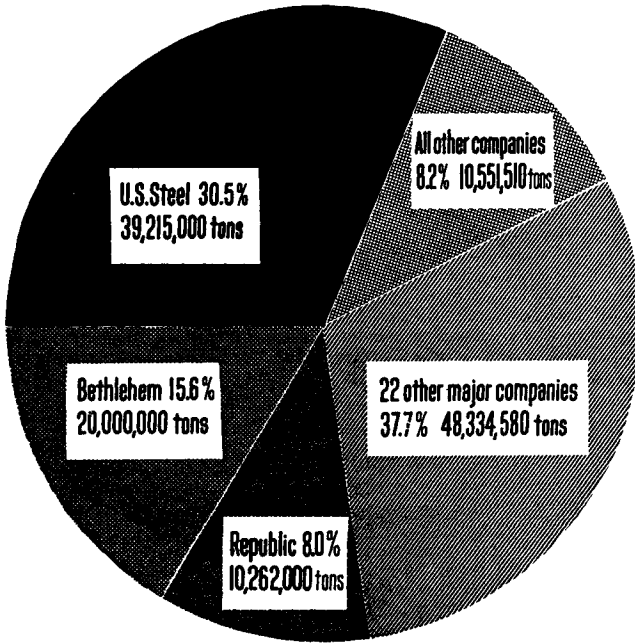
This 117,811,580 tons of capacity of these 25 Companies is 91.8% of the total capacity (128,363,090 tons) of the Industry as of January 1, 1956.

SOURCE.—American Iron and Steel Institute.

CHART 1

Steel Ingot Capacity as of January 1, 1956

128,363,090 tons



The Big 3 Steel Companies have 54.1% of the Industry's Capacity

SOURCE: American Iron and Steel Institute

Summary Statement

The Union's proposals for improvements in the current agreements with the Steel Industry (25 Companies) are fully justified on the basis of the facts. These are fully documented in the detailed analysis which follows. Some of the highlights of that documentation are:

1. Profits of the Steel Industry (25 Companies) are at a record high level:

The 1956 annual rate of Profits Before Taxes is \$2,350.7 million. This is:

- 15.3% higher than in 1955 (\$2,038.5 million)
- 107.4% higher than in 1954 (\$1,133.6 million)
- 238.3% higher than in 1947 (\$ 694.9 million)
- 1,390.6% higher than in 1939 (\$ 157.7 million)

The 1956 annual rate of Net Profits is \$1,153.4 million. This is:

- 13.1% higher than in 1955 (\$1,019.4 million)
- 95.6% higher than in 1954 (\$ 589.8 million)
- 192.5% higher than in 1947 (\$ 394.3 million)
- 812.5% higher than in 1939 (\$ 126.4 million)

2. Profit margins for the Steel Industry (22-25 Companies) have **widened**. For All Manufacturing Corporations profit margins have **narrowed**.

In Steel

Net Profits as a share of the Sales Dollar rose from 6.2¢ in 1947 to 7.9¢ in 1956.

In All Manufacturing

Net Profits as a share of the Sales Dollar declined from 5.7¢ in 1947 to 4.3¢ in 1956.

In Steel

Net Profits as a rate of Return on Net Worth rose from 10.5% in 1947 to 13.8% in 1955.

In All Manufacturing

Net Profits as a rate of Return on Net Worth declined from 15.1% in 1947 to 12.3% in 1955.

3. The Steel Industry (25 Companies) has handsomely rewarded its stockholders. Dividend payments in 1956 are at an annual rate of \$412.9 million, a record high. This is an increase of 223.1% since 1947. All Corporations showed an increase during this period of **only 80.0%**.

4. The Steelworker has increased his productivity—output per manhour—sharply.

By 4.7% in the 1st quarter of 1956

By 11.2% in 1955 (a record high for a year)
By 68.8% since 1939

For his efforts the entire Steel Industry wants to reward him with a **decreasing** rate of wage increase:

11.3¢ actual average wage settlement in last four years

7.3¢ offered average wage increase for next five years

5. The entire Steel Industry has reaped a bonanza from Steel Price increases out of all proportion to increased costs. Since 1945 there have been 8 rounds of wage increases (plus pensions and insurance during another year) and 18 rounds of price increases.

The cumulative impact of the Price and wage increases measured on 1955 operations meant to the entire Steel Industry.

Additional Revenues\$5,697.2 million
Additional Labor Cost\$1,783.2 million

Total Gain\$3,914.0 million

For each \$1.00 increase in labor costs the Steel Industry has generated \$3.19 in additional revenues by their unjustifiably big Price increases.

6. Since 1947 (through March, 1956)

Prices of Steel Sold (1st quarter, 1956, average is 77.7%) +78.2%
Prices of Materials Purchased +26.7%

7. An examination of major "fringe" practices in Industry which can readily be compared shows the serious lag of the Steel Industry.

	American Industry Practices	Steel Industry Practices
Pay for Sunday Work....	Double time	Single time
Pay for Saturday Work	Time and one-half	Single time
Paid Holidays	7	6
Premium above Holiday Pay for Work on Holidays	One-half time or better	None
Vacations for:		
3 years of service....	2 weeks	1 week
10 years of service....	3 weeks	2 weeks
Over 15 years of service	3 or 4 weeks	3 weeks
Shift Differentials:		
Evening	10¢	6¢
Night	15¢	9¢

A. THE FINANCIAL POSITION OF THE STEEL INDUSTRY

The facts on the Steel Industry tell a most remarkable story. Never in the history of the Steel Industry has its financial position been as strong and as sound as it is today. Measured by any standard and measured against any year, the Profits of the Industry are at a fabulous and exorbitantly high level. This applies to the Industry as a whole and to the individual Steel Companies comprising the Industry. Within the framework of its current Profit structure

the Industry can grant the workers substantial wage increases and other benefits, absorb them, and still maintain Profits at record or near record levels. The steady and almost uninterrupted increase in the Profits of the Industry are readily apparent from even a cursory inspection of its own financial reports.

TABLE 2 is a summary showing pertinent financial data since 1939 for the Steel Industry:

Table 2

COMPARATIVE FINANCIAL DATA*

(dollars in millions)

STEEL INDUSTRY

(25 Companies)

	Sales	Profits Before Taxes	Net Profits	Common Stock Cash Dividends	Net Worth (a)	Net Profits as a Rate of Return on Net Worth (a)
1956**	\$14,576.2	\$2,350.7	\$1,153.4	\$412.9	.....	15.6%
1955	12,993.9	2,038.5	1,019.4	353.9	7,390.4	13.8%
1954	9,855.1	1,133.6	589.8	269.0	6,681.0	8.8%
1953	12,165.1	1,600.7	679.4	248.7	6,303.0	10.8%
1952	9,966.3	929.6	492.5	238.8	5,890.8	8.4%
1951	11,053.3	1,884.0	633.5	240.3	5,668.4	11.2%
1950	9,064.3	1,530.7	728.5	246.0	5,177.1	14.1%
1949	7,179.3	933.3	521.8	167.9	4,714.0	11.1%
1948	7,867.5	985.9	534.9	150.2	4,395.3	12.2%
1947	6,421.6	694.9	394.3	127.8	3,754.1	10.5%
1946	4,514.9	368.3	249.9	95.6	3,527.3	7.1%
1939	2,368.1	157.7	126.4	16.4	3,025.7	4.2%

* Includes 25 Companies. Two of the smaller Companies were not operating in 1939. Exclusion of the figures for these two Companies for later years to make the number of Companies entirely uniform throughout would have only a negligible effect on the above comparisons.

** Annual rate projected from 1st quarter 1956 figures (except for Kaiser for which 6 months ending 12/31/55 was used).

(a) Net Worth is as of the end of year. Computation of the rate of Return on Net Worth was based on Net Worth as of the end of the year except for 1956 for which beginning Net Worth was used.

SOURCE.—Based on other Tables.

As can be seen from these figures, Sales, Profits Before and After Taxes, and Common Stock Cash Dividends all were at record peaks in the year 1955. The 1st quarter 1956 reports of the Industry indicate that the results for the year

1956 will even surpass those new records established in 1955.

What is most significant is not only that the dollar amounts of Profits are at a record high level, but that profit margins themselves are ex-

Table 3
PROFITS BEFORE TAXES*
 (dollars in millions)
STEEL INDUSTRY
 (25 Companies)

	1956**	1955	1954	1953	1952	1951	1950	1947	1939
U. S. Steel	\$844.8	\$786.1	\$385.4	\$545.1	\$282.3	\$622.7	\$485.0	\$244.4	\$54.1
Bethlehem	357.2	361.2	251.8	294.9	156.9	268.5	245.0	82.1	30.8
Republic	208.8	170.3	102.8	157.2	86.9	175.4	154.3	58.3	13.1
Jones & Laughlin ^a	106.8	96.6	47.6	58.9	14.7	85.3	73.6	31.6	3.7
National	117.2	96.6	58.1	118.5	79.6	145.3	124.4	49.6	14.2
Youngstown S and T	82.8	83.8	32.4	58.9	40.2	69.6	74.5	42.9	5.9
Inland	117.2	105.5	79.2	73.2	36.9	87.9	79.2	48.4	13.5
Armco	160.0	131.0	83.6	84.7	74.4	104.1	95.2	41.5	4.8
Colorado F and I ^b	32.0	21.6	13.2	22.6	14.2	29.3	7.1	7.8	0.2
Wheeling	45.6	35.8	18.1	26.5	18.4	51.1	35.7	19.4	6.6
Sharon	18.0	15.8	5.0	13.9	7.9	27.3	18.9	10.9	0.5
Kaiser ^c	15.0	10.5	15.2	20.3	21.8	15.7	21.6	X	N.O.
Crucible	33.2	23.8	3.1	12.0	11.0	26.5	14.5	3.1	3.4
McLouth	20.4	15.5	-0.4†	16.3	13.8	16.5	11.2	2.9	0.4
Pittsburgh ^d	21.2	14.8	3.1	10.0	9.6	22.5	12.5	6.9	0.7
Detroit ^e	18.4	13.0	0.8	11.8	8.9	32.3	17.2	12.9	0.7
Granite City	31.3	26.3	8.4	13.4	7.5	13.1	11.1	2.6	0.4
Barium	14.0	1.7	-2.2†	6.2	9.3	12.8	3.6	2.9	-0.2†
Allegheny Ludlum	38.8	31.5	8.7	19.5	8.8	29.0	20.1	10.1	2.5
Northwestern S&W ^f	14.4	8.7	2.1	1.1	2.8	8.1	4.4	3.4	0.1
Lukens ^g	12.0	5.7	4.8	13.3	6.2	12.7	3.7	4.7	0.1
Alan Wood	5.2	4.2	1.5	5.7	4.7	6.5	4.3	3.2	0.8
Copperweld	8.4	5.4	1.3	6.0	4.7	8.3	4.4	2.7	1.2
Lone Star	18.8	9.4	-1.0†	2.5	3.2	5.6	2.6	0.2	N.O.
Laclede	9.2	8.7	6.0	7.7	4.9	7.9	6.6	2.4	0.2
TOTALS	\$2,350.7	\$2,038.5	\$1,133.6	\$1,600.7	\$929.6	\$1,884.0	\$1,530.7	\$694.9	\$157.7
Increase in 1956 over other years ^h		15.3%	107.4%	46.9%	152.9%	24.8%	53.6%	238.3%	1,390.6%
Increase in 1955 over other years ^h			79.8%	27.4%	119.3%	8.2%	33.2%	193.4%	1,192.6%

* The figures cover each Company's fiscal years ending in the years indicated. The figures are Profits Before Federal Taxes on Income. Where the Companies' Annual Reports have shown such a figure separately, it has been used. Where no such figure was reported, it was derived by adding Federal Income Taxes to the Stated Net Profits. (In a few cases it was necessary to add an Income Tax figure which included State and/or Canadian Income Taxes because they could not be segregated.) In the few instances in which there was a Net Loss reported for a year, the Loss figure was used as a minus Profit Before Taxes figure unless a Loss Before Taxes figure was shown separately.

The only adjustments made in the Stated Profits Before Taxes figures were for those few Companies which have used Accelerated Depreciation Charges. Since these amounts were, and are, not allowable for income Tax purposes, they were added to the Profits Before Taxes figures shown in the Annual Reports in order to correct for the understatement of Profits Before Taxes resulting from the use of this accounting device. The Companies, years and amounts (in millions) involved were

	1954	1953	1952	1951	1950	1949	1948	1947
U. S. Steel			\$21.6	\$40.4	\$35.5	\$22.0	\$55.3	\$26.3
Republic				3.0	11.3	3.0	7.0	4.0
National				5.0	5.5	11.9	10.5	3.5
Kaiser		\$ 1.6	1.5	1.5	1.6	1.7	1.5	1.8
Lukens	\$ 0.7	0.3	0.2	0.3	0.3	0.3	0.3	...

** Annual rate projected on a straight-line basis from 1st calendar quarter of 1956 for all Companies except Lukens (12 weeks ended 3/24/56), Northwestern Steel & Wire (3 months ended 4/30/56), and Kaiser (6 months ended 12/31/55).

†—Loss.

X—Less than \$50,000.

N.O.—Not Operating.

* For 1939 the figure was computed by adding the revised Net Profits figure to the revised combined Income Tax figure. From this total was subtracted the Income Taxes other than Federal as originally reported by the Corporation.

^a Fiscal years ended June 30th.

^b For certain of the earlier years the figures were computed by adding revised Net Profits and Income Taxes, from a prospectus, and subtracting State Income Taxes as shown in Moody's Industrials and the Company's Annual Reports.

^c Includes reported Net Profits of Portsmouth (acquired at end of 1949) for 1947 (also for 6 months of 1946 and for 1948 and 1949 not here shown).

^d Fiscal years ended July 31st.

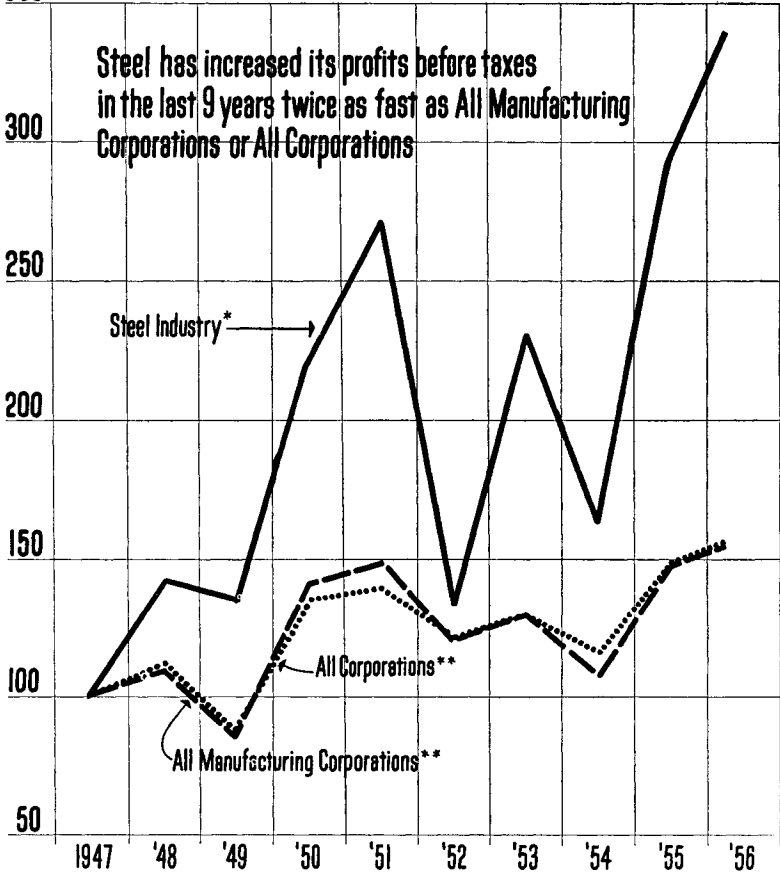
^e Fifty weeks ended 12/31/55. Prior fiscal years are 52 week periods ending at various dates in October.

^f If Kaiser and Lone Star were excluded from the later years' figures, the percentage increases would be very slightly affected. Only the percentage comparisons with 1939 are affected slightly as here shown.

SOURCE.—Annual Reports of the Companies; Moody's Industrials. Calculations ours.

CHART 2 Profits Before Taxes

Index (1947=100)



* 25 major companies accounting for 91.8 of total steel capacity, source: Annual and quarterly reports of the same corporations

** SOURCE: U.S. Department of Commerce

traordinarily high. Profits Before Taxes in 1955, as a rate of Return on Net Worth were 27.6%—a rate exceeded only twice (1950 and 1951) in the Industry's recent financial history. In 1956 the rate has jumped to 31.8% which surpasses all recent years (except 1951). Since it is from Profits Before Taxes that wage "cost" increases would come if the "costs" were absorbed, this measure of profitability is most significant.

Net Profits (After Taxes) as a rate of Return on Net Worth for 1955 were 13.3%, which is considerably higher than the rate for any year in the last quarter of a century (except for 1950) and more than double the 6% rate which normally and traditionally has been considered to be a fair and reasonable rate of return on stockholder investment. The rate of return for 1956 is 15.6%, which is more than 13% higher than the near record rate achieved last year.

Profits Before Taxes in 1955 represented 15.8¢ out of each Sales Dollar. This margin has further widened to 16.2¢ in 1956. These exorbitant margins reflect the degree by which the Industry has overpriced its products. The 1955 rate has been surpassed only twice in recent years (1950 and 1951). They are too high by any standard. Net Profits (After Taxes) as a share of the Sales

Dollar were 7.9¢ in 1955 and have held at this rate so far in 1956. This is a high rate of return on Sales for this Industry—and one which has only been equalled once in the last 15 years. It comes at a time when the Industry can readily cut profit margins per Sales Dollar and still make a fair Profit because of its high operating rate and peak Sales volume.

The record high Profits result in part from increased productivity and in part from higher Steel Prices charged by the Steel Companies for their products. As pointed out elsewhere in this analysis, the Industry has not shared equitably with its employees the huge gains resulting from increased productivity. The public has received no share whatsoever of these gains. At the same time the Industry has increased its Prices far more than was necessary to compensate for increased "costs". This is true even if one accepts the Industry's faulty and mistaken premise that it must raise Prices every time the "cost" of materials or labor increases. Actually, those presumed "costs" have already been absorbed by productivity gains and by high level operations.

A more detailed examination of these financial facts about the Steel Industry follows:

1—Profits Before Taxes

Profits Before Taxes (Federal Corporate Income Taxes) of the Industry (25 Companies) reached a record high level in 1955—and even this record high level is being far surpassed in 1956. The annual rate of Profits Before Taxes for 1956 is \$2,350.7 million. This is 15.3% higher than Profits Before Taxes in 1955. It is more than double the level in 1954 and 1952 and more than double that for any year preceding 1950. In fact, it is almost 15 times as much as was earned in 1939. It is most significant to note that the rate of growth of Profits Before Taxes in Steel between 1947 and 1956 has been more than twice as rapid as in All Corporations and in All Manufacturing Corporations.

These data appear in TABLE 3 and CHART 2 (also TABLE 22).

2—Net Profits (After Taxes)

In 1955 the Industry (25 Companies) reported Net Profits (After Taxes) of over a billion dollars (\$1,019,400,000) for the first time in its history. This was 72.8% higher than Net Profits in 1954,

It is within the framework of its Profits Before Taxes that a Company's or an Industry's ability to absorb a "cost" increase is measured, whether the increase be wage "cost" or any other "cost". These 25 Companies in 1955 employed an average of approximately 775,000 persons. If this same employment is assumed for 1956 and if a 2,000 hour man-year is assumed for each employee, total annual manhours would be about 1,550 million. This means that for each manhour worked in 1956 the Industry is making an average Profit of \$1.52—a rather substantial Profit on each hour of labor—one which is more than 60% of the total amount actually paid for each hour of work. It certainly leaves an adequate margin within which substantial labor "cost" increases can be absorbed.

\$9.9% higher than Net Profits in 1950, the prior record year, and more than 8 times as much as Net Profits in 1939.

This is a record of Profit growth which should have been eminently satisfactory. But in 1956 it

Table 4

NET PROFITS—REPORTED*

(dollars in millions)

STEEL INDUSTRY

(25 Companies)

	1956**	1955	1954	1953	1952	1951	1950	1947	1939
U. S. Steel	\$416.8	\$370.1	\$195.4	\$222.1	\$143.7	\$184.4	\$215.5	\$127.1	\$41.1
Bethlehem	180.0	180.2	132.8	133.9	90.9	106.5	123.0	51.1	24.6
Republic	100.0	86.3	52.9	56.7	44.3	54.9	63.8	31.0	10.7
Jones & Laughlin	54.4	50.1	25.0	31.0	19.5	31.0	39.7	20.1	3.1
National	56.4	48.3	30.3	49.2	37.6	45.3	57.8	26.8	12.6
Youngstown S and T.	40.8	41.7	20.2	30.8	22.9	30.6	40.6	26.3	5.0
Inland	56.0	52.5	41.3	33.9	23.3	34.4	38.0	29.9	10.9
Armed	78.8	64.4	41.1	33.9	31.3	35.0	47.0	25.0	4.0
Colorado F and I ^a	16.0	10.9	7.1	8.0	5.8	10.0	4.4	5.2	0.1
Wheeling	21.4	17.3	9.6	12.5	11.0	17.4	13.3	11.7	5.6
Sharon	9.2	8.0	3.1	6.7	5.1	8.9	9.3	6.7	0.4
Kaiser ^a	7.8	5.7	7.9	9.1	10.4	7.5	11.9	-1.3†	N.O.
Crucible	14.8	13.2	3.7	5.1	5.4	8.4	8.3	2.1	2.8
McLouth	9.6	8.1	1.7	5.2	4.2	5.2	5.3	1.8	0.8
Pittsburgh	10.0	7.5	2.2	4.6	5.2	7.3	6.4	4.0	0.6
Detroit ^b	8.8	6.3	0.9	5.2	4.3	10.5	3.9	8.0	0.5
Granite City	15.8	12.6	4.0	6.5	5.0	5.1	5.7	1.7	0.3
Barium	6.0	0.7	-0.4†	2.3	2.7	4.2	1.5	1.7	-0.2†
Allegheny Ludlum	18.4	15.0	4.2	7.8	5.9	8.8	9.8	6.0	2.0
Northwestern S&W ^a	6.8	4.1	1.0	0.4	2.0	3.1	2.7	2.0	0.1
Lukens ^d	5.6	2.6	2.0	3.6	2.3	3.5	1.9	2.8	0.1
Alan Wood	2.8	2.6	1.2	3.2	2.3	2.9	2.3	2.0	0.7
Copperweld	4.0	2.4	0.7	2.9	2.3	2.7	2.6	1.5	0.9
Lone Star	8.8	4.8	-1.0†	2.1	2.5	3.1	1.6	0.2	N.O.
Laclede	4.4	4.0	2.9	2.7	2.1	2.8	3.2	1.4	0.2
TOTALS	\$1,153.4	\$1,019.4	\$589.8	\$679.4	\$492.5	\$633.5	\$723.5	\$394.3	\$126.4
Increase in 1956 over other years*		13.1%	95.6%	69.8%	134.2%	82.1%	53.3%	192.5%	812.5%
Increase in 1955 over other years*			72.8%	50.0%	107.0%	60.9%	39.9%	158.5%	706.5%

*—The figures cover each Company's fiscal years ending in the years indicated. The figures shown are Stated Net Profits without any adjustment, except for revisions made by the Companies themselves in subsequent Annual Reports. Where such revisions have been made by the Companies, they have been used in every case where they were available.

**—Annual rate projected on a straight-line basis from 1st calendar quarter of 1956 for all Companies except Lukens (12 weeks ended 3/24/56), Northwestern Steel & Wire (3 months ended 4/30/56), and Kaiser (6 months ended 12/31/55).

†—Loss.

N.O.—Not Operating.

^a—Fiscal years ended June 30th.

^b—Includes reported Net Profits of Portsmouth (acquired at end of 1949) for 1947 (also for 6 months of 1946 and for 1948 and 1949 not here shown).

^c—Fiscal years ended July 31st.

^d—Fifty weeks ended 12/31/55. Prior fiscal years are 52-week periods ending at various dates in October.

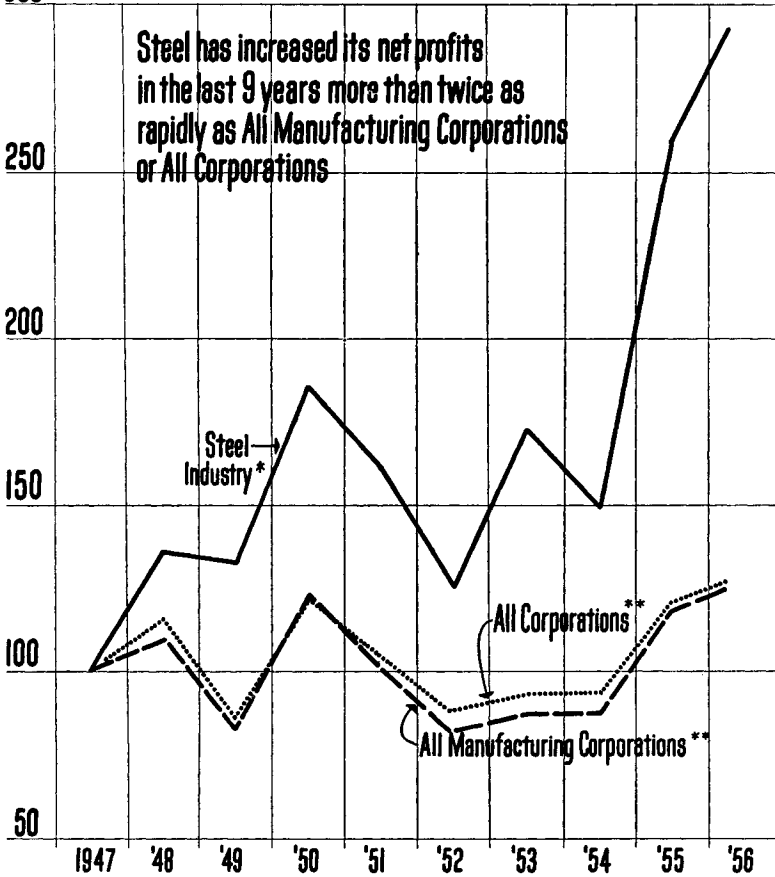
†—If Kaiser and Lone Star were excluded from the later years' figures, the percentage increases would be very slightly affected. Only the percentage comparisons with 1939 are affected slightly as here shown.

General Note: A number of these Companies reported their Net Profits and Profits Before Taxes on a different basis than the other Steel Companies. These Companies in their reports to stockholders showed regular Depreciation on expanded or new facilities rather than Rapid Amortization as permitted by the tax laws under certain circumstances. However, they took credit for Rapid Amortization for tax purposes and showed the tax savings as a Reserve for Future Taxes. This method resulted in an overstatement (comparatively speaking) of Net Profits. These overstatements were not great enough, however, to alter seriously the comparisons shown and the conclusions reached in this analysis. McLouth, Pittsburgh, Granite City, Northwestern Steel & Wire and Lone Star used this method beginning in 1953. Jones & Laughlin, Kaiser, Detroit and Barium used this method of reporting beginning in 1954. Colorado Fuel and Iron and Lukens adopted the new method of reporting Profits in 1955. As a result, their Profits figures for these years are not entirely comparable with their Profits figures for some prior years.

SOURCE.—Annual Reports of the Companies; Moody's Industrials. Calculations ours.

CHART 3 Net Profits

Index (1947=100)



Steel has increased its net profits in the last 9 years more than twice as rapidly as All Manufacturing Corporations or All Corporations

* 25 major companies accounting for 91.8% of total steel capacity, source: annual and quarterly reports of the same corporations

** SOURCE: U.S. Department of Commerce

appears that Net Profits will even exceed the record established in 1955. The annual rate of Net Profits for 1956 is \$1,153.4 million, which is 13.1% higher than record Net Profits for the full year 1955.

It is interesting to note that 16 of these 25 Companies reported record-breaking Net Profits in 1955. So far in 1956 a total of 17 of these Companies are reporting Net Profits at an all time

record-breaking rate. The unparalleled prosperity that the Industry is enjoying is being shared by nearly all Companies, big and small. Again, it should be noted that the rate of growth of Net Profits in Steel between 1947 and 1956 has been more than twice as rapid as in All Corporations and in All Manufacturing Corporations.

The supporting data are shown in TABLE 4 and CHART 3 (also TABLE 23).

3—Dividends

Over the years the Common stockholders of the Industry (25 Companies) have fared extremely well. In 1939 Cash Dividends totalled \$16.4 million. In 1955, total cash payments had risen to \$353.9 million. The annual rate of Cash Dividend payments for 1956 has risen to \$412.9 million, some 25 times the level of 1939. This annual rate for 1956 likely understates probable payments for the full year since several Companies customarily declare year-end "extra" Dividends which have been ignored in projecting the annual rate.

Not only have total dollar Dividend payments shown a sharp increase, but the number of these Companies paying Cash Dividends to their stockholders has increased sharply since 1939. In that year only 7 of these Companies made a cash payment to their Common stockholders. In 1947 this number had increased to 19 and currently 22 of the 25 Companies are paying Cash Dividends to

their Common stockholders. The Dividend growth in Steel between 1947 and 1956 has been almost twice (1.8 times) as great as in All Corporations.

The supporting data are in TABLE 5 and CHART 4 (also TABLE 24).

Many Companies have also paid Stock Dividends in addition to, or in lieu of, Cash Dividends. In 1955, for instance, 6 Companies made such payments amounting to \$13.7 million in value, an amount substantially greater than the Cash Dividends paid by these same Companies to their stockholders in 1956.

In addition to receiving handsome increases in Dividend payments, the Common stockholders have benefited from a sharp increase in the equity value of their stockholdings. The Net Worth of these Companies has increased from just over \$3 billion as of the end of 1939 to almost \$7.5 billion as of the end of 1955. This represents the book value increase. The actual market price increase of Steel stocks has been much greater.

4—Net Worth and Rate of Return on Net Worth

The profit margin of the Steel Industry (25 Companies) is further demonstrated when Profits Before Taxes are measured as a rate of Return on

Net Worth. This margin in 1955 was 27.6¢ on each dollar of stockholder investment. In 1956 it has climbed to 31.8¢ on the dollar. This reflects an inflationary Pricing policy for the Benefit of the Steel Industry only. These margins follow:

PROFITS BEFORE TAXES AS A RATE OF RETURN ON NET WORTH

STEEL INDUSTRY (25 Companies)

	1956	1955	1954	1953	1952	1951	1950	1947	1939
Totals (25 Companies)	31.8%	27.6%	17.0%	25.4%	15.8%	33.2%	29.6%	18.5%	5.2%

Table 5

CASH DIVIDENDS*
ON
COMMON STOCK
(dollars in millions)

STEEL INDUSTRY
(25 Companies)

	1956**	1955	1954	1953	1952	1951	1950	1947	1939
U. S. Steel	\$139.2	\$122.9	\$ 85.5	\$ 78.3	\$ 78.3	\$ 78.3	\$ 92.7	\$ 45.7	None
Bethlehem	85.9	69.5	55.1	38.3	38.3	38.3	39.3	17.9	4.8
Republic	38.6	38.4	28.9	26.7	23.6	23.6	25.1	11.3	None
Jones & Laughlin	15.7	14.0	12.4	12.1	11.2	10.7	7.1	5.0	None
National	29.5	23.9	22.0	23.9	22.0	22.0	20.9	8.9	3.7
Youngstown S and T. Inland	18.5	12.6	12.6	12.6	10.1	10.1	10.1	8.4	None
Armed	22.0	23.0	18.9	17.2	14.7	17.1	17.1	12.2	6.5
Colorado Fuel and Iron	26.0	20.6	15.6	15.6	15.6	14.8	15.7	6.5	None
Wheeling	6.1	2.9	1.9	3.5	3.1	3.2	1.8	1.0	None
Sharon	5.7	5.3	4.3	4.3	4.3	4.3	2.8	1.0	None
Kaiser	3.3	2.8	2.8	4.4	4.4	3.4	2.9	1.2	None
Crucible	1.3	1.3	1.6	1.6	0.8	None	None	None	N.O.
McLouth	5.4	3.6	None	None	None	None	None	None	None
Pittsburgh	None	None	None	None	None	None	None	0.4	None
Detroit ^b	1.5	0.4	None	None	None	None	None	None	None
Granite City	3.0	0.8	None	1.8	2.4	2.4	2.4	2.9	0.3
Barium	4.2	3.9	None	None	1.5	2.7	1.9	0.4	None
Allegheny Ludlum	None	None	0.5	1.1	1.1	0.9	None	None	None
Northwestern S&W	6.0	4.0	3.4	3.3	3.4	4.1	3.2	2.6	0.6
Lukens	1.0	0.4	None	None	None	None	None	1.1	None
Alan Wood	1.4	0.5	1.1	1.0	1.3	1.3	0.6	0.4	None
Copperweld	0.9	0.9	0.2	0.9	0.8	0.8	0.3	None	None
Lone Star	1.5	1.0	0.9	1.0	1.0	1.2	1.0	0.4	0.3
Laclede	None	None	None	None	None	None	None	None	N.O.
Laclede	1.2	1.2	1.3	1.1	0.9	1.1	1.1	0.5	0.2
TOTALS	\$412.9	\$353.9	\$269.0	\$248.7	\$238.8	\$240.3	\$246.0	\$127.8	\$16.4

* The figures cover each Company's fiscal years ending in the years indicated. They are total Cash Dividends only. Stock Dividends paid in addition to, or in lieu of, Cash Dividends (except for Stock splits) as valued (in \$ millions) by the Companies, follow:

Republic—1948—\$7.7 (4%)
 Jones & Laughlin—1949—\$7.4 (5%)
 National—1948—\$19.0 (10%)
 Armed—1949—\$16.2 (20%)
 Colorado Fuel and Iron—1955—\$1.1 (2.5%); 1954—\$2.0 (5%); 1951—\$6.9 (25%)
 Wheeling—1955—\$8.9 (10%); 1950—\$7.1 (25%)
 Sharon—1950—\$8.8 (50%)
 Crucible—1954—\$1.5 (3%); 1953—\$1.6 (8%); 1952—\$2.7 (10%); 1951—\$3.7 (16%)
 McLouth—1953—\$5.7 (25%); 1950—\$5.9 (100%)
 Pittsburgh—1955—\$1.2 (4%); 1953—\$0.5 (2%)
 Detroit—1955—\$1.2 (4%); 1953—\$0.5 (2%)
 Granite City—1954—\$1.8 (5%); 1953—\$2.9 (12%); 1952—\$0.8 (3%); 1949—\$0.3 (4%)
 Barium—1955—\$0.97 (5%); 1954—\$0.91 (7.5%); 1949—\$0.91 (10%)
 Allegheny Ludlum—1953—\$1.0 (2%); 1952—\$1.1 (2%)
 Alan Wood—1955—\$0.4 (3%); 1954—\$0.4 (5%); 1950—\$0.4 (5%); 1949—\$0.6 (10%)
 Lone Star—1949—\$0.5 (25%)

** Annual rate based on Dividends declared in 1st half of calendar 1956 (except for Kaiser which normally distributes only one Dividend per year).

N.O.—Not Operating.

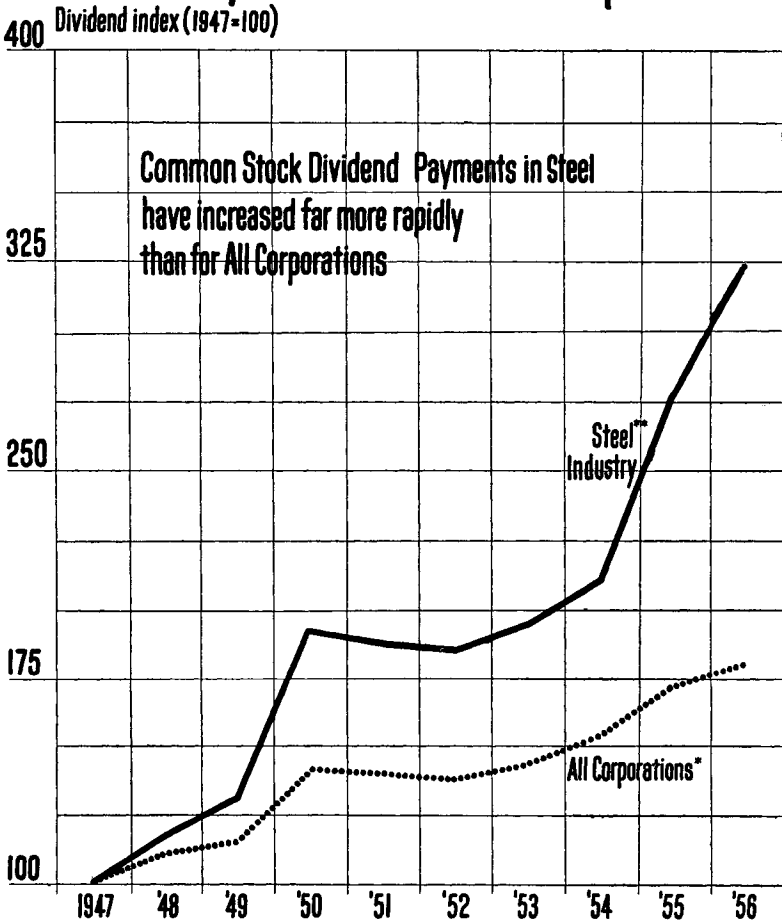
^b Kaiser, for all intents and purposes, had no Common Stock prior to October 1950. It had only 1,000 shares of Common Stock, all closely held, valued at \$100,000. The stock issued in 1951 carried a book value of \$3,200,000.

^c Includes Common Stock Cash Dividends for Portsmouth (acquired in 1949) for 1947 (also for 1946, 1948 and 1949 not here shown).

SOURCE.—Annual Reports of the Companies; Moody's Industrials; Moody's Dividend Record. Calculations ours.

CHART 4

Dividend Payments in Steel vs. All Corporations



* all cash dividends of All Corporations, source: U.S. Department of Commerce
 ** only cash dividends on common stocks of 25 steel corporations accounting for 91.8% of total steel capacity, source: Annual and quarterly reports of the same corporations

A portion of these Profits Before Taxes do not accrue to the Steel owners but are paid in taxes to the Federal Government. The amount available to the stockholders either for Dividends or as an increase in equity is shown in the Net Profits figures, which are also measured as a rate of Return on Net Worth.

While the Steel Industry constantly complains of an inadequate return on its investment, the actual figures certainly do not bear this out.

It has long been accepted in accounting and financial circles that Net Profits After Taxes at 6% on Net Worth represent a fair and reasonable rate of return. In 1939 the Steel Industry did not quite reach this standard. The rate of return that year was 4.2%. Since then the rate of Return on Net Worth has exceeded 6% in every year except during World War II. In most peacetime years since 1939, the rate has been in excess of 10%. In 1955 the over-all rate for the Industry

Table 6

**NET PROFITS
AS A RATE OF RETURN ON NET WORTH*
STEEL INDUSTRY
(25 Companies)**

	1956*	1955	1954	1953	1952	1951	1950	1947	1939
U. S. Steel	16.1%	14.3%	8.8%	9.9%	6.7%	8.8%	10.7%	8.4%	3.1%
Bethlehem	15.2	15.2	12.3	13.3	9.9	12.2	15.2	9.0	5.2
Republic	16.5	14.2	9.8	12.1	10.1	13.0	16.3	10.6	4.5
Jones & Laughlin	12.9	11.9	6.5	8.3	5.5	8.9	13.0	8.8	1.9
National	14.2	12.1	8.1	13.5	11.4	14.4	19.9	13.4	9.6
Youngstown S and T	11.2	11.5	6.1	9.5	7.5	10.4	14.9	14.4	3.5
Inland	16.9	15.8	14.4	13.6	10.2	15.4	18.4	19.8	10.7
Armco	20.4	16.7	12.1	10.8	10.6	12.5	20.6	15.4	3.1
Colorado F and I	13.9	9.5	6.6	7.8	6.9	13.5	6.5	10.3	0.5
Wheeling	11.8	9.6	6.1	8.2	7.5	12.3	14.0	11.5	6.8
Sharon	13.5	11.7	4.9	10.7	8.5	15.0	19.7	22.3	2.6
Kaiser	7.4	5.4	7.6	9.1	10.9	8.5	26.6	-†	N.O.
Crucible	15.1	13.5	4.2	5.9	6.5	10.6	8.7	3.2	2.9
McLouth	15.4	13.0	2.9	17.3	16.9	25.2	37.7	41.9	20.0
Pittsburgh	11.6	8.7	2.8	5.8	6.9	10.2	12.0	9.3	1.7
Detroit*	15.3	10.9	2.2	13.3	12.1	31.2	34.8	33.1	13.5
Granite City	23.2	18.5	6.6	11.3	9.7	11.3	21.1	11.9	2.5
Barium	26.3	3.1	-†	10.9	13.8	23.0	10.0	16.5	-†
Allegheny Ludlum	20.3	16.5	5.2	9.8	7.8	12.0	16.1	15.1	7.4
Northwestern S & W	32.7	19.6	5.8	2.5	13.4	23.7	27.0	40.8	3.4
Lukens	19.2	8.9	7.4	13.7	9.5	15.1	9.1	17.6	1.5
Alan Wood	9.1	8.5	4.1	11.4	8.9	11.8	12.1	11.6	4.8
Copperweld	13.2	7.9	3.0	12.0	10.1	14.7	15.3	12.5	13.0
Lone Star	32.7	17.8	-†	9.3	12.1	17.0	16.5	12.5	N.O.
Laclede	20.3	18.4	15.4	15.7	13.5	19.4	25.2	19.2	3.4
AVERAGES**	15.6%	13.8%	8.8%	10.8%	8.4%	11.2%	14.1%	10.5%	4.2%

* Computed by dividing Net Profits for each Company for each of the fiscal years ending in the years indicated by Net Worth as of the end of each fiscal year (except for 1956 for which computation the beginning Net Worth figure was used). Based on Net Profits and Net Worth figures from prior Tables.

** Averages computed by dividing total Net Worth into total Net Profits for each year for all Companies for which data were available.

-†—Loss.

N.O.—Not Operating.

* Includes Net Profits as a rate of Return on Net Worth for Portsmouth (acquired in 1949) for 1947 (also for the years 1946, 1948, and 1949 not here shown).

SOURCE.—Annual Reports of the Companies; Moody's Industrials. Calculations ours.

(25 Companies) was a phenomenal 13.8% with only 2 Companies earning a rate of less than 6% and 17 Companies earning more than 10%. The annual rate for 1956 is 15.6%, a record high, with no Company earning less than 6% and 23 of the Companies earning more than 10%. These data appear in TABLE 6.

As the Return on Net Worth was skyrocketing, the Industry was able to increase very sharply its combined Net Worth from \$3,025.7 million as of the end of 1939 to \$7,390.4 million as of the end of 1955—an increase of 144.3%—almost entirely from undistributed Profits. These facts are shown in TABLE 7.

Table 7

NET WORTH*

(dollars in millions)

STEEL INDUSTRY

(25 Companies)

	1955	1954	1953	1952	1951	1950	1947	1939
U. S. Steel	\$2,582.6	\$2,348.7	\$2,254.7	\$2,136.1	\$2,096.0	\$2,015.2	\$1,510.8	\$1,314.8
Bethlehem	1,186.1	1,079.9	1,008.7	919.6	873.6	811.6	565.4	473.9
Republic	606.1	537.8	470.1	440.7	421.6	392.0	293.1	239.1
Jones & Laughlin	420.7	383.5	372.4	354.9	348.1	305.5	228.2	164.7
National	397.9	372.1	363.2	330.0	314.6	291.1	199.8	131.2
Youngstown S and T	362.9	332.8	325.0	306.7	293.9	273.3	183.2	144.1
Inland	332.3	287.3	249.8	232.7	223.6	206.4	151.3	101.4
Armco	326.7	339.7	313.6	295.4	279.7	228.0	162.6	127.1
Colorado F and I	115.0	107.4	103.0	83.7	74.2	67.9	50.6	19.0
Wheeling	180.9	156.7	153.1	146.7	141.8	130.8	101.8	82.0
Sharon	68.1	62.9	62.5	60.2	59.4	47.1	30.0	15.6
Kaiser	105.7	103.9	100.3	95.0	87.8	44.7	17.1	N.O.
Crucible	98.0	88.6	85.9	82.6	79.3	72.8	65.3	97.3
McLouth	62.2	58.0	30.0	24.8	20.6	15.4	4.3	1.5
Pittsburgh	86.1	80.0	79.1	75.8	71.9	53.5	43.2	35.0
Detroit*	57.7	40.2	39.1	35.6	33.7	25.6	24.2	2.7
Granite City	68.2	60.6	57.3	51.4	45.3	27.0	14.3	11.8
Barium	22.3	22.2	21.1	19.6	18.3	15.0	10.3	4.4
Allegheny Ludlum	90.8	80.1	79.6	75.4	73.2	60.7	39.7	27.1
Northwestern S & W	20.9	17.1	16.1	14.9	13.1	10.0	4.9	2.9
Lukens	29.2	27.2	26.3	24.2	23.2	20.9	15.9	6.8
Alan Wood	30.7	29.6	28.0	25.8	24.5	23.2	17.2	14.5
Copperweld	30.2	23.7	24.2	22.8	18.4	17.0	12.0	6.9
Lone Star	26.9	22.2	22.7	20.6	18.2	9.7	1.6	N.O.
Laclede	21.7	18.8	17.2	15.6	14.4	12.7	7.8	5.9
TOTALS	\$7,390.4	\$6,681.0	\$6,303.0	\$5,890.8	\$5,668.4	\$5,177.1	\$3,754.1	\$3,025.7
Increase in 1955 over other years ^b		10.6%	17.3%	25.5%	30.4%	42.8%	96.9%	144.3%

* The figures cover Stockholders' Equity in the business as of the end of each fiscal year for each Company. Where the Companies have labeled a figure "Net Worth" or "Stockholders' Equity" this figure has been used, including the most recent revisions shown by the Companies.

N.O.—Not Operating.

* Includes Net Worth of Portsmouth (acquired in 1949) for 1947 (also for the years 1946, 1948 and 1949 not here shown).

^b If Kaiser and Lone Star were excluded from the later years' figures, the percentage increases would be very slightly affected. Only the percentage comparison with 1939 is affected slightly as here shown.

SOURCE.—Annual Reports of the Companies; Moody's Industrials. Calculations ours.

5—Sales and Distribution of the Sales Dollar

(a) Sales

Sales of the Industry (25 Companies) are currently at an all-time peak. The annual rate of Sales for 1956 are \$14.6 billion, which is 12.2% higher than record 1955 Sales. It is interesting to

note that not only are total Sales at a record high, but the Sales for every one of the individual 25 Companies, with one exception, are at an annual rate for 1956 which exceeds Sales in any prior year. In part, these record Sales reflect an increased volume of production; although the increase in production has not come close to matching the increases in Sales. In modest part, for the

Table 8

SALES*
(dollars in millions)

STEEL INDUSTRY (25 Companies)

	1956**	1955	1954	1953	1952	1951	1950	1947	1939
U. S. Steel	\$4,402.0	\$4,097.7	\$3,250.4	\$3,861.0	\$3,137.4	\$3,524.1	\$2,956.4	\$2,122.8	\$ 846.0
Bethlehem	2,400.0	2,096.6	1,656.8	2,082.0	1,691.7	1,798.1	1,439.8	1,082.3	414.1
Republic	1,330.4	1,188.6	846.3	1,137.1	918.4	1,052.7	881.8	645.3	230.3
Jones & Laughlin	781.2	696.5	492.9	624.4	495.4	564.3	487.5	350.1	113.6
National	682.4	622.0	484.1	634.2	548.6	618.5	537.0	329.0	131.1
Youngstown S and T	704.0	617.4	428.2	548.1	434.2	483.7	404.0	306.2	117.0
Inland	761.6	659.7	533.1	575.6	458.0	518.7	459.3	315.0	115.3
Armco	760.0	692.7	532.0	588.9	518.6	534.8	439.3	311.7	94.9
Colorado F and I	325.0	257.5	250.2	248.8	195.8	191.4	112.6	94.7	22.1
Whoeeling	271.6	246.7	187.6	217.4	178.3	227.1	184.8	131.7	85.7
Sharon	199.2	171.2	98.2	167.2	131.3	169.0	135.4	93.9	17.8
Kaiser	146.4	136.1	128.5	134.5	117.9	100.5	84.5	33.8	N.O.
Crucible	277.2	237.7	160.6	232.3	180.3	202.9	147.7	110.2	48.0
McLouth	162.4	145.0	59.1	96.4	79.2	78.9	57.8	18.0	N.A.
Pittsburgh	199.6	176.7	124.0	140.7	129.0	149.3	118.0	85.1	23.6
Detroit*	120.8	101.8	51.7	98.4	87.4	113.7	92.9	75.2	4.6
Granite City	144.0	116.3	69.3	87.9	74.6	86.6	59.8	25.8	10.2
Barium	108.8	75.1	53.5	89.7	99.1	91.6	53.5	41.4	0.1
Allegheny Ludlum	299.2	255.2	169.6	241.6	189.2	228.7	177.4	106.6	37.3
Northwestern S & W	96.4	51.4	35.6	44.3	34.0	40.9	28.9	21.5	5.8
Lukens	94.0	82.4	75.0	97.9	69.6	80.5	52.9	52.8	11.9
Alan Wood	69.2	58.4	36.1	59.8	60.5	58.8	45.0	36.0	14.7
Copperweld	100.4	78.5	49.7	83.8	71.6	76.2	55.6	53.3	10.4
Lone Star	86.8	74.5	37.2	27.3	18.7	19.6	12.8	2.9	N.O.
Laclede	63.6	58.2	45.4	50.8	47.5	47.7	39.6	26.3	8.6
TOTALS	\$14,576.2	\$12,998.9	\$9,855.1	\$12,165.1	\$9,966.3	\$11,053.3	\$9,064.3	\$6,421.6	\$2,368.1
Increase in 1956 over other years ^b		12.2%	47.9%	19.8%	46.3%	31.9%	60.8%	127.0%	515.5%
Increase in 1955 over other years ^b			31.8%	6.8%	30.4%	17.6%	43.4%	102.3%	448.7%

* The figures cover each Company's fiscal years ending in the years indicated. The figures shown are Net Sales except in a few instances where they were not reported separately from Other Income. The latest figures as revised by the Companies were used in every case in which they were available.

** Annual rate projected on a straight-line basis from 1st calendar quarter of 1956 except for Lukens (12 weeks ended 3/24/56), Northwestern (3 months ended 4/30/56), Kaiser (6 months ended 12/31/55) and Colorado Fuel and Iron (estimated by Company).

N.A.—Not Available.

N.O.—Not Operating.

^a Includes Sales of Portsmouth (acquired in 1949) for 1947 (also for 6 months in 1946, and for 1948 and 1949 not here shown).

^b If Kaiser, McLouth and Lone Star were excluded from the later years' figures, the percentage increases would be very slightly affected. Only the percentage comparisons with 1939 are affected slightly as here shown.

SOURCE.—Annual Reports of the Companies; Moody's Industrials. Calculations ours.

full period, they probably reflect a net weighted change in product mix. The most important factor which accounts for the increased Sales figures for most years, however, is the Industry's policy of constantly increasing Steel Prices. The old principle of classical Economics that increased Sales volume, since it permits greater efficiency and the spreading of certain so-called fixed costs, permits lower prices and lower profit margins per unit of product apparently is not subscribed to by the Steel Industry. In fact, the reverse appears to be true. This is reflected in the constantly increasing Prices and widening profit margins which

are being earned by the Steel Industry.

The Sales figures are shown in TABLE 8.

(b) Shares of the Sales Dollar

Measurement of the shares of the Sales Dollar which are used for Payrolls, Materials Costs, Depreciation, Profits, and other items sheds considerable further light on this matter of profit margins. TABLE 9 and CHART 5 (also TABLE 25) show Profits Before Taxes as a share of the Sales Dollar for most of the Industry (22 Companies, including U. S. Steel Corporation, 89.1% of the Industry's capacity).

Table 9
PROFITS BEFORE TAXES*
AS A SHARE OF THE SALES DOLLAR

	1955	1954	1953	1952	1951	1950	1947	1939
Steel Industry (22 Companies)	15.8¢	11.6¢	13.1¢	9.1¢	17.0¢	16.8¢	10.9¢	6.6¢
Steel Industry (21 Companies excluding U. S. Steel)	14.8	11.5	12.6	9.2	16.7	17.0	10.5	6.8
U. S. Steel	18.0	11.9	14.1	9.0	17.7	16.4	11.5	6.4

* The same 22 Companies are used for all years shown. They are the only Companies of the 25 major Companies for which data are available for all years.

SOURCE.—Based on Profits Before Taxes and Sales figures from prior Tables. Calculations ours.

It is clear from these figures that U. S. Steel is widening its profit margin at an even more indefensible rate than is the Industry as a whole—although neither has grounds for complaint about the level of its profit margins. The Industry widened its profit margin from 6.6¢ out of each Sales Dollar in 1939 to a peak of 17.0¢ in the Korean inflation of 1951. The 1955 Profits share of 15.8¢ out of each dollar of Sales is well above the return for most other years, and 1956 is at a rate of 16.2¢. Like the rest of the Industry, U. S. Steel reached a high point in 1951 but, in 1955, it was

able to widen its profit margin to a record high of 18.0¢ Profits on every dollar of Sales. In 1956 it is even higher—19.2¢. But most significant is the fact that Steel's share of the Sales Dollar Before Taxes between 1947 and 1956 has risen from 10.9¢ to 16.2¢ while the share of All Manufacturing has fallen from 9.3¢ to 8.6¢.

Much the same pattern is evident when Net Profits (After Taxes) are examined as a share of the Sales Dollar for the same 22 Companies. TABLE 10 shows these figures.

Table 10
NET PROFITS*
AS A SHARE OF THE SALES DOLLAR

	1955	1954	1953	1952	1951	1950	1947	1939
Steel Industry (22 Companies)	7.9¢	6.1¢	5.6¢	4.9¢	5.7¢	8.0¢	6.2¢	5.3¢
Steel Industry (21 Companies excluding U. S. Steel)	7.4	6.0	5.5	5.0	5.9	8.3	6.3	5.6
U. S. Steel	9.0	6.0	5.8	4.6	5.2	7.3	6.0	4.9

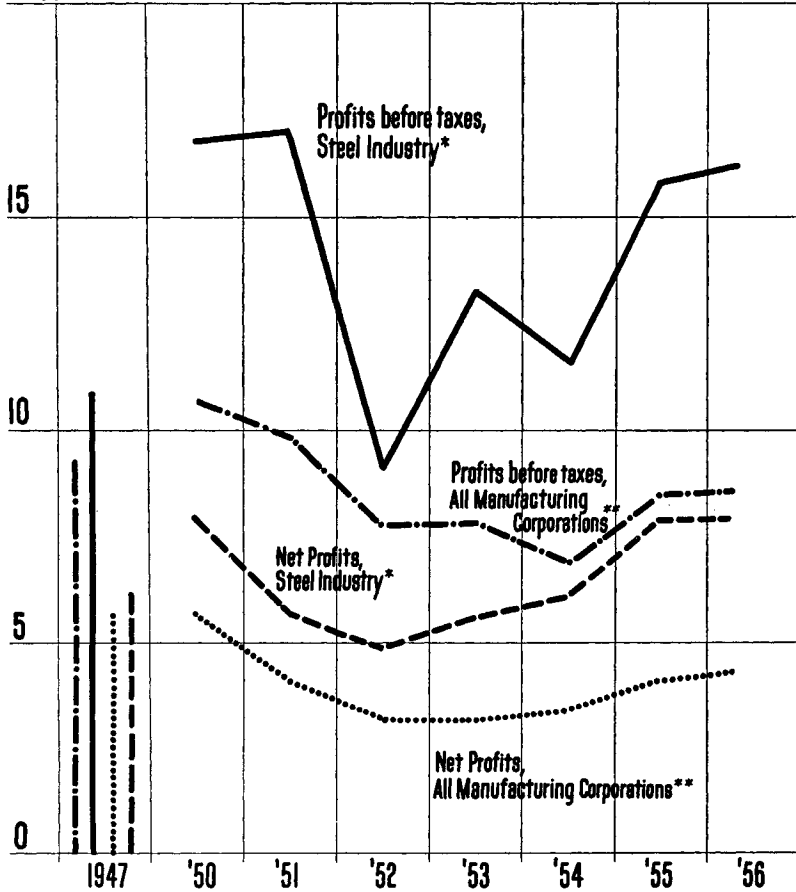
* The same 22 Companies are used for all years shown. They are the only Companies of the 25 major Companies for which data are available for all years.

SOURCE.—Based on Net Profits and Sales figures from prior Tables. Calculations ours.

CHART 5

Profits, Before & After Taxes as Shares of the Sales Dollar

20%



* SOURCE: annual quarterly reports of 25 Steel Companies accounting for 91.8% of total steel capacity.

** SOURCE: U.S. Department of Commerce

As can be seen from TABLE 10, the Industry has managed to push its return per Sales Dollar to a peak level. The Net Profits in 1955, and so far in 1956, of 7.9¢ on each dollar of Sales are higher than for any of the years shown (except for 1950 when the return was fractionally higher at 8.0¢). U. S. Steel did even better than the Industry. It earned 9.0¢ in 1955 on each Sales Dollar compared with 7.3¢ in 1950. In 1956 U. S. Steel is earning an even higher rate of 9.5¢. These are higher profit margins achieved through increasing productivity and higher Prices at the expense of the buying public. It is likewise evident here as in Profits Before Taxes that Steel is

out of step with the rest of the Economy. Between 1947 and 1956, a time when the Net Profit margin of All Manufacturing was declining from 5.7¢ to 4.3¢, the Steel Industry's share was pushed up from 6.2¢ to 7.9¢.

While it is evident that over the years Profits have taken a larger share of the Sales Dollar, the same is clearly not true of Wages and Salaries. As noted in TABLE 11, Wages and Salaries include, for some Companies, money spent on the worker's behalf, as well as money paid to him in wages. TABLE 11 shows the relationship of Wages and Salaries to the Sales Dollar.

Table 11
WAGES AND SALARIES*
AS A SHARE OF THE SALES DOLLAR

	1955	1954	1953	1952	1951	1950	1947	1939
Steel Industry (11 Companies)	35.5¢	38.7¢	36.4¢	37.8¢	34.7¢	35.2¢	38.8¢	40.5¢
Steel Industry (10 Companies excluding U. S. Steel)	33.0	36.0	33.6	34.9	31.9	32.0	36.2	36.7
U. S. Steel	39.4	42.7	40.6	42.1	39.0	39.9	42.6	45.7

* The Wages and Salaries figures are Total Employment Costs including Pensions, Social Security Taxes, Insurance, etc. for 5 of the Companies; for 5 others they exclude such additional items; and for 1 Company they include these additions from 1946 on and exclude them for 1939. The same 11 Companies are used for all years. They are the only Companies of the 25 major Companies for which data are available for all years.

SOURCE.—Annual Reports of the Companies; Moody's Industrials. Calculations ours.

In 1939, Wages and Salaries of 11 major Steel Companies accounted for 40.5¢ out of each Sales Dollar. In subsequent years the wage earner's portion of the Sales Dollar has grown smaller and smaller, reaching a low of 34.7¢ in 1951. Thereafter, it fluctuated upward in 1952 and 1954 particularly because of the work stoppage in 1952 and the recession in 1954. It then dropped sharply to 35.5¢ out of each Sales Dollar in 1955.*

For U. S. Steel the trend was almost identical with that of the Industry. It shows an elapsed decline from 45.7¢ in 1939 to 39.4¢ in 1955.

Materials costs followed a slightly different trend from Wages and Salaries. This is shown in TABLE 12.

* There are not sufficient data available to show the full Industry trend in 1956. The 11 Companies here included account for 72.3% of the Industry's capacity.

Table 12
MATERIALS COSTS*
AS A SHARE OF THE SALES DOLLAR

	1955	1954	1953	1952	1951	1950	1947	1939
Steel Industry (9 Companies)	40.1¢	39.7¢	43.0¢	47.0¢	43.6¢	42.9¢	45.2¢	40.8¢
Steel Industry (8 Companies excluding U. S. Steel)	44.9	43.2	47.3	50.6	47.6	46.5	49.2	45.3
U. S. Steel	33.1	34.9	36.7	41.7	37.7	37.8	39.5	34.7

* The Materials Costs figures are Materials (or Products) and Services Purchased (or a comparable item similarly labeled.) Where no such figure was shown separately, an approximate one was derived by deducting Employment Costs (or Wages and Salaries) from Cost of Goods Sold (or a similar item). Materials Costs were specifically listed for 4 Companies for all years, for 2 Companies for all years except 1939 (computed for that year). They were computed for all years for 3 Companies. The same 9 Companies are used for all years. They are the only Companies of the 25 major Companies for which data are available for all years.

SOURCE.—Annual Reports of Companies; Moody's Industrials. Calculations ours.

Materials costs for 9 Companies accounted for 40.8¢ of the Sales Dollar in 1939. By 1947 this figure had risen to 45.2¢ as a direct result of the inflation which followed the weakening of price controls. Thereafter these costs fluctuated downward until 1952. In that year Materials costs rose abruptly and reached a peak of 47.0¢. Since then, they have dropped sharply reaching lows of 39.7¢ in 1954 and 40.1¢ in 1955.* For U. S. Steel the pattern was much the same with one important exception—the downward trend, and a sharp one, continued through 1955. In that year Materials costs accounted for 33.1¢ out of each Sales Dollar.

This was the lowest level for any of the years shown.

It is readily apparent from these data that over the years the two major cost items, Wages and Salaries and Materials costs, have moved downward. Profits, not the consumers, have benefited. This conclusion is even more strikingly illustrated by examination of the complete breakdown of the U. S. Steel's Sales Dollar. This is shown for the same years in TABLE 13.

* There are not sufficient data available to show the full Industry trend in 1956. The 9 Companies here included account for 70.4% of the Industry's capacity.

Table 13
DISTRIBUTION
OF THE
SALES DOLLAR (100¢)
IN
U. S. STEEL CORP.

	1955	1954	1953	1952	1951	1950	1947	1939
Payroll Costs.....	39.4¢	42.7¢	40.6¢	42.1¢	39.0¢	39.9¢	42.6¢	45.7¢
Materials Costs.....	33.1	34.9	36.7	41.7	37.7	37.8	39.5	34.7
Subtotals.....	72.5	77.6	77.3	83.8	76.7	77.7	82.1	80.4
Depreciation.....	7.0	8.1	6.1	4.9	3.5	3.7	4.1	7.5
Profits Before Taxes.....	18.0	11.9	14.1	9.0	17.7	16.4	11.5	6.4
All Other Items.....	2.5	2.4	2.5	2.3	2.1	2.2	2.3	5.7
Totals.....	100.0¢	100.0¢	100.0¢	100.0¢	100.0¢	100.0¢	100.0¢	100.0¢

SOURCE.—Annual Reports of U. S. Steel Corp.

Payrolls and Materials costs, combined accounted for 72.5¢ out of each Sales Dollar in 1955 (and almost exactly the same amount in 1956)—the lowest portion for any of the years shown. Comparison with 1947—a good postwar year, and a relatively recent one—shows a **decline** by 1955 of 9.6¢ per dollar of Sales in these combined costs. This decline was used largely by the Corporation to increase Profits Before Taxes which accounted for 11.5¢ of the Sales Dollar in 1947 and 18.0¢ in 1955—a **rise** of 6.5¢. The rest of the decline was taken up by Depreciation charges, a non-cash ex-

pense, which rose from 4.1¢ in 1947 to 7.0¢ in 1955—a **rise** of 2.9¢. This rise in Depreciation charges results largely from extraordinary charges for Rapid Amortization of emergency facilities which was first permitted by the Government in 1950 but which did not begin to have a significant impact until 1952. Had such a charge not been permitted in 1955, Depreciation would have accounted for only 3.4¢* of each Sales Dollar.

* This amount may have been as much as 4.1¢ depending on the precise fashion in which U. S. Steel treats the item which it labels Rapid Amortization charges.

6—Ability of the Steel Industry to Absorb a Wage "Cost" Increase

The relatively small share of total costs represented by wage "costs" and the great profitability of the Steel Industry would permit the absorption of a substantial wage increase in 1956.

For varying wage "cost" increases effective for a full year the impact on the 1956 annual rates of Profits and Profit ratios is shown in the following tabulation:

EFFECT OF A WAGE INCREASE ON STEEL PROFITS

(Assuming No Increase in Productivity)

(dollars in millions)

Wage "Cost" Increase Per Hour	Gross "Cost"	Net "Cost"	Resulting Profits and Profit Ratios			
			Profits Before Taxes	Net Profits	Net Profits as a % of Net Worth	Net Profits as a Share of the Sales Dollar
30¢	\$465.0	\$223.2	\$1,885.7	\$930.2	12.6%	6.4¢
40¢	\$620.0	\$297.6	\$1,730.7	\$855.8	11.6%	5.9¢
50¢	\$775.0	\$372.0	\$1,575.7	\$781.4	10.6%	5.4¢

The above computations show that within the framework of its 1956 operations the Steel Industry could absorb for a full year a wage "cost" increase of as much as 50¢ per hour, forego a Price increase and still have:

Profits Before Taxes on the same level as in 1953, a banner year,

Net Profits higher than for any year prior to 1955, a record year,

Return on Net Worth of 10.6% which is well above the fair and reasonable rate of 6%, and Return on Sales of 5.4¢ which still is well above

the 4.3¢ earned by All Manufacturing Corporations in 1956.

But these computations ignore one very important factor—increased productivity. Even if only a modest 4% increase in Steel productivity in 1956 is assumed, this would result in increased Sales revenues of \$583.0 million with the same number of employees and manhours. When this factor is taken into consideration, the impact on 1956 Profits and Profit ratios of varying wage "cost" increases effective for a full year would be as follows:

EFFECT OF A WAGE INCREASE ON STEEL PROFITS

(Assuming a 4% Increase in Productivity)

(dollars in millions)

Wage "Cost" Increase Per Hour	Gross "Cost"	Net Revenue Gain from Productivity *	Gross Change in Profits Before Taxes	Net Change in Profits After Taxes	Resulting Profits and Profit Ratios			
					Profits Before Taxes	Net Profits	Net Profits as a % of Net Worth	Net Profits as a Share of the Sales Dollar
30¢	\$465.0	\$349.2	—\$115.8	—\$54.7	\$2,234.9	\$1,098.7	14.9%	7.2¢
40¢	620.0	349.2	—270.8	—130.0	2,080.0	1,023.4	13.8%	6.8¢
50¢	775.0	349.2	—425.8	—204.4	1,924.9	949.0	12.8%	6.3¢

* Computed on the basis of a 4% increase in Sales less additional Materials Costs based on a 40.1% ratio of Materials Costs to Sales.

The implications are clear. Even with a modest 4% productivity increase the Industry could absorb a labor "cost" increase of as much as 30¢ or 40¢ per hour for a full year and still have Profits in excess of any prior full year. In fact, a labor "cost" increase of as much as 50¢ per hour could be absorbed with these results:

Profits Before Taxes would top any previous full year, except 1955;

Net Profits would top any previous full year, except 1955;

Return on Net Worth would be more than double the standard 6% rate;

Return on the Sales Dollar would be well above the 5.7¢ earned by the Industry in 1947 and the 4.3¢ earned by All Corporations in 1956.

The cost computations made above should be halved to measure their actual impact on 1956 operations, since the wage "cost" increase would be in effect for only 6 months in 1956.

B. THE PRODUCTIVITY OF STEELWORKERS

The amount of Steel produced by each Steelworker for each hour worked has multiplied by leaps and bounds in recent years. This increased productivity, both per hour worked and per man, has had the result of lowering sharply the unit

labor costs of the Industry. This means significant cost savings which can be shared with the employees and the public if the Industry is willing. The facts on increased productivity are shown in TABLE 14 and CHART 6.

Table 14
PRODUCTIVITY INDEXES
IN
STEEL
(1947-1949=100)

	Weighted Production	Production Workers	Manhours	Output per		Unit Labor Requirements	
				Production Worker	Manhour	Production Workers Per Unit	Manhours Per Unit
1956*	154.7	111.0	116.6	139.4	132.7	71.8	75.4
1955	141.3	106.8	111.4	132.3	126.8	75.6	78.8
1954	107.0	96.5	93.9	110.9	114.0	90.2	87.8
1953	133.4	109.6	114.0	121.7	117.0	82.2	85.5
1952	113.4	95.3	97.8	119.0	116.0	84.0	86.2
1951	128.5	109.7	115.2	117.1	111.5	85.4	89.6
1950	118.4	104.4	106.9	113.4	110.8	88.2	90.3
1949	93.2	93.4	91.8	99.9	101.6	100.1	98.4
1948	106.0	105.2	106.6	100.8	99.4	99.2	100.6
1947	100.7	101.4	101.5	99.3	99.2	100.7	100.8
1946-1942	NOT AVAILABLE**						
1941	95.5	108.6	110.6	87.9	86.3	113.7	115.8
1940	73.3	94.8	90.0	77.3	81.4	129.3	122.8
1939	59.0	82.9	75.1	71.2	78.6	140.5	127.3

* Based on projections of preliminary 1st quarter data.

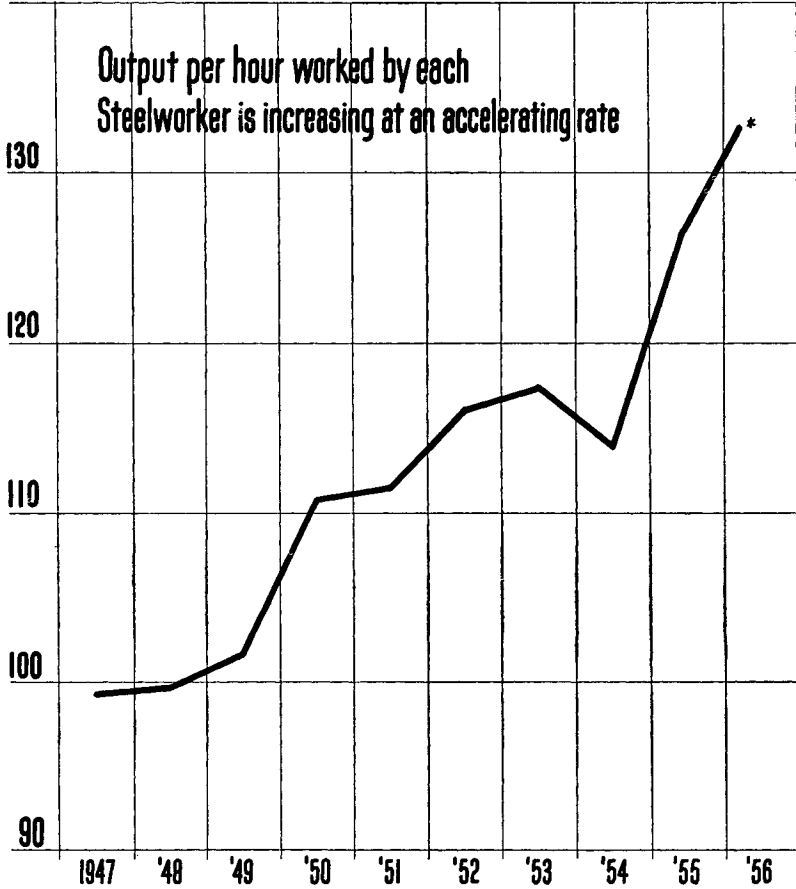
** Not available because certain wartime production and manhours figures cannot be segregated to exclude the portion devoted to munitions manufacture.

SOURCE.—Bureau of Labor Statistics. A Preliminary Index as released to the Productivity Conference and to the Industry and Union in mid-1950 and since revised and improved and extended through 1954. The figures have been extended by the Union through the 1st quarter of 1956 by use of the BLS production weights and American Iron and Steel Institute production data.

CHART 6

Productivity in Steel (Output per manhour)

Index (1947-49=100)



* based on projection of preliminary first quarter data

SOURCE: BLS data - a preliminary index

It is now commonly accepted that, over long periods, wage gains and rising living standards must come largely from increased productivity, i.e., rising output per manhour. With this concept the Union has no quarrel as long as one prior condition is met—namely, that the income shares as between management and investors on the one hand and labor on the other at the beginning of any period of computation of productivity changes are fair and equitable. There is no such equitable sharing in the Steel Industry today. The Industry has taken as its share in Profits far too much of what should have gone to the workers in the mills and to the public. In our opinion the Steel Industry owes its employees a substantial wage increase this year—even if no further increase in productivity were in prospect. But this is somewhat academic because, as noted, there has been a large and consistent increase in productivity.

In the Steel Industry, productivity has shown

a pronounced growth in the past several decades. In the period from 1919 to 1929 it nearly doubled, according to the Index maintained by the United States Bureau of Labor Statistics (BLS). In 1939 productivity in the Industry was more than one-third above this 1929 figure. Thus, it had risen by 167% in 20 years, or at a rate approximating 5% per year compounded annually over a period which included the Great Depression.

When this Index is brought up to date, as is done in the Preliminary Index set forth in TABLE 14, it shows that the individual Steelworker has continued, in the period since 1939, to produce more and more Steel for every hour worked. In the 1st quarter of 1956 he was producing nearly 70% more Steel than he did in 1939. Thus, despite the ups and downs in particular years, the Steelworkers' average output per manhour rose at a rate of 3.2% compounded annually over this period of more than 16 years. The year-by-year changes are shown in TABLE 15.

Table 15

**PRODUCTIVITY CHANGES
IN
STEEL
(year to year)**

	Increase Over Prior Year in Output per		Decrease From Prior Year in Unit Labor Requirements	
	Production Worker	Manhour	Production Workers Per Unit	Manhours Per Unit
1956*	5.4%	4.7%	- 5.0%	- 4.3%
1955	19.3%	11.2%	-16.2%	-10.3%
1954	-8.9%	-2.6%	+ 9.7%	+ 2.7%
1953	2.3%	0.9%	- 2.1%	- 0.8%
1952	1.6%	4.0%	- 1.6%	- 3.8%
1951	3.3%	0.6%	- 3.2%	- 0.8%
1950	13.5%	9.1%	-11.9%	- 8.2%
1949	-0.9%	2.2%	+ 0.9%	- 2.2%
1948	1.5%	0.2%	- 1.5%	- 0.2%
1947 (re 1941)	13.0%	14.9%	-11.4%	-13.0%
1946-1942	NOT AVAILABLE			
1941	13.7%	6.0%	-12.1%	- 5.7%
1940	8.6%	3.6%	- 8.0%	- 3.5%
1939				

* Based on projections of preliminary 1st quarter data.

SOURCE.—Computed from indexes in prior Table.

Most significant, however, is the sharp acceleration in the productivity rate in the most recent years. It is running currently at an annual rate 4.7% higher than in banner 1955. In 1955 alone, it was 11.2% above 1954. And, even when the small decline of 1954 is offset, the 2-year average from 1953 to 1955 was 4.2% per year.

The fact that productivity is growing at an accelerating rate in Steel is significant in connection with the Industry's demand for a 5-year contract providing annual wage increases of a lesser amount than have been negotiated in the past. Since even the wage increases negotiated up to now have been less than warranted by productivity growth, it is clear that the Industry seeks to provide its workers with an even smaller portion of their share of increased output per man-hour for the next 5 years.

Increases in productivity mean simply that unit labor requirements decline—that each ton of Steel is produced with less hours of labor. Even if the cost of each hour of labor is increased by wage rate increases proportionate to rising productivity, these increases can be absorbed out of the gains in productivity.

These productivity increases bluntly mean that the "real" earnings level of Steelworkers can rise significantly without increasing Steel costs or necessitating an increase in Steel Prices. Unfortunately the Steel Industry has been unwilling to set its Prices within the bounds of its costs but has, instead, insisted on raising its Prices to increase profit margins. This not only has caused inflation. It is inflation.

It is true that the Steelworkers' standard of living has risen during the last few years. But the increases received—and more—could have been met from the gains in productivity. Unwilling to accept this fact, however, the Industry has insisted on raising Prices—on receiving increases which have, in the main, added unwarranted increments to Profits.

Surely Steelworkers have every right to a fair share in the productivity gains which they have helped to achieve. This would permit stockholders and Steel users also to share in these gains. This is the fair way to divide up these gains. The Union has not asked for more. The Union has asked, as a basic floor, that Steelworkers' "real" wages increase as rapidly percentage-wise as the "real" productivity increases in Steel. This, the Union has not been able to achieve.

Consistently "real" productivity increases have outrun the increases in "real" wages. This is evident in the following moderately long range comparison which covers most of the period since the Union was founded:

	Increase in "Real" Productivity in Steel	Increase in "Real" Straight Time Average Hourly Earnings in Steel
1939-1956 (more than 16 years)	68.8%	47.1%

Currently, in 1956, productivity is running 4.7% higher than in the record year, 1955. Steelworkers, of course, have received no wage adjustments in 1956.

In the past, the Union has often been forced to demand wage increases which in dollars and cents amount have exceeded the percentage increase in productivity. This has been forced on the Union because of the Industry's Price Policy which has caused inflation in Steel and has contributed greatly to it in the Economy and has, thereby, robbed the workers of the wages they were already receiving. They and their Union have been forced to pursue these rising prices—the cost of living—just to maintain their "real" wage position, i.e., their existing standard of living. This purely defensive role of a significant portion of many of the Union's wage proposals in recent years is generally unknown or overlooked.

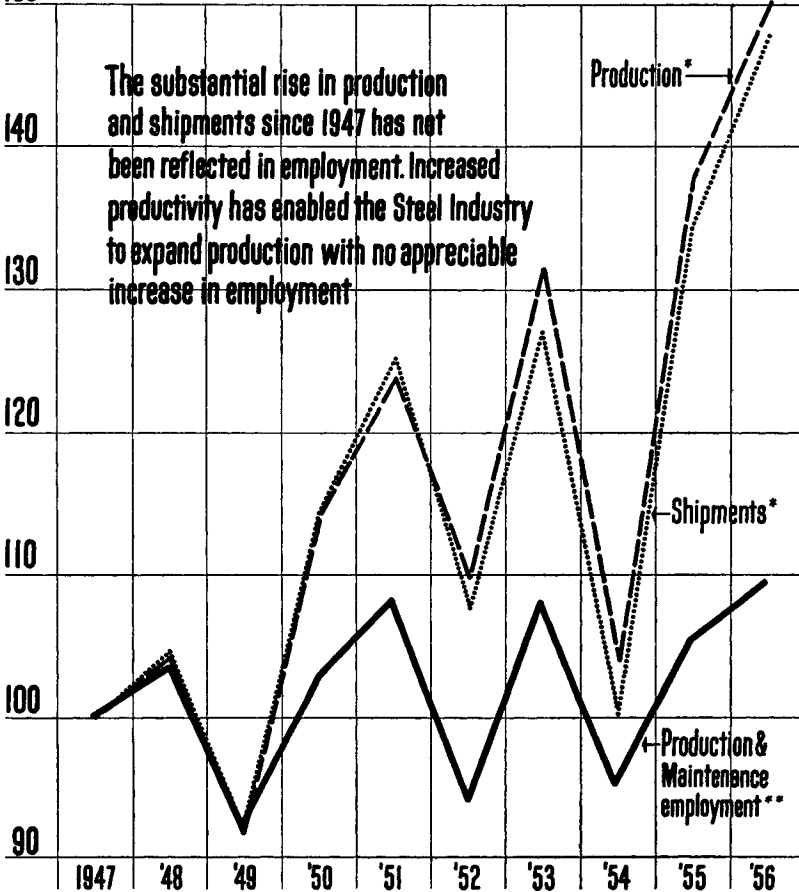
If management, including Steel management, would refrain from insisting on its all too frequent, unnecessary, and inordinately large Price increases so that there could be price stability, there would be no need to catch up constantly with a rising cost of living, and increased money wages would then bring increased "real" wages. It would then be possible for labor to improve its wages, "fringes" and working conditions more nearly within the framework of rising productivity. Until management is willing to abandon its inflationary pricing policy, certainly, the Union has no choice but to insist on money wage increases greater in amount than the percentage productivity increases—if it is even to hold its own, let alone make any gains in "real" wages and in its standards of living.

As a corollary to this productivity story in Steel,

CHART 7

Production, Shipments & Employment in Steel

Index (1947=100)



* SOURCE: American Iron and Steel Institute

** SOURCE: BLS

it is appropriate to examine the effect of productivity growth on Employment.

In the first quarter of 1956 Shipments of Finished Steel were at an annual rate almost 48% higher than in 1947, and Production of Steel ingots was over 50% higher than 1947. But this substantially greater output in the 1st quarter of 1956 was produced by a work force only 9.5% larger than in 1947.

Last year, in 1955, Shipments were at a record

annual high level—34.3% above 1947, and Ingot Production was 37.9% above 1947. Employment, however, was only 5.3% higher. Despite record Production and Shipments in 1955, there were less production and maintenance workers in the Basic Steel Industry in that year than in 1953 or in 1951 when Production and Shipments were at a lower level. The relationship between Production, Shipments and Employment from 1947 to 1955 is shown in CHART 7 and TABLE 26.

C. STEEL PRICE INCREASES

For an extended period the Steel Industry has defended the Price increases it has levied by publicizing these claims:

1. Steel wage increases have forced higher Steel Prices;
2. A Steel wage increase always results in higher Materials costs equal to the cost of the wage increase; and

3. Steel profit margins traditionally have been too low.

In recent years the Steel Industry has placed increasing emphasis on an additional fourth claim (really 2 claims) for higher Steel Prices—the alleged inadequacy of the charges permitted for Depreciation by the Federal Income Tax Law, and the “need” for larger Profits to finance the Industry’s expansion of Steel capacity.

Each of these claims is examined in this section.

1—Steel Wages in Relation to Steel Prices

The Industry habitually refers to wage increases it has negotiated as “rounds” of increases but understandably is reticent about reviewing its Price increases.

In the 10 years from 1946 through 1955, Steelworkers negotiated wage increases in 8 years. In one year, 1949, there was no wage increase, but pension and insurance programs were negotiated. In 1951 there was no wage increase or other benefits of any sort.

In contrast, in the same 10-year period the Steel Industry generally raised its Prices as follows:

“General” Price Increases (on most products)	12 times
Selected Price Increases (on some products)	3 times
“Extras” (increases other than in base prices)	3 times
Total “Rounds” of Price Increases	18 times

This means simply that the Industry has raised its Prices twice for each wage or “fringe” increase

negotiated with its employees. This is evident from the facts shown in TABLE 16.

The Bureau of Labor Statistics’ Index of Wholesale Prices of Steel Mill Products shows a rise in Steel Prices (including “Extras” on some products) in more than 36 months during that 10-year period (TABLE 16).

The total hourly cost of all the wage and “fringe” settlements in that period was \$1.318. These facts and the data on revenue gained from Price increases in the same period are shown in TABLE 17 and CHART 8.

As indicated in TABLE 17, there were more than 1.3 billion manhours worked in 1955 by all employees in the Industry. Accordingly, the current annual “cost” of all of the wage and “fringe” benefits negotiated from 1946 through 1955 (based on 1955 manhours) equals slightly less than \$1.8 billion.

The cumulative increase in the Price of Steel products from January, 1946, through December, 1955, has been \$67.25 a ton. Finished Steel Shipments in 1955 totaled 84.7 million tons. Therefore, the current annual revenue gain (based on

Table 16
PRICE CHANGES
IN
STEEL

Date of Steel Wage Increase	Date of Steel Price Index	Months When Most of the Cumulative Increase Occurred	BLS Wholesale Price Index		Steel Magazine Price Composite		
			Index (1947-49=100)	% Change From Last Prior Date to Date Shown	Price Per Ton	Change from Last Prior Date to Date Shown \$	%
Feb., 1946...	Jan., 1946		70.3		\$55.20		
	Mar., 1946	Feb., Mar.	76.1	8.3%	60.48	\$5.28	9.6%
April, 1947...	.....	Dec., '46, Jan., '47 ("extras")	.....	.....	.....	6.00(est.)	9.9%
	Feb., 1947	Dec., '46, Jan., '47	85.7	12.6%	64.30	3.82	6.3%
	Sept., 1947	July, Aug.	92.9	8.4%	69.88	5.58	8.7%
July, 1948	Mar., 1948	Jan., Feb., Mar.	97.1	4.5%	73.64	3.76	5.4%
	June, 1948	May	95.3	-1.9%	72.90	-0.74	-1.0%
Oct., Nov., '49 (Pens. & Ins.)...	Sept., 1948	July, Aug.	108.1	13.4%	82.28	9.38	12.9%

Dec., 1950.	Feb., 1949	Jan.	110.4	2.1%	84.00	1.72	2.1%
	Oct., 1949	Apr., May	109.4	-0.9%	82.64	-1.36	-1.6%
July, 1952...	Jan., 1950	Dec., '49, Jan., '50	114.5	4.7%	84.60	1.96	2.4%

June, 1953...	Nov., 1950	July, Oct.	115.7	1.0%	85.48	.88	1.0%

July, 1954...	Feb., 1951	Dec., '50, Jan., '51	124.7	7.8%	93.14	7.66	9.0%

July, 1955...	May, 1952	Nov., '51	125.2	0.4%	93.14	0	0
	Aug., 1952	July, Aug.	131.1	4.7%	98.24	5.10	5.5%
July, 1956...	.....	May '53 ("extras")	.....	.....	.....	5.00(est.)*	5.1%

July, 1956... (?)	May, 1953	May	134.4	2.5%	98.74	.50	0.5%
	July, 1953	June, July	142.7	6.2%	102.60	3.86	3.9%
July, 1954...	June, 1954	Sept. '53	141.9	-0.6%	102.82	.22	0.2%
	July, 1954	July	145.6	2.6%	105.22	2.40	2.3%
July, 1955...	June, 1955	Oct., '54	145.9	0.2%	105.40	.18	0.2%
	July, 1955	July	155.0	6.2%	112.48	7.08	6.7%
July, 1956... (?)	.....	Jan., Feb., '56 ("extras")	.....	.....	.....	1.90(est.)*	1.1%

CUMULATIVE INCREASE—							
Jan., 1946-May (Mar.), 1956.....			125.0%			\$71.72**	129.9%**

* Iron Age 7/2/53 and Steel Magazine 5/21/56 respectively. The \$1.90 is computed from a \$2.75 increase from 11/14/55 to 5/21/56 less the intervening base Price increase of 85¢.

** Including \$12.90 in "extras".

SOURCE.—BLS Index of Wholesale Prices of Steel Mill Products; Steel Magazine's Finished Steel Weighted Price Composite. Calculations ours.

Table 17
COMPARISONS OF REVENUE GAINS AND LABOR COST INCREASES
DURING THE LAST 10 YEARS

	Finished Steel Shipments ¹ (tons)	Finished Steel Weighted Price Composite ² (\$ per ton in Dec.)	Price Increase ³ (\$ per ton Dec. to Dec.)	Revenue Gain from Price Increase (per year)	Hourly Cost of Wage & "Fringe" Settlement	Total Hours Worked ⁴	Adjusted Total Hours Worked ⁴ (100%)	Increased Labor Cost (all empls.)	\$ Increase in Steel Prices Per \$ Increase in Labor Costs
1945		\$55.20							
1946	48,775,532	61.13	\$5.93	\$289,238,905	18.5¢	1,010,171,703	1,079,935,538	\$199,788,075	\$1.45
1947	63,057,150	70.04	8.91	561,839,207	15.0¢	1,167,582,947	1,254,386,492	188,157,974	2.99
1948	65,973,138	82.28	12.24	807,511,209	13.0¢	1,219,563,700	1,310,372,515	170,348,427	4.74
1949	58,104,010	83.84	1.56	90,642,256	12.5¢	1,073,204,921	1,146,463,968	143,307,996	0.63
1950	72,232,292	90.95	7.11	513,571,596	16.0¢	1,214,394,580	1,302,998,476	208,479,756	2.46
1951	78,928,950	93.15	2.20	173,643,690	0¢	1,344,670,029	1,412,913,763	0	....
1952	68,003,612	98.23	5.08	345,458,349	21.1¢	1,189,893,622	1,250,807,970	263,920,482	1.31
1953	80,151,893	102.80	4.57	366,294,151	8.5¢	1,344,116,422	1,411,442,215	119,725,883	3.06
1954	63,152,726	105.40	2.60	164,197,088	12.0¢	1,117,109,108	1,172,941,104	140,752,932	1.17
1955	84,717,444	113.18	7.78	659,101,714	15.2¢	1,285,299,398	1,352,946,734	205,647,904	3.21
CUMULATIVE INCREASE—									
IN BASE PRICES—									
	Dec. 1945 to Dec. 1955.....		<u>\$57.98³</u>						
CUMULATIVE INCREASES—									
(INCLUDING SOME "EXTRAS")—									
	Dec. 1945 to Dec. 1955.....		<u>\$67.25⁴</u>	<u>\$1.318</u>					
Revenue and Labor Cost Impact for the 10-year period (based on 1955 operations).....							<u>\$1,783,183,795</u>	<u>\$3.19</u>	

¹ American Iron and Steel Institute.

² Derived from Steel Magazine's Finished Steel Weighted Price Composite as of December, converted to dollars per ton. The Price Increase figures do *not* include "extras."

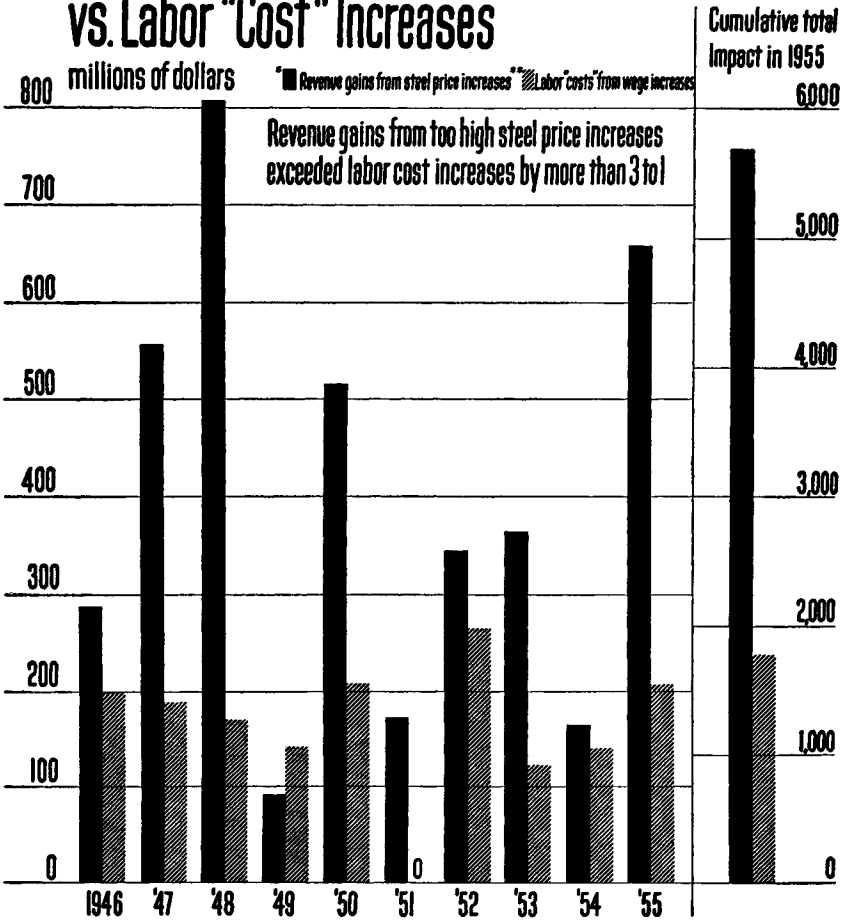
³ American Iron and Steel Institute data including Salaried hours for 93-95% of the Industry. Adjusted to 100% as indicated from the AISI reports.

⁴ Between Dec. 1945 and Dec. 1955 "extras" have been raised generally on two occasions. The impact of these "extras" increases appears to have been at least \$9.27 per ton in addition to the \$57.98 shown by the Steel Magazine Index. This brings the total increase to \$67.25. This difference was estimated for this purpose by using the difference between the increase (121.9%) in the BLS Steel Mill Products Index (which includes some "extras") and the increase (105.1%) in the Steel Magazine Index (which includes no "extras").

SOURCE.—The sources are indicated. Calculations ours.

CHART 8

Revenue Gained from Steel Price Increases vs. Labor "Cost" Increases



* American Iron & Steel Institute and Steel Magazine
 ** American Iron & Steel Institute Data

1955 Shipments) from Steel Price increases since early 1946 is **\$5.7 billion**, or **\$3.9 billion** more than increased labor costs (TABLE 17).

In short, since 1945, Steel Prices were increased by **\$3.19** for each **\$1.00** increase in total labor costs

2—Steel Materials Costs in Relation to Steel Prices

The cost of the Materials purchased by the Steel Industry has risen somewhat in the postwar period. But this rise has been moderate in relation to the rise in the Price of Steel products sold by the Industry.

The base period of the BLS Wholesale Price Indexes is 1947-49. From the base period to March, 1956 the Price of Steel Mill Products sold by the Industry has risen by **58.2%**. This is equal to **78.2%** on a 1947 basis.

This is far in excess of the price rise of the most important products purchased by the Steel Industry. Examples of the price increases of such products since 1947-49 include Scrap—22.3%, Bituminous Coal—7.0%, Petroleum and Products—16.8%, Gas—22.0%, Tin (pig)—10.4%, Oxygen—5.3%, Cement—38.5%, Sand, Gravel and Crushed Stone—22.4%, Electricity—a decline of 5.7%, Material Handling Equipment—48.1%—all of which have risen far less than Steel Prices.

The Annual Reports of the larger Steel Companies do not break out separately their Materials costs relating solely to Steel production. Accordingly, a precise estimate of such costs cannot be made. However, in testimony before the T.N.E.C., a United States Steel spokesman referred to the BLS Price Index of "All Commodities Other Than Farm and Food Products" (which the President's Council of Economic Advisors refers to as "industrial prices") as a close indicator of the movement of prices of the Materials purchased by the Corporation. That Index, from the year 1947 through the 1st quarter of 1956, rose by **26.7%** (it was **27.6%** by April). These figures are shown in CHART 9 and TABLE 27. The continued validity of that Index in relation to United States Steel's purchases is indicated by the fact that, from 1947 to 1955, U. S. Steel's total Materials costs (all materials) per ton of Steel products shipped increased by an almost identical amount—**27.9%**.

Thus, while Materials costs have risen about **28.0%** since the year 1947, Steel Prices have been

—a ratio of more than **3 to 1**. This is also evident in CHART 9 and TABLE 27 where labor costs measured from 1947 show an increase of **28.0%** vs. a Price increase of **78.2%** through March 1956—a **77.7%** average for the 1st quarter.

raised by **78.2%**. Again Steel Prices have exceeded cost increases by a ratio of nearly **3 to 1**.

An additional indication of the far more rapid rise of Steel Prices than of Steel's Materials costs since 1947 is the relationship of payments for Materials to the receipts from Sales. In 1947 Materials costs represented 45.2¢ out of each Sales Dollar, but by 1955 they had declined to 40.1¢.* U. S. Steel's Materials costs were 39.5¢ of each Sales Dollar in 1947, but only 33.1¢ in 1955.

All available data establish not only that Steel Prices have risen far more rapidly than the Industry's Materials costs, but also that there is no validity to the claim that increased labor costs somehow have a one-to-one relationship with increases in Materials costs.

The Industry's leading producer, United States Steel, demolished the Industry's own contention with a Table contained in the Corporation's 1952 Annual Report. It showed that the rise in average hourly employment costs had no fixed relationship to the rise in the average cost in Steel operations of purchased products and services (Materials) per ton of Steel Shipments. These comparisons from the Corporation's own 1952 Annual Report are shown in TABLE 18.

* Based on the 9 of the 25 leading Companies for which Sales, Materials, and Wages and Salaries data are available for all years since 1939.

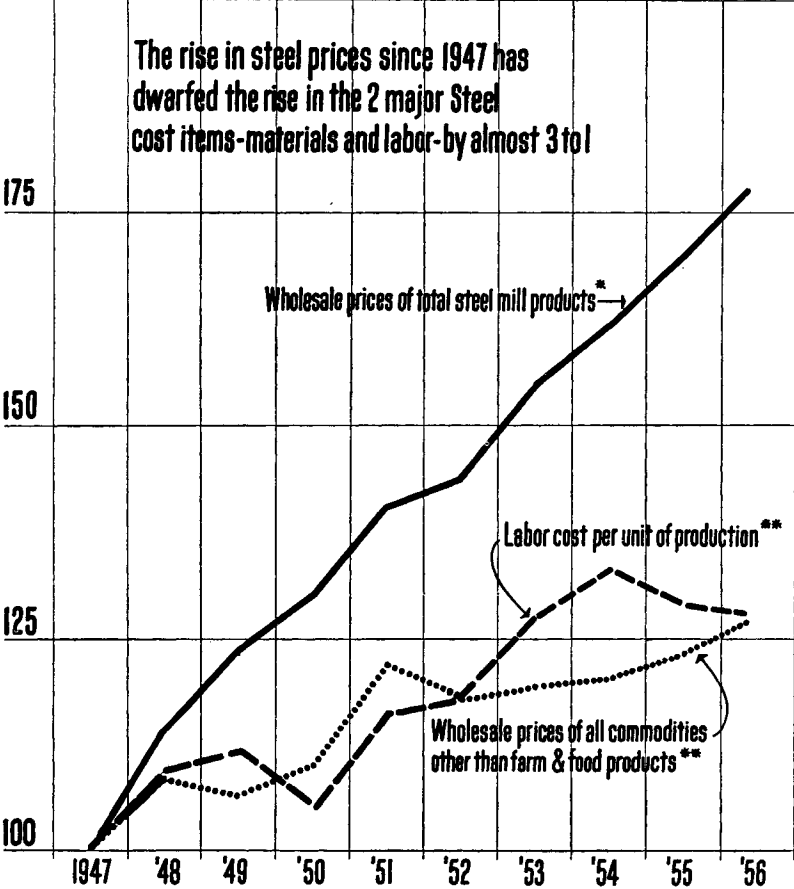
Table 18
COMPARATIVE CHANGES IN MATERIALS AND EMPLOYMENT COSTS IN U. S. STEEL CORP.

Period Covered	Increase as Percent of 1940	
	Employment Cost	Cost of Materials
January, 1941-April, 1947.....	56%	47%
April, 1947-July, 1948.....	16	42
July, 1948-November, 1949.....	14	18
November, 1949-December, 1950.....	19	3
December, 1950-July, 1952.....	23	24
July, 1952-December, 1952.....	27	4

CHART 9

Prices in Steel vs. Materials & Labor Costs

Index (1947=100)



* SOURCE: BLS data
 ** SOURCE: BLS

Prior to the Corporation's publication of its 1952 Annual Report, the Industry was involved in a public controversy on this matter. In 1952 the Industry sought a Price increase which, at that time, required approval of the Office of Price Stabilization. The Steel Companies wanted a Price increase sufficient to cover an increased wage cost plus a mark-up to cover an "anticipated" rise in Materials costs. The director of the Office of Price Stabilization, Mr. Ellis Arnall, testified on this matter before a Senate Committee. After noting that, although the Industry agreed that increased labor costs would be less than \$6 a ton, it demanded a price increase of \$12 a ton, Mr. Arnall said in part:

"... They justify this position by asserting that historically every increase in employment costs has been paralleled by an approximately equal increase in the cost of purchased goods and services.

"... The fallacy of the Steel Industry's position may be further demonstrated by looking at the record of the past few years. In the middle of 1948 there was a substantial wage increase which raised employment costs per ton between \$3 and \$4. Material costs per ton, however, remained steady throughout the entire period from the beginning of 1948 until the Korean outbreak.

"Similarly, the last general increase in steel wages occurred in December, 1950. This in-

crease raised employment costs per ton by about \$3.80 on the average. At the same time, steel prices were raised by an amount in excess of \$8 per ton. Yet, our figures indicate that since December, 1950 there has been virtually no net change in the cost of purchased services and materials for the steel industry. Actually, the cost of the most important single item purchased by the steel industry—steel scrap—was reduced . . . and is now lower than it was in December, 1950.

"It is true that in the past the steel industry has often followed the practice, when granting wage increases, of raising its prices by a substantially greater amount than the increase in labor costs. The effects of this policy are clearly reflected in the steady increase in its profits per ton from a level of \$9 in 1947 to an average of more than \$20 in 1951. . . ."

These are the words of an United States Government official who was in charge of the governmental agency seeking to hold back the forces of inflation in time of war.

It is apparent that the "formula" by which the Industry has attempted to justify Steel Price increases over a series of years—i.e., that the minimum amount by which Steel Prices must rise is **double** the cost of a wage increase (with no allowance for increased productivity) in order to offset future increased Materials costs—is a "formula" unrelated to reality.

3—Steel Profits in Relation to Price Increases

The Industry is not quite fair in using Net Profits as a measure of its profit margin in a labor cost dispute, since wage increases are paid out of Profits Before Taxes, but the facts on Net Profits only have been analyzed here, in order to meet the Industry's argument directly on the Industry's chosen ground.

The Net Profits of the Steel Industry (25 Companies) amounted to \$126.4 million in 1939. The rate of Return on Net worth was 4.2%, a relatively modest return. By 1947 Net Profits more than tripled to \$394.3 million, which was equivalent to a 10.5% Return on a 24% larger Net Worth—which is certainly a substantial Return.

Since 1947, despite an ever-larger demand for Steel, and a tremendously expanded capacity which enabled the Industry to meet this demand, the Steel Industry has persisted in a policy designed to widen already huge profit margins.

Thus, between 1947 and 1955 the Industry expanded its Net Profits from \$394.3 million to more than a billion dollars (\$1,019.4 million). Its rate of Return on Net Worth climbed from 10.5% in 1947 to **13.8%** in 1955. In the 1st quarter of 1956 Net Profits increased further to an annual rate of **\$1,153.4 million**, and its rate of Return on Net Worth to **15.6%**. Increased Net Profits were achieved not only as a result of increased Sales, but by virtue of increased Profits per Dollar of Sales. Net Profits of 22 of the largest Steel Companies were equal to 6.2¢ per Dollar of Sales in 1947 and **7.9¢** in 1955. For U. S. Steel it was 6.0¢ in 1947, **9.0¢** in 1955, and **9.5¢** in the 1st quarter of 1956.

In this same period between 1947 and 1955 when the rate of Return on Net Worth in Steel increased from 10.5% to **13.8%** (and to **15.6%** in the 1st quarter of 1956), Net Profits in relation to Net

Worth declined in All Manufacturing Industries from 15.1% in 1947 to 12.3% in 1955,* Net Profits per Dollar of Sales which were 5.7¢ in 1947 in All Manufacturing Corporations, declined to 4.1¢ in 1955 and to 4.3¢ in the 1st quarter of 1956.**

* F.T.C.-S.E.C. Quarterly Industrial Financial Report Series for All Manufacturing Corporations. Data for 1st quarter 1956 were not available.

** U. S. Department of Commerce.

Since Net Profits in Steel have climbed by 706.5% from 1939 to 1955 (812.5% to 1956), by 158.5% from 1947 to 1955, and the rate of Return on Net Worth, as well as Net Profits per Dollar of Sales, has passed the average of All Manufacturing Industries, the Steel Industry understandably has reached for a new rationale for further Price increases.

4—Replacement and Expansion Needs as a Basis for Price Increases

For the past few years, and especially in recent months, the Industry has rested its case for even higher Prices and greater Profits on a new theory. Steel Industry spokesmen are attempting to "sell" the proposition that (1) the Administration's refusal to revise the tax laws pertaining to Depreciation along the lines desired by the Steel Compa-

nies requires the Industry to raise its Prices again in order to have sufficient funds to maintain and replace its properties, and (2) Steel Prices must be higher so that Profits will be great enough to pay for the cost of **expanding** the Industry's capacity.

The Industry has already applied this theory in some of the large Steel expansion of recent years. That expansion is shown in TABLE 19.

Table 19

STEEL INGOT CAPACITY ON JANUARY 1st

(millions of tons)

1956.....	128.4	1947.....	91.2
1955.....	125.8	1946.....	91.9
1954.....	124.3	1945.....	95.5
1953.....	117.5	1944.....	93.9*
1952.....	108.6	1943.....	90.6
1951.....	104.2	1942.....	88.9*
1950.....	100.0*	1941.....	85.2*
1949.....	96.1	1940.....	81.6
1948.....	94.2	1939.....	81.8

* Average capacity as of January 1st and July 1st.

SOURCE.—American Iron and Steel Institute.

This position of the Steel Industry on securing funds for maintaining facilities and for further capacity **expansion**—a position based on the Government's refusal to provide further special Depreciation allowances for the Industry—is an insistence that the public accept as a fair and equitable solu-

tion the proposition that the American consumers foot the bill in the form of higher Steel Prices. In addition, the American people are being told by the Steel Companies that a further boost in Steel Prices will be levied in order to pay for new Steel plants! Steel Companies' stockholders, under this

plan, are to receive a gift—new Steel plants and enlarged facilities which will increase their equity in their Company, and, eventually, increase their Dividends—all at the expense of American consumers who will pay the costs by paying higher Prices for Steel products. Gone, apparently, is the concept of “risk” capital, of financing industrial expansion through flotation of stock or by means of borrowing on bond issues. Instead, the Steel Industry argues its right to collect “riskless” capital from unwilling consumers by forcing upon them higher Prices.

Lip service is given to the desirability of encouraging greater participation by the public in the ownership of the Industry. But the Steel Industry's actions have no such effect. The American people are to be given no opportunity to share in the Steel Industry's growth and prosperity. Raising funds for expansion through the sale of Common Stock to the public is rejected by the Steel Companies. The public is called upon to provide the funds, but it is shut out of participation in the Profits to be realized from the use of these funds.

As for the allied contention that higher Steel Prices were required to pay for the cost merely of maintaining the Steel Companies' existing properties (Depreciation), here again the Steel Companies' own financial reports demonstrate the falsity of the claim.

For example, from 1952 through most of 1955, prices in general, except for Steel Prices, were relatively stable—i.e., the cost of maintaining Steel facilities, replacing outworn and obsolete equipment, etc., was not appreciably different in 1953, 1954 and 1955. The financial reports of the Steel Companies to the Securities and Exchange Commission for the last 3 years demonstrate conclusively that additional revenue in the form of higher Steel Prices was **not** required to enable the Industry to replace obsolete facilities. The higher Prices charged in these three years, and the resulting increase in Profits, were forced consumer investments (without benefit of stock certificates) in the expansion of steel-making capacity, and were not necessary simply to replace and maintain existing facilities. This is shown in TABLE 20.

Table 20
MONEY AVAILABLE 1953-55 FOR STEEL REPLACEMENT AND EXPANSION OF FACILITIES

	Totals for 1953, 1954 and 1955 (millions)
Reported Net Profits After Taxes.....	\$2,945
Charges for Depreciation.....	+2,304
<hr/>	
Cash available from operating Profits for Dividends, Replacement and Expansion of Facilities.....	\$5,249
Paid out in Dividends.....	-1,282
<hr/>	
Cash available from operating Profits for Replacement and Expansion of Facilities	=\$3,967.
Increase in long-term debt from end of 1952 to end of 1955.....	+167
<hr/>	
Total Cash available for Replace- ment and Expansion of Facilities.....	<u>=\$4,134</u>

Thus, in the 3 years from 1953 through 1955 the Steel Industry had \$4.1 billion available for reinvestment in the Industry, of which only about 4% represented borrowed “outside” capital. In those 3 years the Industry accomplished the following:

1. Replaced obsolete capacity.
2. Expanded capacity by 10,815,620 ingot tons.*
3. Increased Dividends to stockholders by more than 30% (from \$384 million in 1953 to \$501 million in 1955).
4. Increased Working Capital by \$1.5 billion.

The fact that all of the foregoing purposes were accomplished by the Industry without floating stock or borrowing more than a negligible amount of capital effectively disposes of the assertion that even higher Steel Prices are now required in order to yield sufficient funds for replacement. Instead of preparing for higher Prices the Steel Industry should be considering the extent of Steel Price **reductions** which it can and should put into effect.

* An annual rate of expansion greater than is projected by the Steel Industry for the next 5 years.

D. THE INDUSTRY'S POSITION

The position of the steel companies in the current crisis is plain and unequivocal. They say flatly, as they did in making their offer of June 13, that "no increase in employment costs at this time would be in the nation's best interests . . ." because any such increase would set off "another ruinous round of inflation."

It is plainly **not** true that increases in employment costs in steel would set off another round of inflation. Inflation is an increase in prices—and it is the companies' price policies which have an inflationary effect, not its wage policies. As has been shown above, the steel industry—unlike almost every other American industry—has refused to absorb wage increases in the past and has, instead, passed on to the consumer **three times** the cost of each wage increase. The steel industry—unlike almost every other American industry—has increased its profit on each dollar of sales, instead of lowering it, as volume increased. The steel industry—unlike almost every

other American industry—has refused to recognize that wages should increase without a price increase when workers produce more steel for each hour they work.

The steel industry, in short, can afford a substantial increase in employment costs without increasing prices, and without setting off any inflationary effect whatsoever.

The steel companies, however, assumed in their proposals to the union that every wage increase must be accompanied by a price increase. On this false basis they did, on June 13, offer some increase in wages and some improvement in fringe benefits, but only on condition that the union agree to a "5-year non-reopenable" agreement.

There has been much misinformation about this offer. The precise facts as to the nature of the offer were set forth in a letter by President McDonald to the membership of the Steelworkers Union. It is reproduced in part below:

June 18, 1956

TO THE OFFICERS AND MEMBERS OF ALL LOCAL UNIONS OF THE UNITED STEELWORKERS OF AMERICA

Dear Sir and Brother:

I am writing this letter to each local union so that our members can have the facts—the straight facts—rather than industry propaganda—about the current situation in our bargaining with the basic steel industry.

On June 13 the representatives of the industry made us a "take-it-or-leave-it" offer. In making this offer the representatives of the industry stated quite clearly that, although we could bargain about details and the allocation of the costs of the fringe benefits, the total "package" was a fixed "package". They also said that the only basis upon which they would conclude an agreement with us was a fixed contract, without reopeners or room for later negotiations on any subject, for a 5-year term.

* * * * *

The industry has advertised far and wide that the "package" which they have offered us costs 17¢ in the first year of the contract and, over the 5-year term, would cost 65¢ an hour.

I want to label these industry figures as propaganda rather than fact: the industry has *not* offered us either 17¢ this year or 65¢ for 5 years. This is what they have offered, in their own words:

Effective Date	Improvement
July 1, 1956	Advance all job class 1 employees to job class 2 and combine the two classes.
July 1, 1956	Increase all standard hourly wage rates by 6 cents and increase increments between job classes above job class 2 by .2 cent.

July 1, 1956	Establish Supplemental Unemployment Benefits Plan in form attached, with company contributions of 5 cents per hour.
November 1, 1956	Establish improved insurance program in accordance with insurance proposal attached.
July 1, 1957	Increase all standard hourly wage rates by 6 cents and increase increments between job classes above job class 2 by .2 cent.
July 1, 1957	Add a seventh paid holiday.
November 1, 1957	Increase pension benefits in accordance with pension proposal attached.
January 1, 1958	Increase vacation pay of employees with 3 to 5 years of service to 1½ weeks and increase vacation pay of employees with 10 to 15 years of service to 2½ weeks.
July 1, 1958	Increase all standard hourly wage rates by 6 cents and increase increments between job classes above job class 2 by .2 cent.
July 1, 1958	Increase shift premiums to 7 cents for afternoon shift and 10 cents for night shift.
July 1, 1959	Increase all standard hourly wage rates by 6 cents and increase increments between job classes above job class 2 by .2 cent.
July 1, 1959	Establish new premium for Sunday shifts equal to night shift premium.
July 1, 1959	Grant jury pay.
July 1, 1960	Increase all standard hourly wage rates by 6 cents and increase increments between job classes above job class 2 by .2 cent.
July 1, 1960	Increase shift premiums to 8 cents for afternoon shift and 12 cents for night shift.
July 1, 1960	Apply new night shift premium to Sunday shifts.

The above does not tell the whole story. The actual increase for take home pay in the first year under this package would be less than 5¢ an hour. A steel worker in job class 8 (the average job class) would receive a wage increase of 6¢ plus an increment increase of 1.2¢, or a total of 7.2¢. From this average wage increase would have to be subtracted 1.5¢ which the companies insist must be added to the employee contributions under the insurance program. Therefore, the net increase for job class 8 would be 5.7¢. When taxes are subtracted from this net increase, the total in take home pay is less than 5¢ per hour.

The companies' package includes a similar increase in each of the 4 years after this year. In addition, it provides for certain fringe benefits. I think you are entitled to know precisely what these other benefits are:

1. Supplemental Unemployment Benefits. Under the plan offered by the industry practically no benefits would be paid to any of our members. This is because the industry has invented a new gimmick in S.U.B. plans. Under other plans that have so far been negotiated, such as our can plan, the total unemployment benefit (including state unemployment compensation) is 65% of 40 hours take-home pay. The steel companies propose that the total benefit should be 65% of take home pay for the hours actually worked in the 3-month period immediately before the layoff. Since, in most cases, our members work a short week (often down to 32 hours) in the period before they are laid off, this would mean that in many cases the total benefit (including the state unemployment compensation) would be 65% of the take-home pay for 32 hours of work. In almost every state in which we have any number of members, this total benefit would hardly be larger than the state unemployment

benefit. Therefore, under the plan offered by the industry—unlike any other S.U.B. plan—virtually no benefits would be paid out of the fund.

In addition, the companies refused to make adequate provisions by which our members in Ohio, Indiana and Virginia would be guaranteed benefits if the authorities in these states persist in their rulings that supplementation of state benefits is not permissible. Under the plan offered by the companies no benefits would be paid out of the fund in any state in which supplementation or the payment of substitute benefits is not permitted by state law.

2. Insurance. The industry offered us an improved insurance program. The actual cost of the new benefits which they offered us is \$2.25 per employee per month. But they insist, as a condition of this improvement, that the average employee contribution be increased by \$2.55 per month. They did agree to increase the company contributions, also by \$2.55 per month, but all of their money would be retained as reserves.

3. Holidays. The companies offered a 7th paid holiday, but not until the day before Christmas in 1957. They refused even to consider our proposal that premium pay be paid, in addition to the holiday pay, for hours worked on the holiday.

4. Pensions. The companies offered to increase minimum pension benefits to \$2.50 a month for each year of service, but they offered to make this effective only with respect to years actually worked after 1957. This means that it would be 1987 before an employee could retire with 30 years of service at \$2.50 per month—the pension benefit we negotiated with the can industry last year. In can, a worker retiring today with 30 years of service, or more, receives a pension of \$2.50 per month for each year of past service.

For service up to November, 1957, the steel companies offered an increase in the minimum pension from the present \$1.83 a month per year of service to \$2.00 a month per year of service, effective next year. But even this small increase would not be given to present pensioners. In the can industry we not only negotiated a \$2.50 a month pension, effective last year, but the companies agreed to apply it retroactively for all present pensioners.

5. Vacations. The industry offered, effective 1958, to increase the vacations of employees with 3 and 4 years, and with 10-14 years of service, by one-half week. They coupled this offer with a new method of computing vacation pay on the basis of a percentage of the average of the previous year's earnings. And they also required, as a price for this benefit, that the companies be given the unilateral right to require employees to forego their vacations and take vacation pay instead.

6. Shift differentials. The companies offered to increase shift differentials by 1¢ per hour for the second and third shifts in 1958 and again to increase the differential by 1¢ for the second shift and 2¢ for the third shift in 1960.

7. Sunday premium pay. In answer to our request for double time for Sunday work and time and one-half for Saturday, the companies offered to pay the night shift premium for Sunday work—that is, they offered a premium of 10¢ per hour effective 1959, and a 12¢ per hour premium effective 1960. Even this offer was carefully restricted. First, the companies stipulated that not even this night shift premium would be paid for hours worked on Sunday if they were overtime hours. And to make sure that this restriction would apply wherever possible, they propose to change the regular work week, which now begins on Sunday, to a week beginning on Monday, so that Sunday instead of Saturday would be the 7th day.

8. Jury pay. The final fringe benefit offered by the companies was jury pay, and this not to be effective until July 1959.

What is this whole "package" worth to the Steelworkers? Our Research Department has computed the value of each of these items, and, giving the companies the benefit of every doubt, estimates that ultimately the value of these benefits, when they all finally go into effect in 1961, would be 45.3 cents per hour. This includes not only the companies'

payments into the S. U. B. fund, which will average about 3¢ per hour, but also the companies' payments into the insurance fund of 1.5¢ per hour—neither of which, as presently proposed by the companies, will provide any real benefits to the Steelworkers.

But, even counting these in, while the "package" at the end of five years will be 45.3¢, the average benefit over the 5-year term of 1956-1961 amounts only to 28.5¢ per hour. The reason for this is simply that we will not get many of these benefits for several years.

What this actually means is that the industry has offered a package worth, on the average, for the 5 years, a total of 28.5¢ per hour. In return they insist that we execute a firm 5-year contract, forbidding us to negotiate on anything until 1961. We would have to give up, for 5 years, every one of the changes which we have asked be made in our contracts to bring them up to date. At the same time, the companies insist, as part of their offer, that if the government should impose controls at any time during the 5-year term, they would have the right to re-open and cancel all of the future benefits.

In addition, the companies insist on an additional penalty clause, under which every worker who, during the 5 years, participates in a work stoppage or any interference with production, would lose, in addition to his wages, one day's vacation and one week's S. U. B. benefits for every day's work lost.

The industry's 28.5¢ package for 5 years is not a fair offer. This is a year of record prosperity. Despite this, the industry is offering us, for this year and each of the four following years, much less than we have received on the average during the past 10 years.

The International Wage Policy Committee, in rejecting this offer, said that it was "too little, too late and too long." In the words of the Wage Policy Committee:

"The wage offer is too little and would result in a take-home pay increase to the average steel worker this year of about a nickel an hour—about 2%. This trifling 2% increase would be the steelworkers' reward for increasing their productivity by a record-breaking 11% last year."

In rejecting the industry's offer, the Policy Committee reaffirmed the Union's desire to achieve a fair and reasonable settlement. It said:

"Insofar as the union is concerned, the union's negotiators, without stipulating any prior conditions, are ready to meet both day and night, with the industry representatives for the purpose of hammering out a decent settlement.

"We call upon the leaders of the steel industry to meet with the union in the same spirit and without attaching conditions which roadblock 'give-and-take' bargaining."

I am confident that our membership will support this unanimous action of the Wage Policy Committee.

Sincerely yours,



David J. McDonald
President.

[Since this letter was written, the Industry's position has remained the same. On June 27, the companies did make one additional offer—but this involved a decrease in the benefits proposed rather than an increase. What the companies proposed, in their terms, was that the Union

not strike—i.e. that the employees continue to work beyond June 30 without a contract. If the Union agreed, the companies said that they would be agreeable to reducing the term of the new contract to 4 years, 4 months—but with a proportionate reduction in benefits. The actual

reduction in benefits proposed would have amounted to more than 7% each year of the proposed 4 year, 4 month agreement. This was not a new offer intended to provide a possible basis for agreement. It was a step backward intended only to fortify the "take-it-or-leave-it" character of the industry's first order.]

The Steel Industry's proposed wage increase is substantially below the rate of rising productivity in recent years. The change in productivity is likely to accelerate rather than slow down. Further, the wage offer is deficient in denying the Steelworkers an opportunity to share reasonably in the Industry's present phenomenal Profits.

Since the Companies' offer cannot stand on its merits, irrelevancies and exaggerations were introduced. Thus, the Companies stated that Steelworkers are among the highest paid workers in all of industry, that they have made more rapid progress than all other major American industries, that Steelworkers' earnings are above the average for All Manufacturing workers, and that a typical, average Steelworker earns \$6,000 a year.

Steelworkers have made progress. They are proud of that progress—achieved as it has been with the greatest of effort. However, the United Steelworkers of America alone has negotiated wage increases in two other major industries which have exceeded the increases negotiated in Steel—in Aluminum and in Can Manufacturing. Steelworkers' wages have improved through the years but there are higher earnings in a whole variety of industries such as Coal Mining, Petroleum and Natural Gas Production, Building Construction, Petroleum Refining, Tire Manufacturing, Plate Glass, and others.

Steelworker hourly earnings undeniably are above the earnings of workers in numerous industries which make up the "All Manufacturing" average. Nor is it surprising that Steelworker earnings are greater than earnings of workers in Grain-Mill Products, Beet Sugar, Tobacco and Snuff, Textiles, Logging Camps, Cosmetics, and in many other industries in which Profits and profit margins are lower and in which mechanization and productivity are far less advanced, or in which the factors of skill, hazard, training and responsibility required of workers are far less than in Steel. A skilled worker in a profitable industry necessarily earns more than a less skilled worker in a less profitable industry. If comparisons between industries are to be made, the important question is what has happened to the relationship between the industries. The present mar-

gin of Steelworker hourly earnings over the average of earnings in All Manufacturing is equal to a little more than 26% as compared with a margin of more than 32% in 1939. (On the other hand, Steel's Net Profit margin on Sales was more than 83% greater than the margin in All Manufacturing in 1955.)

As for the Steel Industry's claim that the typical, average Steelworker earns \$6,000 a year, it can only be said that in citing this figure the Industry was more careless than ever with the truth. In an advertisement which appeared in a large number of American newspapers on May 14 and 15, 1956, the American Iron and Steel Institute set forth some facts about an individual millwright in a Steel plant. It described his normal living routine, his family's budget and his income. The advertisement noted that his income was \$500 a month (\$6,000 a year), and described him as a typical, average worker.

An income of \$6,000 a year requires earnings of \$3.00 an hour for 2,000 hours a year. Average gross earnings of workers in the Steel Industry are \$2.46 an hour (March, 1956—Bureau of Labor Statistics), or 54¢ an hour less than the earnings of the "average" worker described in the American Iron and Steel Institute's advertisement.

In 1955, a full 84% of the workers in the Basic Steel Industry had gross earnings of less than \$6,000. Only 1 worker in 6 had earnings equal to the "average" worker described by the American Iron and Steel Institute. It is this type of propaganda, which the Industry has substituted for collective bargaining, and which contributes to the difficulty of reaching an agreement. These facts are set forth in TABLE 21.

One defense the Steel Companies have offered for their meager contract proposal indicates that its inadequacy is known to them. That defense is the allegation that Steelworkers received "too much" in 1955—a wage increase of 15¢ an hour. Apparently the Industry, in effect, wants to recover a mythical "excess" which the Steelworkers received last year.

The Industry's claim cannot stand examination.

The Steelworkers Union negotiated a 15¢ an hour wage rate increase with the Steel Companies in 1955. The Steel Companies, along with other Bituminous Coal operators negotiated a 15¢ an hour wage increase with the United Mine Workers of America in 1955 and, in addition, granted an increase in vacation pay equal to a cost of 2½¢

to 3¢ an hour, an additional 10¢ an hour wage increase effective April 1, 1956, and a wage reopening in September, 1956! The Steelworkers Union negotiated a 15¢ wage increase with the 3 leading Basic Aluminum Companies in 1955. The Marine and Shipbuilding Workers negotiated a 15¢ increase with Bethlehem-Atlantic Shipyards. The Rubber Workers negotiated a wage increase which averaged 14.5¢ with B. F. Goodrich and the Packinghouse Workers gained a 14¢ wage increase in negotiations with the "Big Four" Meatpackers in 1955. The Auto Workers negotiated an average

of 15¢ (including geographical differential adjustments) with International Harvester in 1955. Furthermore, some of these settlements were supplemented by "fringe" adjustments. These and numerous other wage settlements in 1955 approximated the 15¢ wage increase in Steel. Settlements in the Can Industry far exceeded the wage increase in Steel. But the Steel Industry has pretended, nevertheless, that 15¢ granted in 1955 justifies a substandard wage increase in 1956 and in every one of the subsequent years through 1960.

Table 21

STEELWORKERS WITH EARNINGS IN 1955 BELOW \$6,000*

Company**	Total employees for whom earnings were reported	**Steelworkers with earnings in 1955 below \$6,000	
		Number	Percentage
Pittsburgh Steel Co.	9,300	5,944	63.9%
Northwestern Steel & Wire Co.	2,258	1,499	66.4%
Detroit Steel Corp.	3,814	2,822	74.0%
Inland Steel Co.	13,695	10,532	76.9%
National Steel Corp.	9,954	7,663	77.0%
Allegheny Ludlum Steel Corp.	10,736	8,306	77.4%
Armco Steel Corp.	12,702	9,870	77.7%
Sharon Steel Corp.	8,132	6,476	79.6%
Republic Steel Corp.	40,302	32,517	80.7%
Youngstown Sheet and Tube Co.	19,511	15,786	80.9%
Jones & Laughlin Steel Corp.	22,833	18,572	81.3%
McLouth Steel Corp.	3,049	2,514	82.5%
Granite City Steel Co.	3,968	3,307	83.3%
U. S. Steel Corp.	135,585	114,186	84.2%
Colorado Fuel and Iron Corp.	16,787	14,187	84.5%
Wheeling Steel Corp.	13,262	11,898	89.7%
Lukens Steel Co.	4,020	3,623	90.1%
Merritt-Chapman & Scott Corp.	1,754	1,605	91.5%
Bethlehem Steel Corp.	77,544	71,851	92.7%
Kaiser Steel Corp.	7,427	6,912	93.1%
TOTALS	416,633	350,070	84.0%

* The data shown are based on 1955 earnings data supplied by the individual Companies. Data were requested by the Union from the 25 largest Steel Companies (except Ford and International Harvester whose operations are not primarily in the Steel Industry). Data from Crucible, Barium and Yinsen have not been received. The earnings include all payments made to employees including such additional payments (over and above base pay, incentive earnings and vacation pay) as overtime, shift premiums, holiday pay and vacation payments in lieu of vacations. Only Production and Maintenance employees represented by the United Steelworkers of America are included. Exceptions and qualifications are noted below:

U. S. Steel.—Basic Steel Producing Operations only; excludes employees hired or terminated during the year.
Bethlehem.—Steel Plants and Fabricating Works; excludes employees hired or terminated during the year and 1,538 employees on layoff or otherwise absent during the year.
Republic.—Steel Operations; excludes employees hired or terminated during the year.
Jones and Laughlin.—Steel Works Divisions—Aliquippa, Pittsburgh and Cleveland; excludes employees with less than one year of service and 29 employees with no earnings.
National.—Great Lakes Detroit Area Plants, Hanna Furnace and Stran-Steel—Terre Haute; excludes employees hired or terminated during the year.
Youngstown.—Employees covered by Master P&M Agreement.
Inland.—Indiana Harbor Works only.
Armco.—Houston, Sand Springs and Kansas City plants of Sheffield Steel Div., Baltimore plant of Rustless Div. and Ashland Works; latter includes 857 employees who did not work the full year.
Colorado F and I.—Includes Clinton, Palmer, Morgan, Buffalo, Claymont and Pueblo and Roebbing and Trenton plants of Roebbing's Sons, Corp.
Wheeling.—Steel Mills and Factories; excludes employees hired or terminated during the year.
Sharon.—Roemer and Lowellville Works, Detroit Tube and Steel Div. and Brainard Steel Div.
Kaiser.—Fontana, California.
McLouth.—Company states earnings were exceptionally high because 1955 was the first year of operation of many new facilities and, therefore, there was an unusual amount of overtime and vacation payments in lieu of vacations.
Pittsburgh.—Allenport and Monessen, Pa., and Warren, Ohio.
Detroit.—Potsmouth Div. only; excludes employees terminated during the year.
Granite City.—Granite City, Ill.
Allegheny Ludlum.—Includes only employees with continuous service the entire year.
Northwestern Steel & Wire.—Includes Parrish-Alford Fence & Machine Co. Northwestern Steel & Wire data excludes employees hired or terminated during the year. Parrish-Alford Fence & Machine data includes all employees who worked any part of the year.
Merritt-Chapman & Scott.—Newport Steel only.
Lukens.—Coatesville, Pa.

** Listed in ascending order of the percentage of employees with gross earnings below \$6,000.

E. THE STEELWORKERS' POSITION

The position of the Union throughout has been that it desired to negotiate, on a basis of genuine collective bargaining, a fair and reasonable settlement. The proposals made by the Union for improvement of the existing contracts with the Steel Industry were reasonable, practical and entirely justifiable.

In essence, the Union has proposed that Steelworkers share equitably in the unparalleled prosperity of the Steel Industry which has been made possible by greatly increased productivity. It has proposed that the working provisions of the Steel contracts be modernized in line with present-day practices in American Industry.

The facts clearly show that the Profit position of the Steel Companies has never been better. Their Profits—Before Taxes or After Taxes—in dollars, or as a percentage of Net Worth, or as a share of the Sales Dollar, or by any other conceivable measure, are tremendous. The growth of Steel Industry Profits has been at double the rate of All Manufacturing Industries combined in the past 8 years.

The facts clearly support the Union's position that:

1. Steelworkers have earned the right to higher wages by their greatly increased productivity.
2. All proposals made by the Union for contract improvements are in line with conditions and

working practices which prevail in major parts of American Industry.

3. No Price increase whatsoever should occur as a result of granting the Union's proposals. A Steel Price increase this year cannot be justified on any basis. Only the force of public opinion, alert to the Industry's profit-taking, can hope to prevent Steel Management from continuing its past policy of making a profit on a wage increase—usually on a 3 to 1 ratio.

4. Higher wages and salaries are in the public interest. The wider distribution of purchasing power throughout our Nation has been a major and indispensable factor in the growth of production in this country.

5. The Steel Companies must undertake serious collective bargaining. The companies have created the present crisis by their refusal to engage in such bargaining. They made their position clear when they refused the Union's offer to extend its contracts for 15 days so as to permit sufficient time for a bargained settlement to be reached without a shutdown. Now that they have achieved their purpose of causing a cessation of steel production, it is their plain duty, not only to their employees, but to the nation as well, to begin—for the first time—the process of give-and-take negotiation which alone can end the present crisis.

APPENDIX TABLES

Table 22

PROFITS BEFORE TAXES OF ALL CORPORATIONS, ALL MANUFACTURING CORPORATIONS, AND STEEL CORPORATIONS

	All Corporations		All Manufacturing Corporations		Steel Industry	
	Billion Dollars ^a	Index (1947=100)	Billion Dollars ^a	Index (1947=100)	Million Dollars ^b	Index (1947=100)
1956*	\$46.2	156.6	\$25.7	155.8	\$2,350.7	338.3
1955	43.8	148.5	24.4	147.9	2,038.5	293.4
1954	34.0	115.3	17.8	107.9	1,133.6	163.1
1953	38.3	129.8	21.4	129.7	1,600.7	230.3
1952	35.9	121.7	20.0	121.2	929.6	133.8
1951	41.2	139.7	24.5	148.5	1,884.0	271.1
1950	40.0	135.6	23.3	141.2	1,530.7	220.3
1949	26.2	88.8	14.1	85.5	935.3	134.3
1948	32.8	111.2	18.1	109.7	985.9	141.9
1947	29.5	100.0	16.5	100.0	694.9	100.0

* Annual rates based on projections from 1st quarter 1956. (Average of 4th quarter 1955 and 1st quarter 1956 used for U. S. Department of Commerce figures.)

SOURCE.—^a U. S. Department of Commerce. Calculations ours. ^b Based on data in prior Tables for 25 major Steel Companies.

Table 23

NET PROFITS OF ALL CORPORATIONS, ALL MANUFACTURING CORPORATIONS, AND STEEL CORPORATIONS

	All Corporations		All manufacturing Corporations		Steel Industry	
	Billion Dollars ^a	Index (1947=100)	Billion Dollars ^a	Index (1947=100)	Million Dollars ^b	Index (1947=100)
1956*	\$23.0	126.4	\$12.6	124.8	\$1,153.4	292.5
1955	21.8	119.8	11.9	117.8	1,019.4	258.5
1954	17.0	93.4	8.8	87.1	589.8	149.6
1953	17.0	93.4	8.8	87.1	679.4	172.3
1952	16.1	88.5	8.3	82.2	492.5	124.9
1951	18.7	102.7	10.3	102.0	633.5	160.7
1950	22.1	121.4	12.4	122.8	728.5	184.8
1949	15.8	86.8	8.4	83.2	521.8	132.3
1948	20.3	111.5	11.0	108.9	534.9	135.7
1947	18.2	100.0	10.1	100.0	394.3	100.0

* Annual rates based on projections from 1st quarter 1956. (Average of 4th quarter 1955 and 1st quarter 1956 used for U. S. Department of Commerce figures.)

SOURCE.—^a U. S. Department of Commerce. Calculations ours. ^b Based on data in prior tables for 25 major Steel Companies.

Table 24

DIVIDEND PAYMENTS IN ALL CORPORATIONS

VS.

STEEL CORPORATIONS

	All Corporations ^a		Steel ^b	
	Billions of Dollars	Index (1947=100)	Millions of Dollars	Index (1947=100)
1956*	\$11.7	180.0	\$412.9	323.1
1955	11.2	172.3	353.9	276.9
1954	10.0	153.8	269.0	210.5
1953	9.3	143.1	248.7	194.6
1952	9.0	138.5	238.8	186.9
1951	9.1	140.0	240.3	188.0
1950	9.2	141.5	246.0	192.5
1949	7.5	115.4	167.9	131.4
1948	7.2	110.8	150.2	117.5
1947	6.5	100.0	127.8	100.0

* Annual rates based on projections from 1st quarter 1956.

SOURCE.—^a U. S. Department of Commerce. Includes all Cash Dividends. Calculations ours. ^b Based on data in prior Tables for 25 major Steel Companies. Includes Cash Dividends on Common Stock only.

Table 25

PROFITS BEFORE AND AFTER TAXES

AS SHARES OF THE SALES DOLLAR

FOR

ALL MANUFACTURING CORPS. VS. STEEL CORPS.

	Profits Before Taxes		Net Profits	
	All Manufacturing Corporations ^a	Steel Industry ^b	All Manufacturing Corporations ^a	Steel Industry ^b
1956*	8.6¢	16.2¢	4.3¢	7.9¢
1955	8.5	15.8	4.1	7.9
1954	6.9	11.6	3.4	6.1
1953	7.8	13.1	3.2	5.6
1952	7.8	9.1	3.2	4.9
1951	9.8	17.0	4.1	5.7
1950	10.7	16.8	5.7	8.0
1947	9.3	10.9	5.7	6.2

* Annual rates based on projections from 1st quarter 1956.

SOURCE.—^a U. S. Department of Commerce. Profit and Sales data. Calculations ours. ^b Based on data from prior Tables for 22 major Steel Companies.

Table 26

PRODUCTION, SHIPMENTS AND EMPLOYMENT IN STEEL

	Operating Rate ^a	Ingot Production ^a		Shipments ^a		Production and Maintenance Employment ^b	
		Millions of Tons	Index (1947=100)	Millions of Tons	Index (1947=100)	Thousands of Empls.	Index (1947=100)
1956*	99.6%	127.49	150.2	93.23	147.8	566.9	109.5
1955	93.0	117.04	137.9	84.72	134.3	545.0	105.3
1954	71.0	88.31	104.0	63.15	100.1	492.7	95.2
1953	94.9	111.61	131.5	80.15	127.1	559.6	108.1
1952	85.8	93.17	109.8	68.00	107.8	486.5	94.0
1951	100.9	105.20	123.9	78.93	125.2	560.2	108.2
1950	96.9	96.84	114.1	72.23	114.5	532.9	103.0
1949	81.1	77.98	91.9	58.10	92.1	476.7	92.1
1948	94.1	88.64	104.4	65.97	104.6	536.3	103.6
1947	93.0	84.89	100.0	63.06	100.0	517.6	100.0

* Annual rates based on straight-line projections from the 1st quarter of 1956.

SOURCES.—^a American Iron and Steel Institute. Calculations ours. ^b Bureau of Labor Statistics. Calculations ours.

Table 27

PRICES IN STEEL

VS.

MATERIALS AND LABOR COSTS

	Manhours ^a (per unit)	Average Hourly Earnings ^b	Labor Cost Index ^c (1947=100)	All Commodities other than Farm and Food Wholesale Price Index ^b (1947=100)	Steel Mill Price Index ^b (1947=100)
1956*	75.4	\$2.463	128.0	126.7	177.7 ^d
1955	78.8	2.380	129.3	122.8	169.7
1954	87.8	2.200	133.2	120.1	161.9
1953	85.5	2.160	127.3	119.6	155.0
1952	86.2	1.990	118.3	118.8	143.6
1951	89.6	1.890	116.7	121.6	140.5
1950	90.3	1.691	105.3	110.2	130.3
1949	98.4	1.646	111.7	106.3	123.8
1948	100.6	1.580	109.6	108.5	114.2
1947	100.8	1.439	100.0	100.0	100.0

* Annual rates based on projections from 1st quarter 1956.

SOURCES—^a Based on data in the prior Steel Productivity Table. ^b Bureau of Labor Statistics. Calculations ours. ^c Based on Columns 1 and 2 above. Calculations ours. ^d Index for March 1956 is 178.2.

STEEL
and
THE NATIONAL ECONOMY
1956

UNITED STEELWORKERS OF AMERICA

1500 COMMONWEALTH BUILDING

PITTSBURGH 22, PENNSYLVANIA



Printed in U.S.A.

JULY, 1956

Summary

1. Economic conditions in the United States in mid-1956 were varied. Despite continued heavy defense spending and sharply rising business investment expenditures, the economy has been on a plateau for some nine months. Even the precarious support from inventory accumulation and higher consumer debt has not resulted in the degree of full employment of 1952 and 1953. Consumer purchases are lagging. Personal income must increase if economic expansion is to be resumed.

2. A growing labor force and rising productivity make possible a doubling of our production and our standard of living within the next 20 years. These can be achieved only if there is an active market for the goods and services we can produce.

3. Consumers buy five out of every six dollars worth of goods and services purchased privately. Wages and salaries largely determine how much money consumers have for expenditures. Wages and salaries must increase if the growing productive capacity of American industry is to be utilized.

4. Wage and salary increases and labor's rising share of total income over much of the last decade provided consumers with the income needed for the profitable prosperity we have enjoyed. Labor's share has fallen in the last year and, unless corrected, this could spell economic trouble.

5. Experience has proved that wage increases have not caused inflation, that wages can be increased without prices being raised, and that rising real wages give us stable prosperity and growth.

6. The inflation in 1946-48 resulted from an accumulated backlog of demands. The Korean inflation was caused by speculation and scare buying. In both instances, wage increases lagged behind price increases and did not cause the inflation.

7. In the two periods of inflation—from 1946 to 1948, and again in 1950-51—wages lagged behind prices. Labor struggled to keep up with the inflation and barely succeeded in restoring the purchasing power eroded by rising prices. On the other hand, in the two periods of stability from 1948 to 1950 and again after mid-1951, wages and

salaries increased while prices remained stable. Since mid-1951 wage rates in manufacturing have risen 23 percent while living costs are up less than 4 percent and industrial prices 4 percent. Total profits before taxes reached record levels in 1955.

8. Productivity in the economy has been increasing more than 3 percent per year. In manufacturing industries, the annual rate has been exceeding 4 percent. Automation will increase the pace. Greater prosperity will come if the benefits of rising productivity are shared with the workers. Real hourly earnings in manufacturing fell behind the rise in productivity at the time of the Korean War and have not caught up yet. This disparity must be corrected through rising real wages.

9. From 1946 to 1948, hourly earnings in manufacturing rose 24 percent in current prices, but remained unchanged in real terms. Manufacturing profits increased 60 percent. Pay to all corporate employees rose 30 percent, industrial prices increased one-third, and corporate profits increased 45 percent. That is the pattern of inflation—rising prices, rising real profits and lagging real wages.

10. Except for the immediate post-war and Korean inflations, the rising volume of business in industry generally, but not in steel, tended to be associated with lower profit margins. This policy yielded prosperity and high total profits. Price stability and sustained high profits ought to be more attractive to business than alternating booming and falling profits which result in part from inflationary pricing policies.

11. In only one year from 1947 to date did the rate of profits after taxes of all manufacturing corporations combined fall below 10 percent of stockholders' equity and that was in the recession year of 1954. In only two years of the last nine did the rate of manufacturing profits before taxes fall below 20 percent of stockholders' equity. Higher volume and lower margins can provide high and sustained profits.

12. In mid-1955 industrial prices started to rise and again spurted ahead of wages. Profits in the first quarter of 1955 were at the 1951 Korean peak, but higher pricing brought a 15 percent increase in profits from the first to the fourth quar-

ter of 1955. Employees' compensation rose 7 percent in the same period. Profit margins rose sharply after four years of a moderate decline. This tendency can spell trouble. It must be reversed.

13. The contrast between the pricing policies of the steel industry and of all manufacturing industries as a whole is rather startling. Steel prices have increased proportionately with wage rates since 1947 ignoring rapidly rising productivity in its pricing policies. For all manufacturing, industrial prices increased considerably less than half as much as wage rates from 1947 to 1955. From 1951 to 1955, hourly earnings in all manufacturing rose 18 percent while industrial prices went up 1 percent. In marked contrast, wage rates in steel were 25 percent higher in 1955 than in 1951, and steel prices were 20 percent higher.

14. Profit margins in steel were 30 percent higher in 1955 than in 1947-49. In all manufacturing, profit margins decreased slightly over this span. Total profits in steel rose more rapidly than in all manufacturing industries.

15. All major categories of steel-users increased their prices far less than did the steel industry. Part of the skyrocketing steel prices were apparently absorbed by steel-fabricating industries.

16. The steel industry does not follow the principle of higher volume and lower margins. If there is any single industry that has followed inflationary pricing practices; that has shown a disregard for the economic welfare of the country, especially relative to its key role in the economy; that has truly practiced inflation; that has the

least right to hide behind the cloak of favoring a sound dollar and to contend that wage increases are inflationary; it is the steel industry.

17. Contentions that there have been uniform rounds and patterns of wage increases since the end of World War II are not based on fact. All workers strived for higher wages in 1946-48 and 1950-51 to regain the losses in real income from rising prices. In between those years and since, all workers justly sought to share in our rising productivity. However, the size of wage increases has varied in substantial degree from industry to industry. There has been neither rigid patterns nor uniform rounds of wage and fringe benefit improvements.

18. High and accelerated depreciation charges permitted generally under the new 1954 tax law and specifically for plants related to national security, have resulted in a probable understatement of reported profits relative to actual profits. Depreciation allowances provide a significant source of funds for investment.

19. Contentions by leaders of the steel industry and other industries that prices must be increased so that there will be more profits with which to finance expansion are astounding. Raising prices to secure funds for new plant and equipment in effect forces the consumer to put up the money for new plants for the benefit of existing stockholders. The consumer gets nothing for his forced "investment." The opportunity for American citizens to participate in the growth of American industry is denied when expansion is financed entirely through exorbitant profits rather than security flotations.

ECONOMIC FACTS

1—Economic Objectives and Wage Policies

In mid-1956 the United States finds itself in a mixed situation of reasonably high levels of general employment and serious unemployment in some key industrial centers, rapidly rising capital investment and continuing weakness in consumer durable goods and home building markets, slowly increasing total income and a depressed farm community, rising industrial prices in the face of larger inventories, and new record profits while over-all business has been on a plateau.

Since V-J Day, we have enjoyed unprecedented improvements in living standards and, with the exception of brief periods, continuing high levels of production and employment. The American economy has demonstrated its immense power to produce. Equally important, better understanding of the functioning of our free enterprise system and increased determination to overcome booms and busts have led to greater confidence in a future of sustained expansion without recurrences of mass unemployment and idle resources.

Since World War II, there have been two periods of inflation and two recessions of moderate intensity and duration. A precipitous rise in prices immediately followed decontrol after the war. A brief but pronounced inflation was associated with the war in Korea. The past five years have been characterized by a considerable degree of price stability, although in the last half of 1955 and early 1956 prices have moved up in some sectors. With some exceptions, especially the depressed status of agriculture and the moderate recession of 1953-1954, the types and degrees of distortions which have tended to be associated with periods of prosperity in the past and which in turn have brought on recessions and depressions did not emerge in the period from June 1951 to mid-1955. On the whole, there is considerable basis for confidence that we can and will have a future of marked growth with sustained high levels of production and employment provided the distortions that have emerged in recent months are promptly reversed.

A sharp rise in 1955 in consumer expenditures based in measurable degree on credit buying, helped to lift the national economy out of the 1953-1954 downturn. This rapid surge in con-

sumer borrowing has left many American families with debts that will probably remain a heavy burden for months to come. The general weakness in consumer markets at present—most pronounced in the markets for homes, automobiles and other consumer durable goods—has created a good deal of concern about the health of the national economy.

This concern about the course of economic developments in the period immediately ahead is heightened by a growing distortion between the capital investment and consumer sectors. Weakness in the consumer sector has been accompanied by sharply rising business expenditures for new factories, machines and instruments. Further substantial and rapid increases in these expenditures are predicted for the remainder of the year. This soaring capital investment has helped prevent an over-all economic decline during the past six months. But a continuation of this distorted condition can bring difficulties in the months ahead. Moreover, even with the high rate of business spending, there has been a relatively less full use of our labor force in 1955 and early 1956 than in 1952 and 1953 when investment rose far less sharply.

New plant and equipment now being built will soon be placed into productive use. They represent not merely additions to our stock of capital equipment, but the planned installation of efficient and increasingly automatic productive machinery. Larger volume of goods and services will be available in the coming months as this equipment is put into operation. There must be a growing market for this growing output. Consumer markets require immediate strengthening for the resumption of economic expansion.

No single segment of the American community can wholly determine the character and pattern, the strength and weaknesses, or the well-being of our free enterprise economy. Yet, each group—workers, farmers, management, consumers and all branches and levels of the government—play a vital role in our economic development. Each group should gear its policies and actions toward a strong and growing system of free enterprise which affords a more abundant life for the American citizen. Labor must continue to play its full part with responsibility and dedication to the best interests of the nation.

Wage earners and salaried workers serve the whole community not only in devoting their efforts and talents to the productive process but as members of unions they use their strength to achieve a better functioning and more equitable and humane society. They seek a fair share of the product of their toil for themselves and their families—an adequate share which is basic to the growth of mass markets to parallel our mass production. They strive to help attain and maintain economic relationships essential to a stable and expanding economy. Labor has no illusions that in its bargaining functions, it can overcome all the flaws and weaknesses in our system. But it can and does make a measurable contribution toward a stronger and healthier economy.

Labor believes that its performance in the past decade has not only served to raise living standards of all workers, but more importantly, its wage policies have contributed to the acceleration in expansion and to moving in the direction of a more stable and depression-proof economy. The progress of the past twenty-five years toward overcoming depressions and expanding the rate of growth has been gratifying, but there is still much to be done before the waste and hardships of booms and busts are fully overcome.

Labor's wage policies will continue to be designed primarily to increase the size of our total production so that workers and farmers and management can enjoy increasing abundance. Labor will continue to strive for rising real wages so that there will be markets for our expanding production. The record of the past decade especially gives evidence of the success of such policies. The short duration and limited degree of the recessions in 1949 and 1954 can in considerable measure be attributed to stable wages—some wage rates even increased—in those years. The road ahead will require continued determination and dedication if the potentialities of our tremendous productive capacity are to be realized. It is toward this end that union wage policies must be dedicated.

2—Keeping the Economy Expanding

The most unique characteristic of the American economy is its extraordinary rate of dynamic growth. Since 1939, the gross national product of the United States has more than quadrupled in value, increasing from less than \$100 billion to approximately \$400 billion annually. Part of this increase reflects higher prices, but even after allowing for price advances, the real value of the

total output of goods and services has more than doubled. In the eight years from 1947 to 1955, an increase of nearly 40 percent has been registered in the output of goods and services. We are nearly one-fourth above the peak of total production during World War II.

At the close of 1955, the economy was producing at the rate of nearly \$2,400 per year for every man, woman and child in the country. The production per gainfully employed person is now \$6,000 per year. These are levels virtually undreamed of only a generation ago. The rise in output not only underlies our present high living standards, but points the way to the more abundant life that lies ahead.

Especially rapid has been the growth in the industrial sector of the economy. Manufacturing production is now more than two and one-half times what it was in 1939. The production of durable goods has increased over 50 percent since 1947 and has more than trebled in the past 17 years. Electric power production has doubled since 1947 and quadrupled since 1939.

Part of these phenomenal increases occurred during World War II. Since the war ended, however, our growth has continued at a rapid rate. Total output of goods and services has risen an average of more than 3½ percent a year since 1946. For the years after 1949, the annual increase averaged 4½ percent for total production. These are real rates of growth, measuring the value of production after eliminating the influence of higher prices. Industrial production has grown over 5 percent per year since the end of World War II and, since 1949, the rate of increase has been 6 percent a year. The output of durable goods has expanded an average of 6½ percent a year since 1946 and at an annual rate of 8½ percent since 1949.

If ever there were doubts about the possibility of banishing poverty, our past record and future prospects should serve to eradicate such doubts. If America's economic expansion can be maintained at the 1946-55 average of 3½ percent, a \$500 billion economy—at present prices—is in sight as early as 1963 and over \$600 billion can be reached before 1970. At the 4½ percent rate actually achieved in the years since 1949, the \$500 billion level can be reached soon after 1960, with \$600 billion accomplished by 1965 and an incredible \$750 billion by 1970. These levels may seem astronomical, but recent accomplishments demonstrate their feasibility.

Our recent growth is reflected in, and has been

sustained by, marked increases in employment and wages. Higher wages place in the hands of the nation's consumers the purchasing power necessary to absorb the country's ever-increasing output. Since the end of World War II, personal consumption expenditures have increased more than 100 percent. Adjusting for price changes, consumer purchases in the aggregate have increased more than 40 percent since 1945 and on a per capita basis have risen approximately 20 percent. There has been a broadening of mass markets with millions of families getting higher incomes and adding to the markets for improved housing, cars, appliances, leisure-time activities, more and better foods and clothing and services. Had this increase in buying power not occurred, our economic expansion could not have been sustained. Rising employment accounted for only part of the expansion in consumer expenditures; a major contributing factor was the steadily rising wage level reflecting effective collective bargaining between labor and management.

To attain the achievable targets in the years ahead, the rise in purchasing power must keep pace with the rise in production. Given a market for its products and services, American industry can be expected to employ our growing labor force. Together, management and workers can achieve further marked progress in productivity. To provide the market for an output of \$600 billion per year in the next decade, assuming peacetime conditions, consumer purchases would have to rise well over 50 percent. Increased employment will contribute in part to this increasing buying power, but the bulk must come from higher wages and higher salaries.

3—Purchasing Power and Wage Policy

Total demand for goods and services is the most important single determinant of the level of total production. Our growth in production rests on the combination of employing the growing labor force, expanding our industrial capacity, and increasing the level of productivity. Whether these resources are used, in turn depends on the ultimate key to our prosperity—an adequate market for the goods and services our economy can produce.

Labor recognizes that wages represent income to workers and costs to employers. Strongly favoring the free enterprise system, American labor appreciates the need for and desirability of profits as incentives and rewards to business. Labor wants its employers to earn fair profits. At

the same time, labor insists that employers pay sufficiently high wages so that workers can share reasonably in the benefits of our mass production and can provide a market for the goods which business produces. Such a market is necessary if there is to be sustained employment and profit opportunities.

Excluding government purchases, over four-fifths of our total output of goods and services is absorbed by personal consumption expenditures. Outlays made by individuals and families in the purchase of residential housing are not normally counted as consumption expenditures. They appear in the national income accounts in the category of investment expenditures. If disbursements for housing were added to expenditures for consumption, then consumers would account for over 85 percent of all non-government purchases. Five out of every six dollars worth of goods and services produced in the United States that are available for private purchase are bought for personal consumption. The balance is purchased largely by business. These figures make crystal clear the need for focusing our attention on consumer buying power in determining sound economic policies.

Labor income accounts for more than 70 percent of total personal income in the United States. Expenditures by farmers and executives and independent professionals are obviously important, but the largest single factor determining the magnitude of disposable personal income is the level of total wages and salaries. In turn, the level of wage rates directly influences total labor income and total personal income. The vast majority of American families are dependent on wages and salaries for their livelihood. Over 70 percent of all gainfully employed persons are wage and salary earners.

Since 1950, the trend of disposable personal income has almost precisely paralleled that of manufacturing wage rates. The indexes of disposable income and of hourly wages in manufacturing on the next page reveal this close relationship.

From 1950 to 1955, total disposable income rose 31 percent, while hourly wage rates of manufacturing workers advanced 29 percent. For each of the intervening years, the proportionate changes in the two series were nearly identical. It is not meant to imply that manufacturing wage rates determine the income of all persons. There are, of course, a great many elements influencing changes in buying power such as increases in population and employment, incomes of other groups

**CHANGES IN DISPOSABLE INCOME AND
HOURLY WAGES IN MANUFACTURING,
1950-55**

(percentage change from preceding year)

Period	Total disposable income	Manufacturing wage rates
1951	+10	+ 8
1952	+ 5	+ 5
1953	+ 6	+ 6
1954	+ 2	+ 2
1955	+ 6	+ 4
1950-55.....	+31	+29

Source: United States Departments of Commerce and Labor.

in the population, changes in taxes, variations in savings, the length of the work week and the like. Nevertheless, the parallel is so close as to make clearly apparent the importance of wage rates in manufacturing industries in influencing wage rates and incomes in other endeavors. Improvements in wage levels in key industries have a profound effect on wages and salaries elsewhere in the economy, though amounts, timing and specific terms of the multitude of wage and salaried changes vary widely.

The rapid growth in the economy over the past decade and especially in the last five years has been associated with rising real wages. There has been a modest but definite increase in labor's share of our national income. Labor income was 63 percent of the total national income in 1946. Since 1953, labor's share has averaged about 67 percent. Similarly, labor income was less than two-thirds of total personal income in the period 1946-50, whereas from 1952 to the present, it has been over 70 percent. Compared with total non-agricultural income, labor's share has also risen. It is also noteworthy that income of employees of all corporations has tended to rise relative to profits before taxes.

The rise in real wages and the shifts in total income distribution over the full span of the past decade in favor of labor contributed materially to our economic growth and relatively stable prosperity. Our progress would have been neither as steady nor as rapid had it not been for these stimulating influences which provided for growing mass markets. Unfortunately, there has been some retrogression in these relationships in the past year.

Profits have persisted since World War II at

highly favorable levels. The rising national income has been associated with rising profits, though the increase in total labor income has exceeded that of total profits. In essence, larger volume of business at slightly lower margins has yielded increasing profits. The high levels and rising trends of investment expenditures by business provide ample proof that attractive incentives for new investments have prevailed. Businessmen and investors benefit more from gradually rising and persistent profits than from sensational profits in boom times followed by bankruptcy in depressions.

Labor's wage policies have made a contribution to sustained profitability. This contribution has been less pronounced in the past nine months, as precarious distortions have tended to emerge. These include a declining share of income for labor, a very marked rise in plant and equipment outlays in the face of very slight increases in consumer income and expenditures, and irresponsible pricing policies in some of the more monopolistic sectors of the economy.

It is increasingly clear that trends in favor of labor income and consumer purchasing power must go further to support a continuation of the rate of progress achieved in the past five years. While consumer incomes have increased substantially, they have still not expanded at a rate commensurate with our growing output of goods and services. The volume of goods and services available for domestic civilian purchase (i.e., gross national product minus government purchases minus net exports) has been rising more rapidly than personal disposable income which is the income available for personal expenditures (i.e., total personal income minus personal taxes). In 1953 and 1954 American individuals and families received enough income, after paying personal taxes, to buy nearly 90 percent of total production available for domestic civilian use. The ratio dropped to 86 percent in 1955 where it remained in the first quarter of 1956. This fall-off in consumer purchasing power relative to production is an unhealthy tendency.

The lack of adequate consumer buying power has been increasingly marked in recent months. Inventories at all levels of business activity have risen sharply in relation to sales. The rise in inventories has been particularly pronounced in consumer durable goods. Production will not stay high for long when an increasing portion of the output is merely serving to increase the supply of goods and services on the shelves of man-

Year	Disposable personal income as % of gross national product available for private purchases in U.S.	Personal consumption expenditures as % of gross national product available for private purchases in U.S.
1947.....	87	85
1948.....	86	81
1949.....	88	85
1950.....	84	79
1951.....	85	79
1952.....	88	82
1953.....	89	82
1954.....	90	83
1955.....	86	81
1956*.....	86	80

* Annual rate, seasonally adjusted, for six months ending March 1956.

ufacturers and wholesalers and retailers. Manufacturing and trade sales, on a seasonally adjusted basis, are no higher than they were last fall, but inventories jumped almost \$4½ billion from September 1955 to April 1956. Such an inventory accumulation was hardly purposeful. It reflects a lack of customers; not because the families of America do not need and want more goods, but rather because they lack the income to buy this larger flow of goods. Manufacturers and storekeepers will cut production and purchases if consumer buying does not increase more rapidly. And consumer purchases will not increase until and unless wages are raised.

Expansion of the economy seems to have lost its momentum in the past six to nine months. Since September, 1955, we appear to have come to a halt on an economic plateau. The general level of industrial production has remained barely stable, with capital goods output rising and consumer durables declining. National income and personal consumption expenditures have advanced very slightly. Numerous weak spots are appearing in the economy despite continued high defense spending and a rather phenomenal increase in business investment in plant and equipment.

The total level of expenditures for new plant and equipment is officially expected to total \$35 billion in 1956, representing an increase of nearly one-quarter over 1955. In the first half of 1956, these expenditures are running one-third above the first half of 1955. In the face of sustained government spending and the extraordinary rise in plant and equipment expenditures, any softness in the business picture can lead to only one conclusion, namely, that consumer incomes and consumer expenditures are inadequate to maintain

high levels of employment and to restore the momentum of the expansion. Not only has huge business spending for modernizing and enlarging our productive capacity failed to bring truly full employment, but such expenditures will not continue to increase unless consumer demand rises. Almost 4½ percent of our civilian labor force was unemployed in the first quarter of 1956, as compared with 3 percent in the fall of 1955 and only 2½ percent in 1952 and 1953. In some areas, such as Detroit, Flint and South Bend, local unemployment has reached serious proportions.

Further evidence of the inadequacy of consumer purchasing power is the fact that a constantly growing share of consumer purchases has had to be financed by credit. Consumer debt outstanding at the end of the first quarter of 1956 was \$35.5 billion, or nearly 20 percent higher than a year earlier. Over the same period consumers had 6 percent more income to spend. Between the first quarter of 1952 and the first quarter of 1956, consumer expenditures increased 21 percent, but consumer indebtedness jumped 71 percent. Mortgage debt on 1-to-4 family houses also increased by more than 70 percent. The increase in mortgage debt on 1-to-4 family houses in 1951 equaled 59 percent of the value of private non-farm residences built in that year. The ratio increased every year and in 1955 was almost 77 percent.

At the beginning of 1952, the ratio of consumer credit outstanding to total disposable income was 9 percent. By the beginning of 1956, it had risen to 13.2 percent. At the beginning of 1952 outstanding consumer credit equaled 10.2 percent of the annual rate of consumer purchases. By the start of 1956 it had increased to 14.2 percent.

Some expansion of credit is, of course, a normal sign of a growing, healthy economy. There can be no fixed rule defining how much expansion is safe. At some point, however, if an individual's indebtedness rises much more rapidly than his income, his credit-worthiness becomes impaired. Further, his burden of paying off debts becomes excessive and limits his ability to make current purchases of essential goods and services for current consumption. It seems reasonable to conclude that the rate of increase in consumer debt in recent years was excessive. Certainly, the decline in automobile and other consumer durable goods sales can be traced in some measure to the fact that many consumers became over-extended.

Our economic growth may well have relied too

heavily upon credit and not enough on increased income over the past few years. We may have reached the limit of that road. If so, this leaves us with only two possible alternatives. One is to lower our sights and gear our output to what can be sold on the basis of the present trend of consumer incomes. That road leads at best to a slower rate of progress than we can attain and more probably to declining business and rising unemployment in the face of the economy's tremendous growth potential. The second alternative is to attack the problem at its root, which is to increase wages and purchasing power so that there are mass markets for the rising output made possible by the growth of our labor force, the increase in our productive capacity and the improvement in our efficiency. This clearly means that real wages must be raised more rapidly. It requires higher wages without higher prices. We have seen not only that wages can be raised without increasing prices, but it is clear that increasing real wages are absolutely essential for prosperity and growth. Only in this manner can our economy be soundly supported on the solid basis of rising buying power, widely distributed, rather than excessive credit. Only if we take this road can we continue to enjoy the fruits of steady and dynamic economic expansion.

4—Inflation or Stabilization?

Contentions by management and by anti-labor spokesmen that all wage increases must result in price increases—that higher wages must lead to inflation—are without basis in theory, in practice and in fact. Rising wages and inflation are not part and parcel of a single phenomenon. Industry need not, and most employers do not, raise prices every time wages are increased. So much has been said and written proving that wages must rise relative to prices, that only economic isolationists in their remote-from-reality hideouts continue to prattle about higher wages causing inflation.

Contentions that wage rates can be increased without limit and still have no impact on prices are equally irresponsible. But, a healthy economy requires that wages and salaries must rise relative to prices and the only meaningful question is the degree to which wages can and must increase relative to prices.

Unions have never contended that higher wages could be paid without higher prices regardless of the size of the wage increase. Rather, labor has contended that the level of profits and

changes in productivity should be taken into account in determining how much wages can be increased without increasing the general price level. On the other hand, those who steadfastly fight against wage increases attempt to propagate the view that every wage increase must result in a price increase.

It is unequivocally clear that unless wages and salaries increase somewhat more than prices, our economic growth will be halted. As our productive capacity and output of goods and services expand, there must be an increase in the real buying power of consumers. Except for inventory and investment booms which cause busts, our economy can grow no faster than the market for its products. The mainstay of that market is the purchasing power of our workers. As already pointed out, more than four-fifths of America's total output of goods and services, excluding what is bought by the Government, is purchased for personal consumption. It is the income of the wage and salary earners that accounts for the bulk of personal consumption. Rising real wages are an absolute prerequisite to economic prosperity and economic growth.

The history of our industrial development is a history of rising output per man-hour of work. The rate of change in productivity has varied from time to time, but the increase in efficiency—in production per man-hour—has been persistent and substantial. Workers can share in the benefits of rising productivity only through rising real wages. But even more important from the economic point of view is the continuing need for higher real wages as a basis for sustained high levels of production and income and employment.

Economists have long argued whether the benefits of rising productivity should be shared through constant prices and higher wages or through constant wages and lower prices, or a combination of the two. Most economists are at least dubious, if not firmly opposed, to a goal of declining prices. Falling prices tend to discourage investment and to retard economic expansion. Even if general price declines were desirable, it is doubtful that prices would actually be reduced by those industries which can best afford it—those whose firm grip on the market has permitted them to reap the largest profits by setting their prices high.

As the economy has grown, business enterprises have developed in size and scale and in organization, bringing much less price flexibility

than was true in the past. Many objective analyses have been made demonstrating the growing stickiness of prices, especially for industrial products. Even when economic activity and productivity have risen relative to wages, there is little evidence of a readiness by the large industrial corporations to cut prices. Rather, our increasingly monopolistic industries tend to change their prices only in one direction, namely upward. If labor were to forego demands for higher wages and wait for employers to pass on the benefits of higher productivity through lower prices, we would surely experience short and intensive booms with tremendous profits and inadequate buying power, followed by severe depressions and mass unemployment. This is not a promising path to economic progress.

Labor often seeks wage increases that are proportionately higher than the rise in productivity, because wages have lagged in the past and profits have become exorbitant. Once labor's share is reasonable, increases should primarily take into consideration changes in productivity. In industries where productivity is rising at a lesser rate than for the total economy, wages should be increased in proportion to the over-all rate, even though some price increase might be necessary. In industries where productivity is increasing very rapidly, wages should rise more than in proportion to the national increase in productivity. This might well leave room for price declines.

The above policies would permit all workers to share in the improving productivity of the economy with extra benefits to workers in those industries where technological advancements are most rapid. It would result in only a slight upward trend in prices.

It should be noted that a percentage increase in wage rates proportionate with changes in productivity results in a sharing of the benefits of productivity between management, labor and investors. Not all the benefits of increased efficiency and mechanization are expected nor sought by labor.

History has demonstrated not only that wages can rise relative to prices, thus providing the increased purchasing power without which our economy would stagnate, but also that there can be substantial increases in wages with virtually no change in prices or living costs. The experiences of the immediate pre-Korea and post-Korea years are significant in this respect.

Since the end of World War II, there have been two periods of general price advances, both oc-

casioned by factors other than higher wages. Also in this decade, there have been two longer periods of general price stability.

Prices rose sharply during the immediate postwar years of 1946 and 1947, following the removal of wartime price controls. This inflation reflected principally the release of accumulated demands for goods of all kinds following the removal of wartime restrictions on consumption and output. As shown in the following table, consumer prices increased 30 percent from January 1946 to January 1948. Wholesale prices for all commodities skyrocketed 50 percent. For all commodities other than farm and food items, the rise was 41.5 percent in these 24 months. Wages increased 30 percent during the same period, seriously lagging behind prices and barely providing workers with the same purchasing power per hour of work in January 1948 as in January 1946. Because of shortening of the work week, real buying power of weekly earnings declined markedly for a time following World War II.

MAJOR PRICE AND WAGE MOVEMENTS SINCE THE END OF WORLD WAR II

(Index Numbers, 1947-49=100)

Period	Consumer prices	Wholesale prices		Hourly wages in manufacturing ¹
		All commodities	All except farm and food	
1. The immediate postwar boom:				
Jan. 1946	77.8	69.6	72.1	75.0
Jan. 1948	101.3	104.5	102.0	97.8
Percent change.....	+30.2	+50.2	+41.5	+30.4
2. Thirty months of stability:				
Jan. 1948	101.3	104.5	102.0	97.8
June 1950	101.8	100.2	102.2	109.0
Percent change.....	+ 0.5	- 4.1	+ 0.2	+11.5
3. The Korean boom:				
June 1950	101.8	100.2	102.2	109.0
June 1951	110.8	115.1	116.2	118.8
Percent change.....	+ 8.8	+14.9	+13.7	+ 9.0
4. Five years of stability:				
June 1951	110.8	115.1	116.8	118.8
April 1956	114.9	113.7	121.7	146.0
Percent change.....	+ 3.7	- 1.2	+ 4.2	+22.9

¹ Index of straight-time hourly earnings in manufacturing industries.

Source: United States Department of Labor.

The increase in personal consumption in 1946 and 1947 was made possible by spending the savings that had been accumulated during the war. Wage increases were not the cause of the inflation. Clearly, during these two years, wages were increased after prices were increased. Labor was on a treadmill trying to catch up with the galloping price level.

Inflation appeared again following the Korean outbreak in June 1950 largely because of speculation and scare buying. The rise in wholesale prices after Korea was, in fact, arrested by the end of January 1951 with the imposition of price controls, though living costs continued to advance for a few months longer. Again, as shown in the tabulation, wage rates barely kept pace with consumer prices. The figures show that between June 1950 and June 1951, both wage rates and retail prices increased 9 percent and wholesale prices of all commodities advanced almost 15 percent.

Between and after these periods of inflation, prices generally remained stable while wages continued to advance as labor productivity steadily improved. In the two and one-half years between January 1948 and June 1950 there was an 11.5 percent rise in hourly wages in all manufacturing industries while living costs advanced only one half of one percent and wholesale prices of all commodities actually declined. This decline was confined largely to farm products and food. Industrial wholesale prices showed little change over the period.

Most striking is the record of the years since the middle of 1951. During this interval of almost five years, wage rates in manufacturing industries rose 23 percent while living costs increased less than 4 percent and wholesale prices declined slightly. Again, food and farm prices dropped, whereas wholesale prices of industrial commodities rose a bit over 4 percent in the 58 months from June 1951 to April 1956. The increase occurred after the middle of 1955.

The rise in the last five years in the consumer price index took place largely in the second half of 1951 and in 1952 as a result of the spill-over of the inflationary impact of the Korean War. Consumer prices are today at practically the same level as they were four years ago. The rise in non-agricultural wholesale prices in the past nine months is difficult to justify. In the middle of 1955, prices of industrial goods were actually lower than at the beginning of 1951. Profits

were already near an all-time peak in mid-1955 when the price advances were put into effect.

This picture covering the past decade, especially most of the last five years and the two and one-half years from the beginning of 1948 to mid-1950, clearly demonstrate that wages can be raised progressively without inflation. Not only have these wage increases during these years been associated with over-all price stabilization, but the fact is that in essence they have made our economic growth possible. There is no better way to generate the increase in consumer purchasing power needed to buy the products of our expanded economy than to raise real wages and salaries of workers.

The general pattern described above has not been characteristic of each and every industry nor of each and every employer. In many areas where prices are not truly free, such as the steel industry, but are subject to some degree of control—control by monopolistic firms—wage increases have been passed on in the form of higher prices, with consequent booming profits. Some evidence of variation in pricing practices will be analyzed below. The data show that the absorption of wage increases over the past five years in most industries has not resulted in a "profitless prosperity." On the contrary, total profits have remained high and we seem to have experienced a general demonstration, with some exceptions, of the thesis that American business firms are interested in large volume at moderate margins. It is unfortunate that not all industries have revealed their belief in the practice of making more profits by producing and selling more and more goods with smaller margins rather than pushing prices and profit margins higher and higher, ignoring the general well-being of the over-all economy.

Some corporations try to justify their price gouging on the grounds that they need more profits to finance expansion. This aspect will be discussed later. Other companies frankly say that they seek to make all the profits they possibly can so that when depressions come they will be better able to weather the storm. This is truly a cynical and dangerous view because such behavior, if widespread, will induce depressions. We need wage and price policies based on confidence in America's future and on a sense of responsibility for the welfare of the entire nation. There are still too many employers who deviate from such policies.

5—Productivity

There are three factors which directly influence the ability of the economy to increase output. One is the growth in the size of the labor force. Second is the degree to which the labor force is employed, i.e., the number at work and length of the work week. Third is the quantity of production per man-hour of input.

If we maintain high levels of employment, then our expanding labor force and rising productivity make it entirely feasible to raise the level of production from the current annual rate of approximately \$400 billion to nearly \$500 billion in 1960 and to \$600 billion by 1965. We can double our output in less than 20 years if we maintain relatively full employment and continue to enjoy the increases of productivity which have occurred in the past few years. Of course, while these levels of output can be reached, they will be reached only if the market demand expands along with our capacity to produce.

The rise in the size of the labor force is a function of our growing population. Despite the fact that larger numbers of our younger people remain in school for more years so as to secure the benefits of advanced education, there is a substantial increase in the working population year by year. Even if productivity were to remain unchanged, our national output would increase because of this expanding labor force. Actually, however, increasing productivity has contributed more to our rising production than has the growth in the labor force. Productivity gives promise of playing an even more important role in the future.

Productivity is difficult to measure, especially for many sectors of the economy. However, the figures that are available indicate that improved skills, increased mechanization and greater efficiency have tended to accelerate the rise in productivity. With the coming of automation, even faster rates of rising productivity are in prospect. A few months ago the Joint Committee on the Economic Report held hearings on automation and startling evidence was revealed of the shrinking labor input per unit of output which will result from automation.

Rising productivity, even at a more rapid rate through automation, can and should prove to be a blessing. Price and wage policies will largely determine whether automation will be associated with sustained full employment, an accelerated rise in living standards, more leisure and less

physical exertion, or whether it will bring only bulging profits and widespread unemployment. If employers will share the benefits of automation in adequate degree with workers and consumers there is every reason to expect that this phenomenon can and will give us a rate of increasing abundance unparalleled in the past. It is in the self-interest of employers to share these benefits if they are to enjoy continued profitability.

The following tabulation indicates that in the years between 1952 and 1955, real total output per man-hour rose more than 3 percent per year.

REAL PRIVATE PRODUCT PER MAN-HOUR

Year	In 1947 dollars	Year-to-year change	Index
1952.....	\$2.28	—	100.0
1953.....	2.38	+4.4%	104.4
1954.....	2.43	+2.1%	106.6
1955.....	2.51	+3.3%	110.1

Source: Based on data in Table 1, Joint Economic Report, Joint Committee on the Economic Report, March 14, 1956, p. 86.

The following indexes of production, man-hours and output per man-hour for all manufacturing industries for the years 1947-53 were submitted by the United States Department of Labor to the Joint Committee on the Economic Report in the Automation Hearings. In the six years between 1947 and 1953, output per man-hour in manufacturing increased 22 percent. Preliminary figures indicate a rise of 10 percent in productivity in manufacturing between 1953 and 1955. On the basis of these data, the rate of increase from 1947 to 1955 exceeded 4 percent per year.

INDEX OF PHYSICAL OUTPUT PER MAN-HOUR—ALL MFG.¹ (1947=100)

Year	Output per Man-hour	Production	Man-hours
1947.....	100.0	100.0	100.0
1949.....	108.6	96.8	89.1
1950.....	117.7	114.4	97.2
1951.....	117.5	121.0	103.0
1952.....	119.1	123.1	103.4
1953.....	122.7	132.2	108.6
1954.....	127.5 ²	n.a.	n.a.
1955.....	135.0 ²	n.a.	n.a.

¹ Current year weights.

² Preliminary estimates.
n.a. Not available.

The rise in productivity (35 percent) in manufacturing since 1947 has been greater than the increase in average hourly earnings, adjusted for changes in consumer prices (26.8 percent). This means that the buying power received by workers in manufacturing industries for each hour worked has increased less than the output per hour worked. It means that workers in factories have not shared fully in the benefits of rising industrial efficiency.

A review of available information indicates that the increase in output per man-hour for the economy as a whole has averaged about 3 percent per year since 1939 and that the rate has been slightly higher in the past decade. In manufacturing the annual rate of increase in the last few years has certainly exceeded 4 percent.

Unless the real wages of workers increase at least proportionate to the rise in productivity, the expansion of the economy will be stymied. This clearly means that wage rates must rise relative to prices. It means that employers generally not only can but must increase wages at least equal to the increase in productivity without increasing prices. If all industries follow the practice of some employers, such as the steel industry, in raising prices every time that wages are increased, not only would we have inflation, but, more seriously, we would have booms and busts and a cessation of expansion in the economy.

Over the years since 1947, real hourly earnings in manufacturing have lagged behind the rise in productivity. There was widening disparity until 1950; then the gap narrowed until 1953; and it has widened again in the past two years. Undoubtedly, the relationship between changing real wage rates and changing productivity has varied from industry to industry. In some sectors where productivity has risen slowly, workers probably have secured real wage increases which have exceeded rising productivity. On the other hand, there are many industries where real wages have unquestionably fallen far behind the improving output per man-hour.

Dollar wage rates have increased far more than real wage rates. Rising prices ate into the buying power of the pay envelope. It was during the 1946-48 and Korean periods of inflation when workers did not get higher real earnings. It was during the periods of price stability in 1948-50 and again after mid-1951 when real earnings moved up with productivity. Labor suffers during inflation and that is why labor fights against inflation. Labor seeks higher wages

which can be clearly justified in relation to profits and rising productivity and which can be granted without precipitating general price increases. Monopolistic conditions too often permit arbitrary control over prices, as in the steel industry, with the result that a fair share of the benefits of expanding productivity go neither adequately to workers in the form of higher wages nor to consumers in the form of lower prices, but rather serve to increase profits further.

The past and prospective growth in productivity lends great weight to the conclusions that wages can be increased without rising prices; that increasing wages in relation to productivity and reasonable profits are not inflationary; that wages can be raised without increasing labor costs per unit of output. These conclusions stand in support of the fundamental principle that wages and salaries must be increased without higher prices if we are to have a prosperous and expanding economy with a stable price level.

6—Wage-Price-Profit Relationships

As already demonstrated, the years since the end of World War II were characterized by two periods of inflation and two periods of relative price stability. Over the entire interval, the output of the economy expanded substantially. Despite two recessions, the country has enjoyed a degree of growth and relatively persistent prosperity probably unparalleled in any previous eleven-year span in the history of the United States. The changing economic relationships within the private economy undoubtedly contributed in considerable measure to this sustained growth. The study of these relationships should be revealing.

Wage rates increased steadily from \$1.02 per hour in all manufacturing industries in 1945 to \$1.88 in 1955. Part of this increase was dissipated through rising prices. In terms of goods and services which workers could buy with their income, hourly earnings in manufacturing dropped with the ending of overtime work in the immediate post-war period. Since 1947, real hourly earnings of factory workers have increased by one-fourth.

Weekly earnings have also been rising over the past few years. Because of the reduced work week, the pay envelope in manufacturing industries shrank considerably immediately after the War. It shrank in actual dollars, but dropped even more in buying power. In 1947, the weekly pay of the average factory worker commanded

15 percent less goods and services in the market than it did in 1944. After 1947, the change was favorable to employees. Average weekly earnings of production workers in all manufacturing industries increased from just under \$44 per week in 1946 to over \$78 early in 1956. Rising living costs took away part of this increase, especially during the war in Korea. It was not until 1953 that the average production worker in manufacturing industries received as much purchasing power in his pay envelope as he did in 1944. He can now buy about 10 percent more goods and services with his weekly pay than he could in 1944. Of course, the length of the work week is shorter. Since the post-war low of 1947, real weekly earnings in manufacturing industries have increased over 30 percent.

CHANGES IN REAL HOURLY AND WEEKLY EARNINGS IN MANUFACTURING INDUSTRIES SINCE WORLD WAR II

(1947-49 dollars)		
Period	Hourly earnings	Weekly earnings
1. The immediate post-war boom:		
1946	\$1.31	\$52.54
1948	1.31	52.67
Percent change	0	+0.26
2. Pre-Korean stability:		
1948	1.31	52.67
1950	1.43	57.71
Percent change	+9.2	+9.6
3. The Korean boom:		
1950	1.43	57.71
1951	1.43	58.30
Percent change	0	+1.0
4. Post-Korean stability:		
1951	1.43	58.30
1955	1.64	66.83
Percent change	+14.7	+14.6

It is significant to note that workers lost ground, in terms of purchasing power, during the immediate post war inflation and barely held their own during the Korean price spurt. On the other hand, immediately before Korea and most of the time since Korea—when there was considerable price stability—real hourly and weekly earnings moved upward with some momentum. Labor's

abhorrence of inflation appears to be well justified by the evidence at hand.

Since the end of World War II, corporate profits have varied somewhat from year to year, generally moving in relation to changes in total business activity. On the whole, however, they have increased measurably. The rise in profits after taxes has been less marked than the increase before taxes. This, of course, has been true for individuals as well as for corporations. Larger military expenditures have placed a heavy tax burden on all groups in the population.

Personal taxes have increased more than corporate taxes. However, the burden of personal taxation has not increased relative to personal income as much as corporate taxes in relation to corporate profits. Personal taxes absorbed 11 percent of total personal income both in 1947 and in 1955. Corporate tax liability was 38 percent of corporate profits in 1947 and approximately 50 percent in 1955.

Total corporate profits before taxes increased from \$6.4 billion in 1939 to \$22.6 billion in 1946 and then more than doubled to a record annual rate of over \$46 billion in the six months ending March 1956. Corporate profits after taxes increased nearly two and one-half fold from \$8.3 billion in 1945 to \$20.3 billion in 1948. Thereafter, the range of fluctuations was more moderate. In the six months ending March 1956, a new peak in the annual rate of corporate earnings after taxes of \$23 billion was reached. Corporate profits before taxes are now about seven times what they were in 1939; after taxes they are approximately four and one-half times the 1939 level. Total compensation of all employees is currently not quite five times what it was in 1939.

In the years after World War II, profits generally tended to rise rapidly during periods of price inflation. For example, between 1946 and 1948, corporate profits before taxes rose 45 percent. Corporate profits after taxes increased over 50 percent. During the same years, namely from 1946 to 1948, total compensation of corporate employees increased 30 percent. This distortion may well have been the most important single factor precipitating the recession of 1949. Profits dropped about 20 percent in 1949 while labor income remained unchanged from 1948. The maintenance of labor income helped to prevent the recession from deepening and lengthening.

Again, the Korean inflation favored profits over wages. From the first half of 1950 to the year 1951, corporate earnings before taxes increased

30 percent, whereas total compensation of all employees rose less than 25 percent.

Profits were far less volatile when prices were not booming. From early 1948 to early 1950, profits tended downward while the compensation of employees rose slightly. Between 1951 and the first half of 1955, labor income rose significantly relative to profits. In the first quarter of 1955, corporate profits before taxes were at about the same level as in 1951 while employees' compensation had increased more than one-sixth.

As industrial prices started to rise in the middle of 1955, profits moved ahead relatively more than wages. From the first quarter to the fourth quarter of 1955, profits before taxes increased nearly 15 percent whereas the compensation of employees increased only 7 percent, both computed after seasonal adjustment.

It is generally agreed that inflation is harmful to the economy and especially to fixed income recipients and should be prevented. From an analysis of the data since the end of World War II, periods of inflation have definitely worked in favor of profits as against labor income. Perhaps some businessmen and groups really favor inflation and have helped fan inflation by their pricing policies. They then follow the maxim that the best defense is the good offense and try to pin the blame on labor, which suffers from inflation and wants no part of it.

Corporate profits are now considerably higher in relationship to corporate payrolls than pre-war. These data again demonstrate that corporate profits increase relative to wages of corporation employees during periods of inflation and tend to decline or remain stable when there is no inflation. The trends within the past year are hardly conducive to sustained prosperity. Corporate profits, before taxes, amounted to 29 cents per dollar of compensation of corporate employees in 1953, slightly over 26 cents in 1954, and then rose to nearly 33 cents late in 1955 and early 1956.

Profits of manufacturing corporations tend to be even more volatile than the profits of all corporations. In 1955, profits before taxes for all manufacturing corporations were nearly seven times the level of 1939 and more than double those of 1946. The series shows a very sharp rise in manufacturing profits as prices increase and a leveling off when prices are stable. Data are not yet available for the first quarter of 1956, but the trend in 1955, especially the second half, was markedly upward, reflecting the increase in industrial prices. Profits before taxes of all manufac-

turing corporations increased 44 percent from the final quarter of 1954 to the final quarter of 1955. Over the same interval, profits per dollar of sales jumped one-fourth and the rate of profit on stockholders' equity increased by one-third. These are dangerous distortions which must be corrected promptly if a down-turn in business activity is to be avoided.

Taking the last five years as a whole, profits before taxes as a ratio to sales of all manufacturing corporations have been somewhat lower than they were in the immediate post-war years. From a post-war peak of 10.7 percent in 1950, there was a decline to 6.9 percent in 1954 and a rise to 8.5 percent in 1955 with an even higher figure indicated for the last quarter. In the years immediately following the war in Korea, a good many manufacturing corporations apparently were operating under the sound principle of earning sizeable profits through a rising volume of sales with lower margins. The application of this principle yielded very satisfactory profits in 1952 and 1953. The recession in 1954, attributable to reduced defense spending and other factors, brought temporarily lower profits. Since the second half of 1955, the policy of a rising volume of production and sales associated with lower profit margins has given way to some degree of opportunistic pricing. Persistence in this direction may well precipitate a recession.

Declining profit margins were associated with high profits in manufacturing industries over the past decade. In only one year since 1947, namely, the 1954 recession year, did the rate of profits after taxes fall below 10 percent of stockholders' equity. In only two years did the rate of profits before taxes on stockholders' equity fall below 20 percent. These are truly very high profit rates and it is clear that manufacturers can cut profit margins much more and still earn handsomely on their investment.

The relationship between prices, wages, and profits for all manufacturing corporations combined is particularly interesting. Between 1947 and 1955, hourly earnings in all manufacturing industries increased a little more than 50 percent and total wages in manufacturing increased 70 percent, whereas prices of industrial products (wholesale prices of all commodities, excluding farm products and food) rose about 23 percent. Profits before taxes based on the Department of Commerce estimates rose almost 50 percent and profits based on the FTC-SEC series increased over 60 percent. Over the period, the ratio of

profits to sales tended downward. From 1951 to 1955, hourly earnings in all manufacturing industries went up 13 percent whereas prices of industrial goods rose about 1 percent. Corporate profits after taxes in 1955 equalled or exceeded the all-time peak of 1951, but the profit margin on sales dropped measurably. If this general trend of rising wages, stable prices, declining profit margins, and sustained attractive profits were maintained, the economy would be far better off than when suffering the distortions which occur during times of boom and inflation and which bring about recessions and depressions.

The data and analyses reveal again and again that periods of rising prices serve to bring marked increases in profits, but operate to the detriment of employees. Periods of price stability bring increased purchasing power to workers and simultaneously permit employers to earn excellent profits. It may be exhilarating for executives of corporations to push up prices and enjoy short-lived big jumps in profits, but such periods are usually followed by sharp declines in profitability. Clearly, history shows the consequences do not justify this policy, but the pattern is often repeated. Perhaps business leaders will ultimately come to recognize the desirability of good profits year in and year out, rather than phenomenal boom-time earnings followed by sharply reduced profits during recessions which such policies tend to precipitate. Businessmen, in considerable measure, can exercise a choice between these two alternatives. Some businessmen have acted sensibly or have been forced to do so because of competition. It is to be hoped that for the best interests of the country as well as for their own benefit, the others will learn to refrain from unnecessary and unwarranted price increases.

An analysis of a few manufacturing industries indicates that the iron and steel industry followed highly arbitrary and inflationary pricing policies. Since 1947, steel prices have very closely paralleled steel wage increases. This has happened despite the very marked increase in productivity per man-hour in the steel industry. Steel prices have risen far, far more than labor costs per unit of output. The steel industry has repeatedly pushed its prices up far more than the rise in prices for materials used by the steel industry. In 1955, profits before taxes per dollar of sales in the steel industry were nearly 30 percent higher than in 1947-49. The evidence is abundantly clear that the leaders of the steel industry do not believe at all in the concept of increased volume and lower or even level

margins of profit. Instead, the industry has pushed prices upward without any concern for the public interest.

The contrast between the price policies of the steel industry and price policies of all manufacturing industries combined is rather startling. Whereas price increases of the steel industry resulted in parallel movements of steel wage rates and steel prices, the data for all manufacturing shows that from 1947 to 1955, average hourly earnings rose over 50 percent as compared with an increase in prices of manufactured products of less than one-fourth. From 1947 to the first half of 1955, the difference was even greater. This means that manufacturing industries as a whole did share some of the benefits of rising productivity with workers. But the steel industry refused to do so. Only because some of the steel price increases were absorbed along the line in fabricating industries and because other industries could not or did not engage in the same pricing practices as steel, there were periods of general price stability in the past decade and real wages of steel workers and other workers increased.

The difference between steel's pricing policies and that of other industries is revealed in the price data. Finished steel prices in the six months ending March 1956 were about 75 percent higher than in 1947. Wholesale prices of all commodities other than farm products and foods rose 26 percent over the same period. All the major steel-using industries show price increases less than in steel, in some instances substantially less. Heating equipment prices were 23 percent higher in 1955 than in 1947. For agricultural machinery and equipment, motor vehicles and electrical machinery, the price increases were between 30 and 40 percent. In construction machinery and equipment, they were nearly 60 percent. These compare with about 75 percent for steel. In some of these steel-using industries, there is a considerable degree of price control by corporations, and more restraint could have been exercised, but in no instance is the record comparable with that of the steel industry.

The steel industry cannot blame labor for high prices, although wage increases in the steel industry have been larger than in manufacturing industries as a whole. Steelworkers have fought to get a fair share of the industry's huge profits. The workers have been trying to "catch up," to establish a reasonable relationship with profits. The comparison with other industries shows that the

blame for the price inflation in steel rests squarely on the employers.

The steel industry has demonstrated its disbelief in the principle of higher volume and lower margins. It seeks ever higher profit margins, which its generally monopolistic nature has made possible. For all manufacturing industries combined, profit margins have tended downward, but not for steel. Despite a spurt in 1955, the ratio of profits before taxes to sales was still lower in 1955 than in 1947-49 for all manufacturing industries combined, but for steel it was up 30 percent.

It can be stated again and again that if there is any single industry that has followed inflationary pricing practices, that has shown a cold disdain for the economic welfare of the country, that has truly practiced inflation, that has the least right to hide behind the cloak of favoring a sound dollar and to contend that wage increases are inflationary, it is the steel industry.

7—Uniform Rounds and Patterns?

Business sources claim there have been annual "rounds" of wage increases in every single year since the end of World War II, implying every union has negotiated a higher wage or better fringe benefits for its membership in every year. Further, it is contended that one settlement sets the pattern for every succeeding negotiation. It is implied, if not always expressly stated, that increases in wages are uniform among different unions and different industries.

In all industries wages and salaries have been raised many times and sometimes by sizable amounts over the past decade. Different factors have been influential at different times. As already demonstrated, higher wages in the immediate post-war period were sought almost universally by labor in the struggle to keep pace with rising living costs. If there has been a tendency for "rounds" of wage increases to develop, employers can hardly criticize unions when the initial cause lay in the inflationary swing. Again, in the year following the outbreak of war in Korea, unions struggled to prevent rising prices and booming profits from squeezing the wage earner. In both of these periods of inflation, real wages did not rise. Workers had to push for wage increases to avoid a sharp drop in buying power and an even bigger increase in profits than did occur.

The wage increases which brought greater purchasing power to workers occurred in the two

and one-half years before Korea and again after the middle of 1951. The struggle to make up for the lag in the preceding periods carried on for some time. Then, the continued improvements in productivity justified further increases in wages. Labor's continuing efforts to share in the benefits derived from rising productivity have had a beneficial effect in the total economy. The resulting increase in buying power of consumers gave support to our expanded prosperity.

In every year since World War II, there were wage increases in varying numbers of industries, but there was no fixed pattern. Wage and fringe benefit improvements in key industries or in major corporations have been a guiding and prodding force for improvements in other industries. But these improvements have not been adopted bodily by one industry from another. There have been broad variations in amounts, timing and specific terms. There have been neither rigid wage and fringe benefit patterns, nor uniform economy-wide rounds of wage increases. In an economic system as varied as ours, such uniformity, except for decent minimum standards, are not possible.

A complete analysis of each union settlement or even of the wage changes in each specific industry can not readily be made. However, the analysis of only a few wage contracts in one or two years indicates that the variations among companies and industries have been substantial.

In 1951 and 1952, the employees in the men's clothing industry received no wage increases. In 1952, employees of the American Woolen Company received a 5 cents per hour increase under the escalator provisions of an earlier contract. In that same year, automobile workers received an advance of 4 cents per hour as an annual improvement factor and 4 cents under the escalator provisions. On the other hand, in 1952 coal mining workers negotiated an increase of \$1.90 per day or nearly 25 cents per hour and the Sinclair Oil contract provided for a 17 cents per hour increase for its employees. Variations similar to these can be found in practically every year.

An analysis of changes in average hourly earnings among major industrial groups does not fully reveal the degree of spread among wage settlements, because variations among industries within each group are obscured by group averages. Nonetheless, the figures are significant. Among durable goods industries, between 1947 and 1955, hourly earnings in the primary metal industry increased 85 cents as compared with 51 cents among furniture and fixture producers. In

the non-durable goods categories, there was a range from 86 cents per hour increase in petroleum and coal products to 35 cents in textile-mill products. In non-manufacturing industries, increases ranged from 92 cents in bituminous coal mining to 24 cents in laundries. On a percentage basis, the increases also show considerable variation from industry to industry. Among major manufacturing groups, hourly earnings between 1947 and 1955 increased from 62 percent in printing and publishing to 34 percent in textile-mill products.

A separate analysis of the periods from 1947 through 1951 and from 1951 to 1955 likewise shows considerable variations among major industry groups. Again, it should be emphasized that if the variations were presented for more detailed industrial classifications, the dispersion would be much greater. If the analysis covered each different contract, there would be an even more pronounced variation.

Generally, it is those same anti-labor sources who expound the false thesis that wage increases are the cause of inflation, who also misrepresent the facts concerning rounds and patterns of wage increases. Certainly, the last ten years have not only justified, but have necessitated higher wages, and it is to be expected that all workers in all industries would have shared in varying measure in the rising income, increasing productivity and expanding prosperity of the country. In view of the marked expansion of the economy in recent years, it is significant that the variations have been so great among different industries and companies.

8—Pricing Policies and Financing Expansion

Risk capital, according to most business spokesmen and economic textbooks, is the source of funds for business investment in the American economy. A business firm that seeks to expand its productive capacity floats new stock issues and sells them to investors. In that way, the company increases its funds for expansion and spreads its ownership.

This is a good theory, but it does not seem to be working in practice. New stock issues provide less and less of a source of money for additional investment. Actually, this source of funds has become relatively insignificant as compared with total investment outlays. In the decade from 1946 through 1955, all corporations in the United States, excluding banks and insurance companies, invested nearly \$200 billion in new

plants and equipment. It is startling to note that less than 10 percent of the funds needed for these purposes was raised by the sale of common and preferred stocks.

The major source of corporate funds for expansion is internal financing—retained profits after the distribution of dividends and depreciation allowances. There has been some borrowing from banks and insurance companies and very limited flotations of corporate bonds. The overwhelming portion of funds for corporate expansion has come from retained profits and depreciation charges.

During World War II and during and after Korea, industry was given the opportunity to accelerate depreciation charges on investments deemed essential for the national security. Further, the tax laws of the United States have been revised to allow all plant and equipment outlays to be depreciated at a more rapid than normal rate. This means more internal money for investment. The March, 1955 Newsletter of the National City Bank of New York stated:

“Depreciation charges are important because they constitute an increasing ‘internal’ source of funds for financing business. This is due to the fact that they are an expense item involving no cash outlay at the time but representing instead the recovery in piecemeal fashion of the original capital investment in plant and equipment.”

In the ten years from 1946 to 1955 depreciation allowances of United States corporations totaled nearly \$90 billion, thus providing nearly half of the money needed for all of the new plants and equipment built and installed. Normal depreciation charges would have been far less. The larger depreciation allowances might be looked upon as extra profits.

For a time after World War II, business spokesmen contended that actual profits were less than reported profits because depreciation charges, based on original cost rather than replacement cost, understated the cost of fixed assets being consumed in the process of production. As a result of the special accelerated depreciation allowed liberally for all investments related to defense, and the liberalization provided for in the new tax legislation, it is likely that profit figures at the present time understate, if anything, the true level of profits. Total depreciation charges now are probably too high, even on the basis of replacement cost, in relation to the life of depreciable assets. In any case, the old argument on

this point is not presented any more except as a last resort type of exhortation.

Undistributed profits of corporations have provided approximately as much funds for investment over the past decade as have depreciation allowances. Retained earnings have risen substantially in the past year. In 1955, undistributed profits were about 50 percent higher than the average for the years 1952 through 1954, even though dividends paid in 1955 were about 25 percent higher than in 1952.

Increasingly, business spokesmen have contended that prices must be increased so that higher profits can be earned in order that all investment outlays of existing corporations can be financed internally. The Wall Street Journal of March 23, 1956 reports:

"Ernest T. Weir, veteran steel maker urged industry to raise steel prices enough to get the money needed for expansion, and suggested steel company managements do so without waiting for price leadership from the U. S. Steel Corporation, the largest producer. . . . He said higher prices are necessary to obtain the money for construction of new steelmaking facilities the country needs."

An editorial in the March 8, 1955 issue of the Journal of Commerce declares:

"The ability of business to meet an increase in its aggregate capital requirements that may reach \$12 billion this year without recourse to external financing seems an anomaly . . . It demonstrates how far American industry has gone in securing sources of funds outside the bank and capital market . . ."

In essence, the leaders of the steel industry and of other industries are asking the American people to finance plant expansion through higher and higher prices. In effect, they propose that risk capital be supplied by consumers without any obligation whatsoever on the part of corporations and without the consumers getting any evidences of ownership or any benefit from their forced "investment." Instead of charging reasonable prices and making reasonable profits and giving the American investor an opportunity to participate in the growth of American industry, these so-called "venturesome" businessmen propose a sort of levy for investment on the consumer. The big trouble is that the consumer gets nothing for his "investment." Corporate executives, in essence, admit that they can fix prices at will, irrespective of market conditions, and they propose

to "fix" prices higher and higher. This is "the public be damned" view with a vengeance.

If American business is not going to float new securities to provide some portion of the funds needed for new and expanded facilities, how can the American investor participate in the growth of the American economy? Of course, he can buy stocks that now exist, but this is merely a matter of transferring shares from one investor to another and does not really make funds directly available for industrial expansion of existing corporations. What will happen to the money that investors are putting into mutual funds? These funds will have to buy existing securities from other investors. This is hardly the process for permitting or encouraging private investment in American expansion. Where is the virtue in saving? How will Americans use their savings to own shares in our expanding economy? Where is the "democracy of corporate ownership" so often espoused? If ever there was a proposal that strikes at the very heart of free enterprise and of democratic ownership of large corporations, this proposal to raise prices and further increase profits to finance expansion is it.

Also, from an economic point of view, the suggestion of the steel industry and other industries is totally unsound. Prices would be raised to a point where purchasing power would be inadequate to take the goods and services of American industry off the market. Where does industry expect to find a market for its growing output if it prices more and more customers out of the market? Further, what will the higher income individuals do with their savings? Mortgage financing cannot provide the entire outlet. Government deficit financing is hardly desirable in itself and if deficits can be avoided there will not be additional government bonds to absorb savings. In effect, this proposal is a sure way to stop the growth of the American economy and create depressions and mass unemployment.

Some of the spokesmen for higher prices and exclusive financing of expansion of existing corporations from internal sources have even suggested that security prices are not high enough to warrant new equity flotations. Such statements, made in the face of a doubling of stock market prices in the past three years, obviously do not warrant any serious hearing.

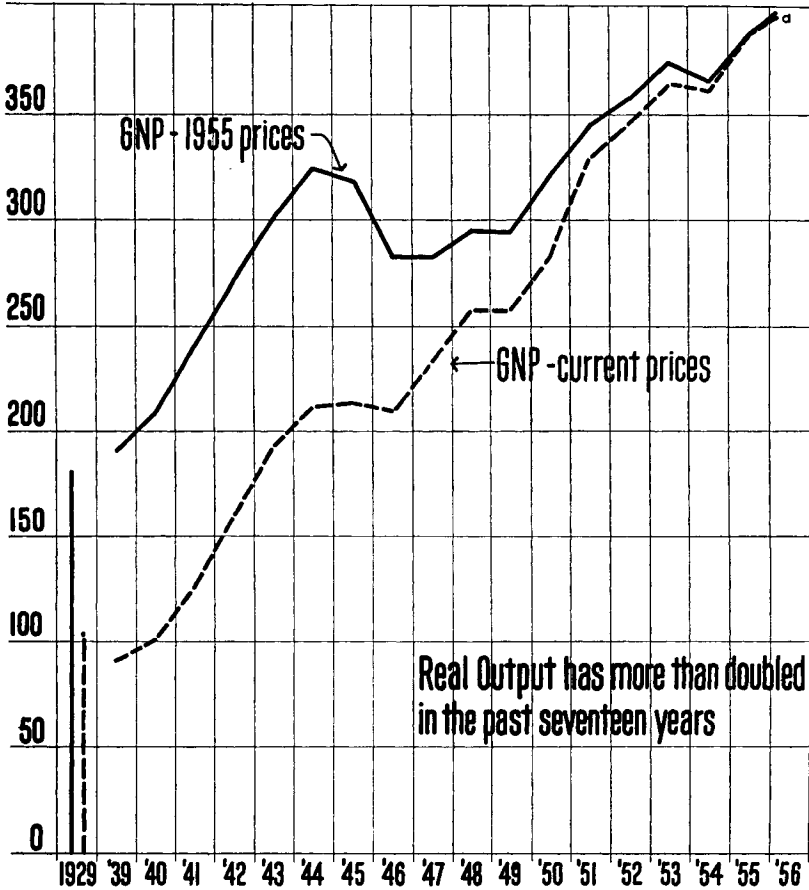
It is high time that the insatiable seeking for ever-higher profits by some of our business leaders give way to some concern for consumers and investors and for the general health of the American economy.

CHARTS AND TABLES

CHART 1

Total Gross National Product in Current & 1955 Prices

400 billions of dollars



% annual rate, seasonally adjusted, 6 mos. ending March 1956

SOURCE: United States Department of Commerce

TABLE 1
GROSS NATIONAL PRODUCT, TOTAL AND PER CAPITA
IN CURRENT AND 1955 PRICES, 1929-56

Year	Gross national product (\$ Billions)		Per capita	
	Current prices	1955 prices	Current prices	1955 prices
1929.....	104.4	181.9	857	1,493
1939.....	91.1	190.4	696	1,453
1940.....	100.6	207.7	761	1,572
1941.....	125.8	240.3	943	1,801
1942.....	159.1	271.1	1,179	2,010
1943.....	192.5	301.2	1,408	2,208
1944.....	211.4	324.1	1,527	2,342
1945.....	213.6	317.5	1,526	2,269
1946.....	209.2	283.1	1,480	2,002
1947.....	232.2	282.7	1,611	1,961
1948.....	257.3	295.8	1,755	2,017
1949.....	257.3	294.9	1,725	1,977
1950.....	285.1	321.8	1,880	2,122
1951.....	328.2	345.4	2,126	2,238
1952.....	345.2	357.5	2,198	2,277
1953.....	364.5	374.3	2,283	2,345
1954.....	360.5	365.4	2,220	2,250
1955.....	387.2	387.2	2,343	2,343
1956*.....	397.9	397.2	2,386	2,382

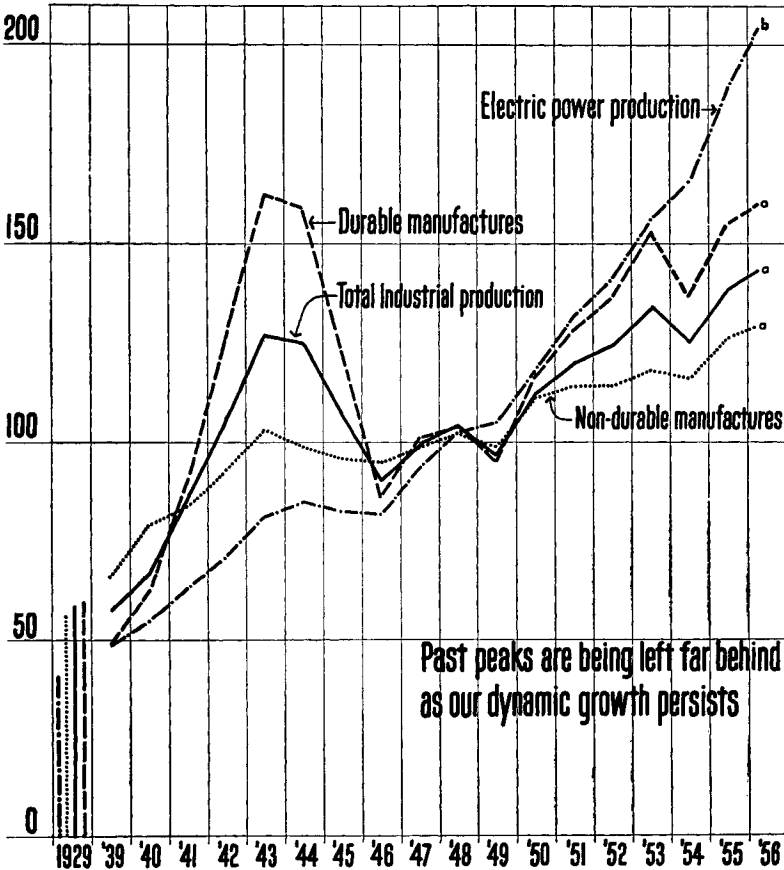
* Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Department of Commerce.

CHART 2

Evidence of America's Economic Growth 1929-56

Index 1947-49 = 100



^{a/} annual rate, seasonally adjusted, 6 mos. ending March 1956 ^{b/} Monthly average 6 mos. ending March 1956
 SOURCE: United States Department of Commerce ; Board of Governors, Federal Reserve System

TABLE 2
EVIDENCES OF AMERICA'S ECONOMIC GROWTH, 1929-56

Year	FRB Index (1947-49 = 100)			Index (1947-49 = 100)
	Total industrial production	Durable manufactures	Non-durable manufactures	Electric power production, (monthly avg.)
1929.....	59	60	56	41.0
1939.....	58	49	66	48.9
1940.....	67	63	69	54.6
1941.....	87	91	84	63.2
1942.....	106	126	93	70.7
1943.....	127	162	103	81.1
1944.....	125	159	99	84.8
1945.....	107	123	96	82.3
1946.....	90	86	95	81.8
1947.....	100	101	99	93.2
1948.....	104	104	102	102.1
1949.....	97	95	99	104.6
1950.....	112	116	111	117.9
1951.....	120	128	114	131.4
1952.....	124	136	114	140.4
1953.....	134	153	118	155.9
1954.....	125	137	116	165.2
1955.....	139	155	126	189.5
1956.....	143 ^a	160 ^a	129 ^a	204.0 ^b

^a Monthly average, six months ending March 1956, seasonally adjusted.

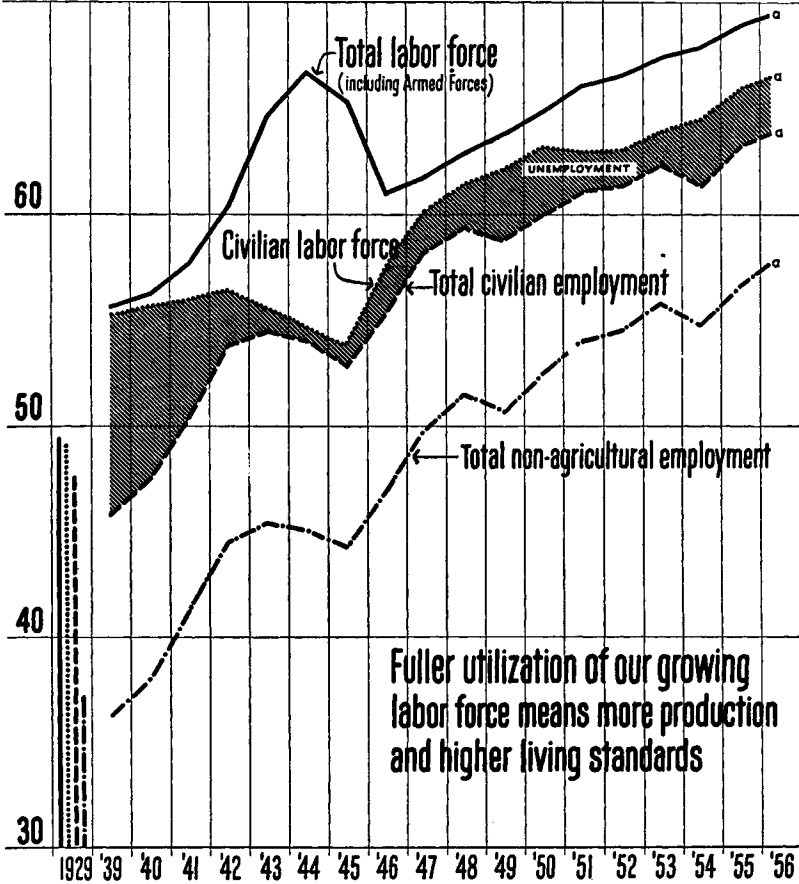
^b Monthly average, six months ending March 1956.

SOURCE.—United States Department of Commerce; Board of Governors, Federal Reserve System.

CHART 3

Labor Force and Employment 1929-1956

70 (millions of persons)



9/ annual rate, seasonally adjusted, 6 mos. ending March 1956

SOURCE: United States Departments of Labor and Commerce

TABLE 3
THE LABOR FORCE, 1929-56

(Thousands of persons)

Year	Total labor force (including armed forces)	Civilian labor force	Civilian employment		Non-agricultural employment as % of total employment	Unemployment:	
			Total	Non-agricultural employment		Number	% of civilian labor force
1929.....	49,440	49,180	47,630	37,180	78.1	1,550	3.2
1939.....	55,600	55,230	45,750	36,140	79.0	9,480	17.2
1940.....	56,180	55,640	47,520	37,980	80.0	8,120	14.6
1941.....	57,530	55,910	50,350	41,250	81.9	5,560	9.9
1942.....	60,380	56,410	53,750	44,500	82.8	2,660	4.7
1943.....	64,560	55,540	54,470	45,390	83.3	1,070	1.9
1944.....	66,040	54,630	53,960	45,010	83.3	670	1.2
1945.....	65,290	53,860	52,820	44,240	83.8	1,040	1.9
1946.....	60,970	57,520	55,250	46,930	85.0	2,270	3.9
1947.....	61,758	60,168	58,027	49,761	85.8	2,142	3.6
1948.....	62,898	61,442	59,378	51,405	86.6	2,064	3.4
1949.....	63,721	62,105	58,710	50,684	86.3	3,395	5.5
1950.....	64,749	63,099	59,957	52,450	87.5	3,142	5.0
1951.....	65,983	62,884	61,005	53,951	88.4	1,879	3.0
1952.....	66,560	62,966	61,293	54,488	88.9	1,673	2.7
1953.....	67,362	63,815	62,213	55,651	89.5	1,602	2.5
1954.....	67,818	64,468	61,238	54,734	89.4	3,230	5.0
1955.....	68,896	65,847	63,193	56,464	89.4	2,654	4.0
1956*.....	69,307	66,378	63,780	57,531	90.2	2,598	3.9

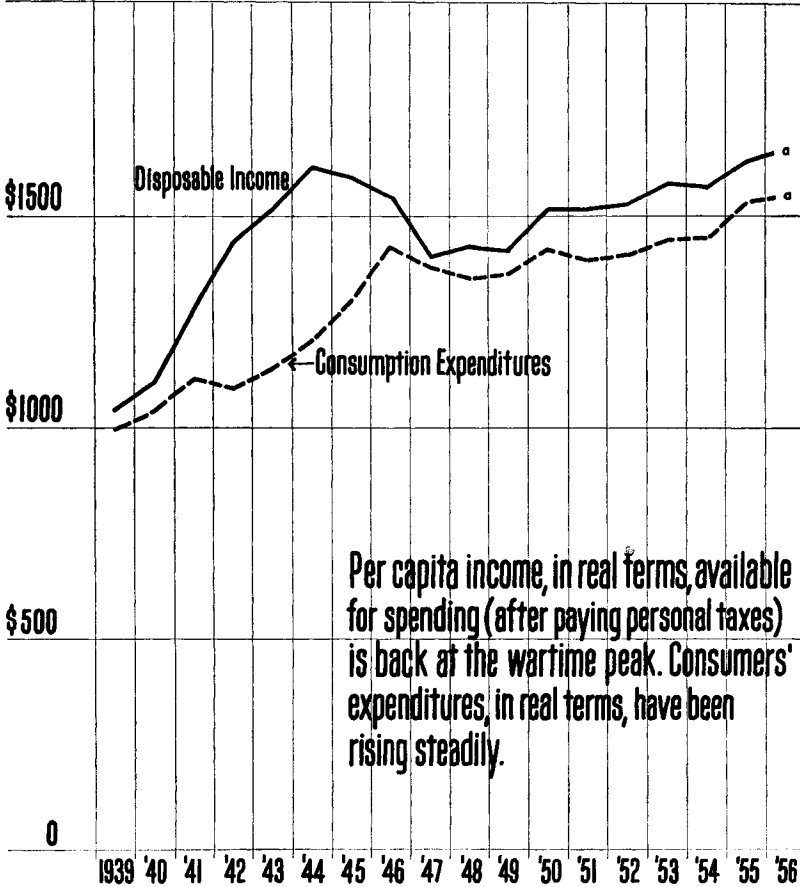
Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Departments of Labor and Commerce.

CHART 4

Per Capita Disposable Income & Consumption Expenditures

\$2000 (in 1955 prices, 1939-56)



Per capita income, in real terms, available for spending (after paying personal taxes) is back at the wartime peak. Consumers' expenditures, in real terms, have been rising steadily.

a/ annual rate, seasonally adjusted, 6 mos. ending March 1956

SOURCE: United States Department of Commerce

TABLE 4
TOTAL AND PER CAPITA DISPOSABLE INCOME AND PERSONAL CONSUMPTION
EXPENDITURES IN 1955 PRICES, 1939-56

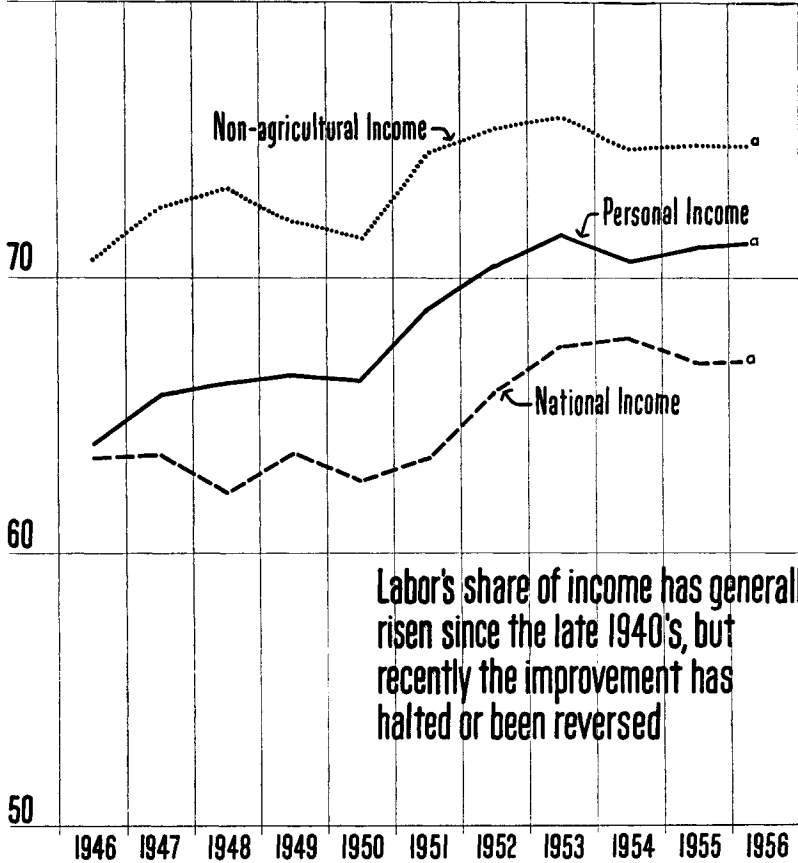
Year	Disposable personal income		Personal consumption expenditures	
	Total (\$ Billion)	Per capita (\$)	Total (\$ Billion)	Per capita (\$)
1939.....	135.6	1,037	130.3	994
1940.....	145.5	1,101	137.5	1,040
1941.....	169.4	1,270	149.2	1,118
1942.....	192.9	1,430	147.3	1,092
1943.....	206.7	1,512	155.6	1,138
1944.....	223.4	1,613	167.1	1,207
1945.....	223.8	1,600	181.1	1,295
1946.....	218.7	1,547	201.4	1,424
1947.....	202.6	1,406	197.8	1,373
1948.....	208.9	1,424	197.8	1,349
1949.....	211.7	1,418	203.1	1,361
1950.....	229.5	1,513	216.0	1,424
1951.....	233.3	1,512	215.0	1,393
1952.....	238.8	1,522	220.3	1,403
1953.....	250.7	1,570	230.8	1,446
1954.....	254.0	1,564	235.8	1,452
1955.....	269.3	1,629	252.4	1,527
1956*.....	276.0	1,655	257.5	1,543

* Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Department of Commerce.

CHART 5

Labor's Share of National Income, Personal Income, and Non-agricultural Income 1946-56



Labor's share of income has generally risen since the late 1940's, but recently the improvement has halted or been reversed

% annual rate, seasonally adjusted, 6 mos. ending March 1956

SOURCE: United States Department of Commerce

TABLE 5
LABOR'S SHARE OF NATIONAL INCOME, PERSONAL INCOME
AND NONAGRICULTURAL INCOME, 1946-56

Year	Billions of dollars				Labor income as percent of:		
	Total national income	Total personal income	Total nonagric. personal income ¹	Labor income ²	National income	Personal income	Nonagric. income
1946	179.6	178.0	161.1	113.8	63.4	63.9	70.6
1947	197.2	190.5	172.8	125.2	63.5	65.7	72.5
1948	221.6	208.7	188.5	137.9	62.2	66.1	73.2
1949	216.2	206.8	190.8	137.4	63.6	66.4	72.0
1950	240.0	227.1	210.5	150.3	62.6	66.2	71.4
1951	277.0	255.3	235.7	175.6	63.4	68.8	74.5
1952	289.5	271.1	253.1	190.5	65.8	70.3	75.3
1953	303.6	286.2	270.2	204.6	67.4	71.5	75.7
1954	299.7	287.6	271.9	202.8	67.7	70.5	74.6
1955	322.6	303.2	288.4	215.5	66.8	71.1	74.7
1956*	333.0	312.6	298.2	222.9	66.9	71.3	74.7

¹ Personal income exclusive of net income of unincorporated farm enterprises, farm wages, agricultural net interest, and net dividends paid by agricultural corporations.

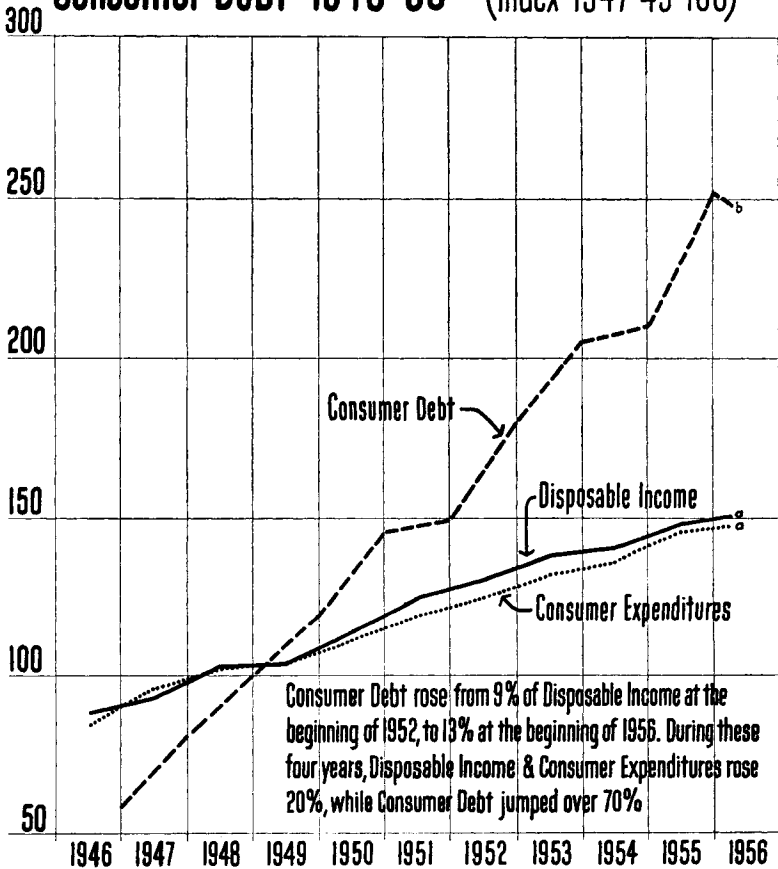
² Compensation of employees, excluding employer contributions for social insurance.

* Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Department of Commerce.

CHART 6

Disposable Income, Consumer Expenditures and Consumer Debt 1946-56 (Index 1947-49=100)



Consumer Debt rose from 9% of Disposable Income at the beginning of 1952, to 13% at the beginning of 1956. During these four years, Disposable Income & Consumer Expenditures rose 20%, while Consumer Debt jumped over 70%

a/ annual rate, seasonally adjusted, 6 mos. ending March 1956
b/ end of March 1956

SOURCE: United States Department of Commerce; Board of Governors, Federal Reserve System

TABLE 6
DISPOSABLE PERSONAL INCOME, CONSUMER EXPENDITURES
AND CONSUMER DEBT, 1946-56

Period	Billions of dollars			Indexes (1947-49 = 100)		
	Disposable income	Personal consumption expenditures	Consumer debt ¹	Disposable income	Personal consumption expenditures	Consumer debt ¹
1946.....	159.2	146.6	8.4	88	84	58
1947.....	169.0	165.0	11.6	93	95	81
1948.....	187.6	177.6	14.4	103	102	100
1949.....	188.2	180.6	17.1	104	104	119
1950.....	206.1	194.0	20.8	114	111	145
1951.....	226.1	208.3	21.4	125	119	149
1952.....	236.7	218.3	25.8	130	125	180
1953.....	250.4	230.6	29.5	138	132	205
1954.....	254.8	236.5	30.1	140	136	210
1955.....	269.3	252.3	36.2	148	145	252
1954: 1 Q.....	253.1	232.2	27.3	139	133	190
2 Q.....	253.9	235.1	28.7	140	135	200
3 Q.....	254.5	237.9	28.9	140	136	201
4 Q.....	257.8	241.0	30.1	142	138	210
1955: 1 Q.....	261.0	245.8	29.9	144	141	208
2 Q.....	267.1	250.5	32.5	147	144	226
3 Q.....	271.7	255.7	34.3	149	147	239
4 Q.....	276.0	257.2	36.2	152	147	252
1956.....	276.5 ^a	258.0 ^b	35.5 ^b	152 ^a	148 ^a	247 ^b

¹ End of period.

^a Annual rate, seasonally adjusted, six months ending March 1956.

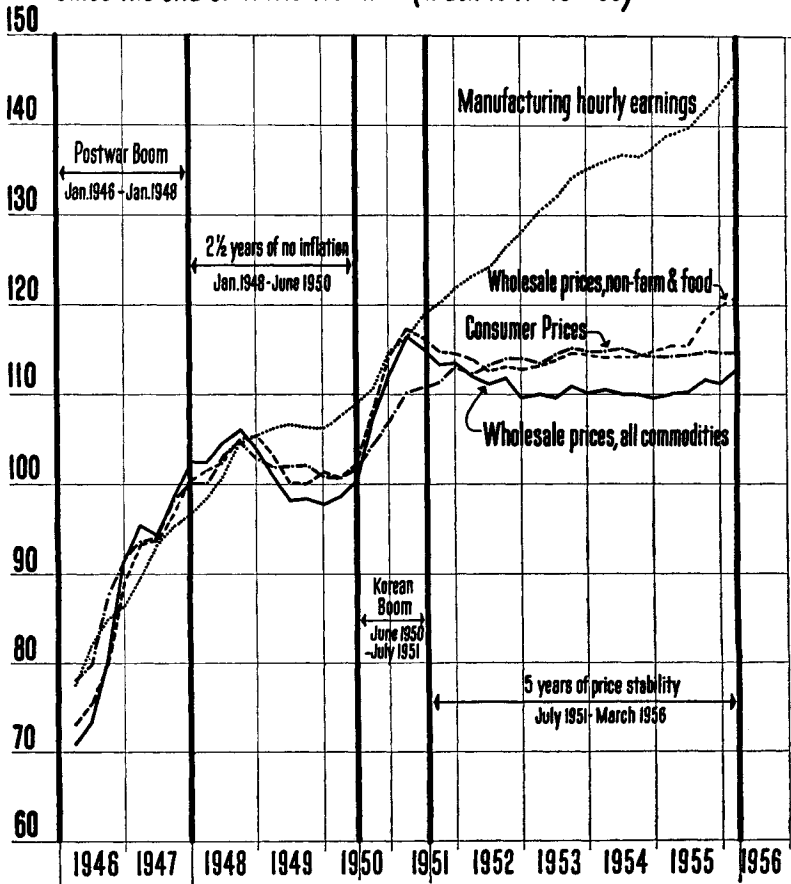
^b End of March 1956.

SOURCE.—United States Department of Commerce; Board of Governors, Federal Reserve System.

CHART 7

Major Wage and Price Movements

Since the end of World War II (Index 1947-49 = 100)



SOURCE: U.S. Department of Labor

TABLE 7

PRICES AND MANUFACTURING HOURLY EARNINGS, END OF EACH QUARTER, 1946-56
(1947-49 = 100)

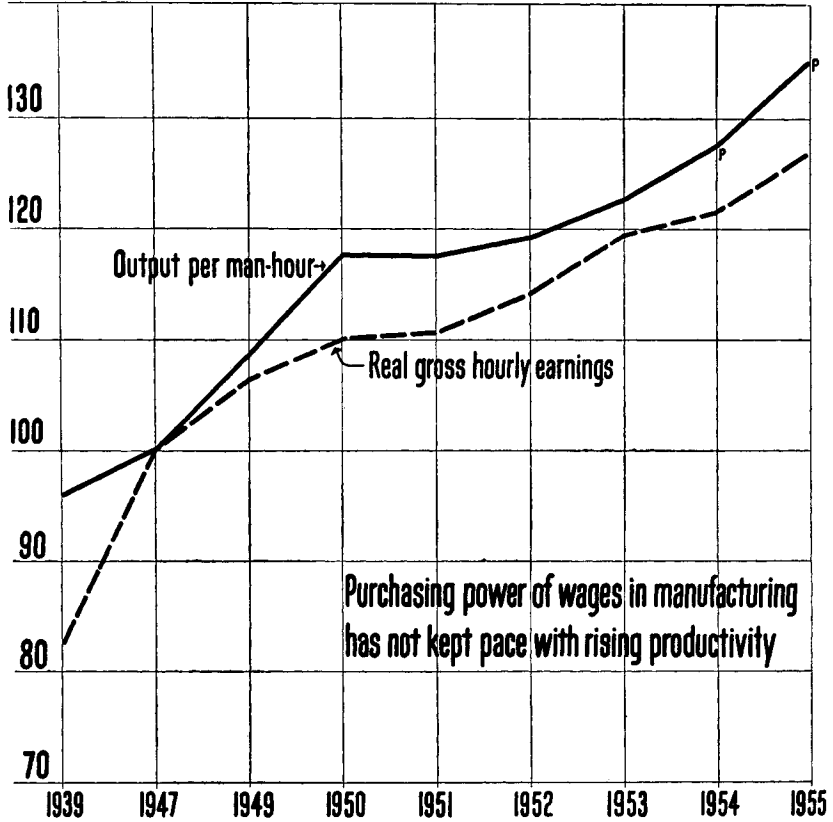
Period	Consumer price index	Wholesale price index		
		All commodities	Other than food & farm products	Index of straight-time hourly earnings in manufacturing
1946: Mar.....	78.0	70.8	73.1	77.6
June.....	79.8	73.3	75.5	81.8
Sept.....	87.4	80.6	80.2	85.1
Dec.....	91.9	91.6	89.2	86.6
1947: Mar.....	93.7	95.4	93.6	89.8
June.....	94.2	94.3	93.9	93.5
Sept.....	98.3	98.4	96.9	95.3
Dec.....	100.2	102.6	100.4	96.7
1948: Mar.....	100.2	102.5	101.6	98.5
June.....	103.1	104.6	102.5	100.9
Sept.....	104.8	106.1	105.1	104.7
Dec.....	103.0	104.0	105.4	105.4
1949: Mar.....	101.9	100.9	103.3	106.2
June.....	102.0	98.2	100.1	106.6
Sept.....	102.1	98.3	100.0	106.3
Dec.....	101.0	97.7	101.3	106.2
1950: Mar.....	100.7	98.5	100.7	107.5
June.....	101.8	100.2	102.2	109.0
Sept.....	104.4	107.1	108.2	110.6
Dec.....	106.9	112.1	114.1	114.8
1951: Mar.....	110.3	116.5	117.3	116.5
June.....	110.8	115.1	116.2	118.8
Sept.....	111.6	113.4	114.8	120.3
Dec.....	113.1	113.5	114.6	121.9
1952: Mar.....	112.4	112.3	113.8	123.4
June.....	113.4	111.2	112.6	124.2
Sept.....	114.1	111.8	113.2	126.6
Dec.....	114.1	109.6	112.9	128.1
1953: Mar.....	113.6	110.0	113.4	130.4
June.....	114.5	109.5	113.9	132.0
Sept.....	115.2	111.0	114.7	134.3
Dec.....	114.9	110.1	114.6	135.1
1954: Mar.....	114.8	110.5	114.2	135.9
June.....	115.1	110.0	114.2	136.6
Sept.....	114.7	110.0	114.4	136.6
Dec.....	114.3	109.5	114.9	137.4
1955: Mar.....	114.3	110.0	115.6	139.0
June.....	114.4	110.3	115.6	139.8
Sept.....	114.9	111.7	118.5	142.1
Dec.....	114.7	111.3	119.8	143.6
1956: Mar.....	114.7	112.8	121.0	146.0

SOURCE.—United States Department of Labor.

CHART 8

Productivity & Real Hourly Earnings in Manufacturing 1947-1955

140 Index (1947 = 100)



^P/ preliminary

SOURCE: United States Department of Labor

TABLE 8
PHYSICAL OUTPUT PER MAN-HOUR AND REAL GROSS HOURLY EARNINGS
IN MANUFACTURING, 1939-55
 (1947=100)

Year	Output per man-hour	Real gross hourly earnings
1939.....	96.0	82.3
1947.....	100.0	100.0
1949.....	108.6	106.3
1950.....	117.7	110.0
1951.....	117.5	110.6
1952.....	119.1	114.0
1953.....	122.7	119.4
1954.....	127.5 ^p	121.4
1955.....	135.0 ^p	126.8

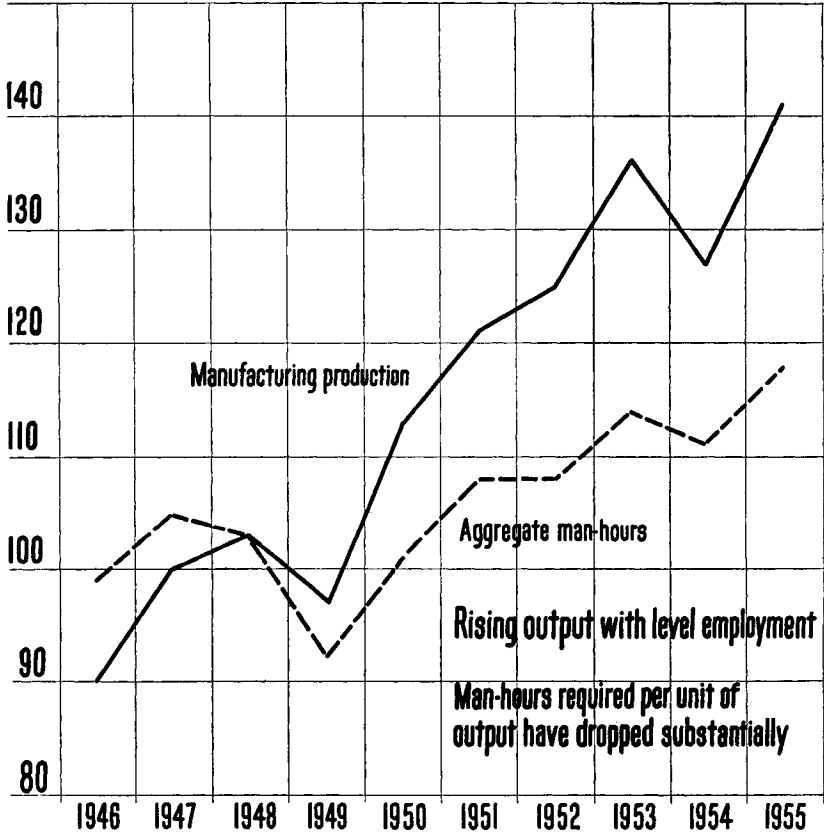
^p Preliminary.

SOURCE.—United States Department of Labor.

CHART 9

Indexes of Production and Total Man-hours Worked in Manufacturing Industries 1946-55

150 Index (1947-49=100)



SOURCE: Board of Governors, Federal Reserve System; U.S. Department of Labor

TABLE 9
INDEXES OF PRODUCTION AND TOTAL MAN-HOURS WORKED
IN MANUFACTURING INDUSTRIES, 1946-55

(1947-49=100)

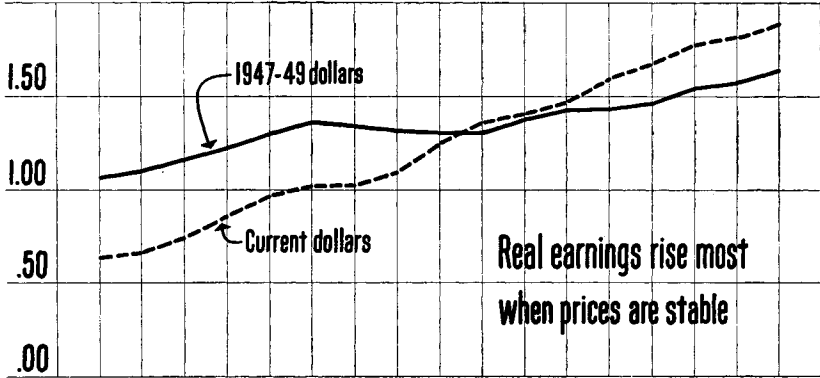
Year	Manufacturing production	Aggregate man-hours
1946	90	99
1947	100	105
1948	103	103
1949	97	92
1950	113	101
1951	121	108
1952	125	108
1953	136	114
1954	127	101
1955	141	108

SOURCE.—Board of Governors, Federal Reserve System; United States Department of Labor.

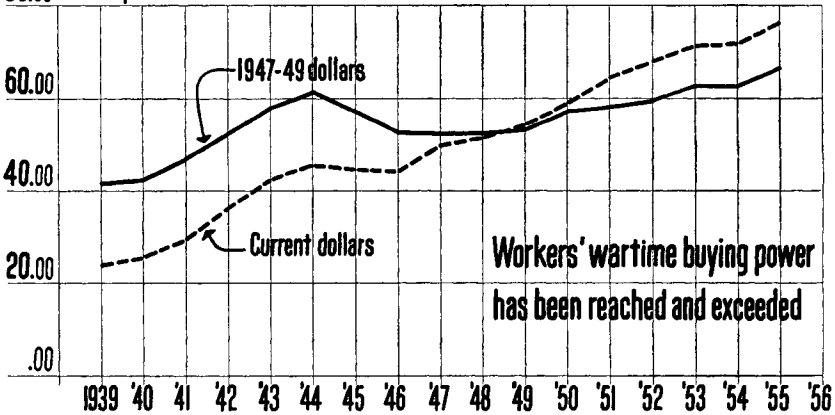
CHART 10

Average Gross Hourly and Weekly Earnings in Manufacturing in Current and 1947-49 dollars

\$2.00 dollars per hour



\$80.00 dollars per week



SOURCE: United States Department of Labor

TABLE 10
 AVERAGE GROSS HOURLY AND WEEKLY EARNINGS IN MANUFACTURING,
 IN CURRENT AND 1947-49 DOLLARS, 1939-55

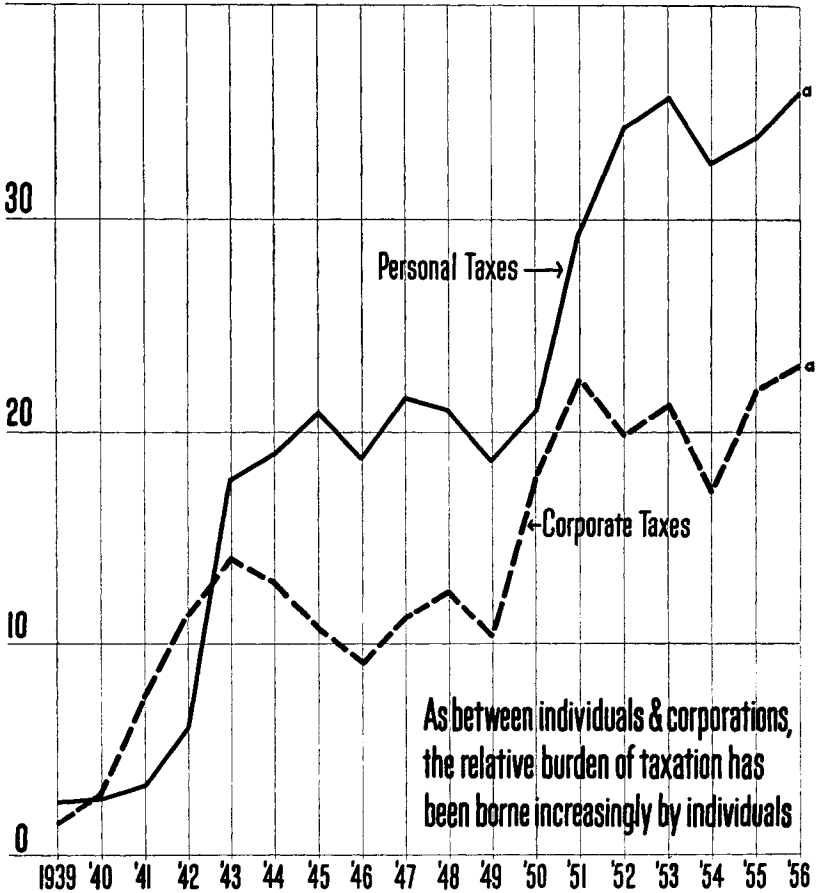
Year	Current dollars		1947-49 dollars	
	Avg. gross hourly earnings	Avg. gross weekly earnings	Avg. gross hourly earnings	Avg. gross weekly earnings
1939.....	0.63	23.86	1.06	40.17
1940.....	0.66	25.20	1.10	42.07
1941.....	0.73	29.58	1.16	47.03
1942.....	0.85	36.65	1.22	52.58
1943.....	0.96	43.14	1.30	58.30
1944.....	1.02	46.08	1.36	61.28
1945.....	1.02	44.39	1.33	57.72
1946.....	1.09	43.82	1.31	52.54
1947.....	1.24	49.97	1.30	52.32
1948.....	1.35	54.14	1.31	52.67
1949.....	1.40	54.92	1.38	53.95
1950.....	1.47	59.33	1.43	57.71
1951.....	1.59	64.71	1.43	58.30
1952.....	1.67	67.97	1.47	59.89
1953.....	1.77	71.69	1.55	62.67
1954.....	1.81	71.86	1.58	62.60
1955.....	1.88	76.52	1.64	66.83

SOURCE.—United States Department of Labor.

CHART 11

Personal Taxes and Corporate Taxes 1939-56

40 billions of dollars



^a/ annual rate, seasonally adjusted, 6 mos. ending March 1956

SOURCE: U.S. Department of Commerce

TABLE 11

PERSONAL TAXES AND CORPORATE TAXES, 1939-56

Year	Billions of dollars	
	Personal taxes	Corporate taxes
1939.....	2.4	1.4
1940.....	2.6	2.8
1941.....	3.3	7.6
1942.....	6.0	11.4
1943.....	17.8	14.1
1944.....	18.9	12.9
1945.....	20.9	10.7
1946.....	18.8	9.1
1947.....	21.5	11.3
1948.....	21.1	12.5
1949.....	18.7	10.4
1950.....	20.9	17.8
1951.....	29.3	22.5
1952.....	34.4	19.8
1953.....	35.8	21.3
1954.....	32.8	17.1
1955.....	33.9	22.0
1956*.....	36.0	23.1

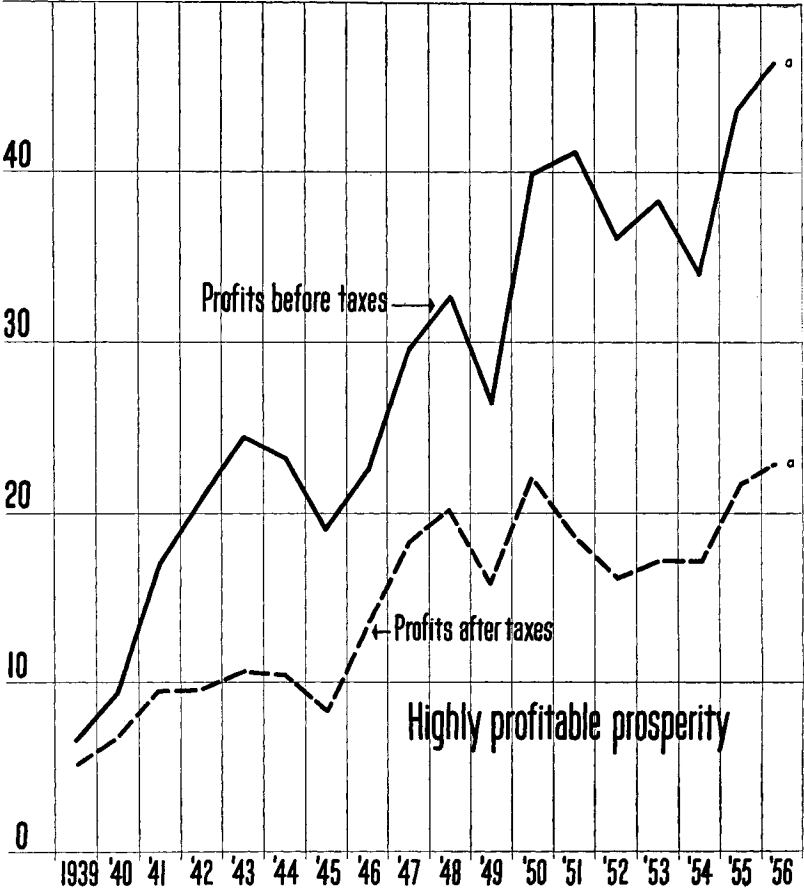
* Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Department of Commerce.

CHART 12

Profits for all Corporations 1939-56

50 billions of dollars



% annual rate, seasonally adjusted, 6 mos. ending March 1956

SOURCE: United States Department of Commerce

TABLE 12
 PROFITS FOR ALL CORPORATIONS, 1939-56
 (Billions of dollars)

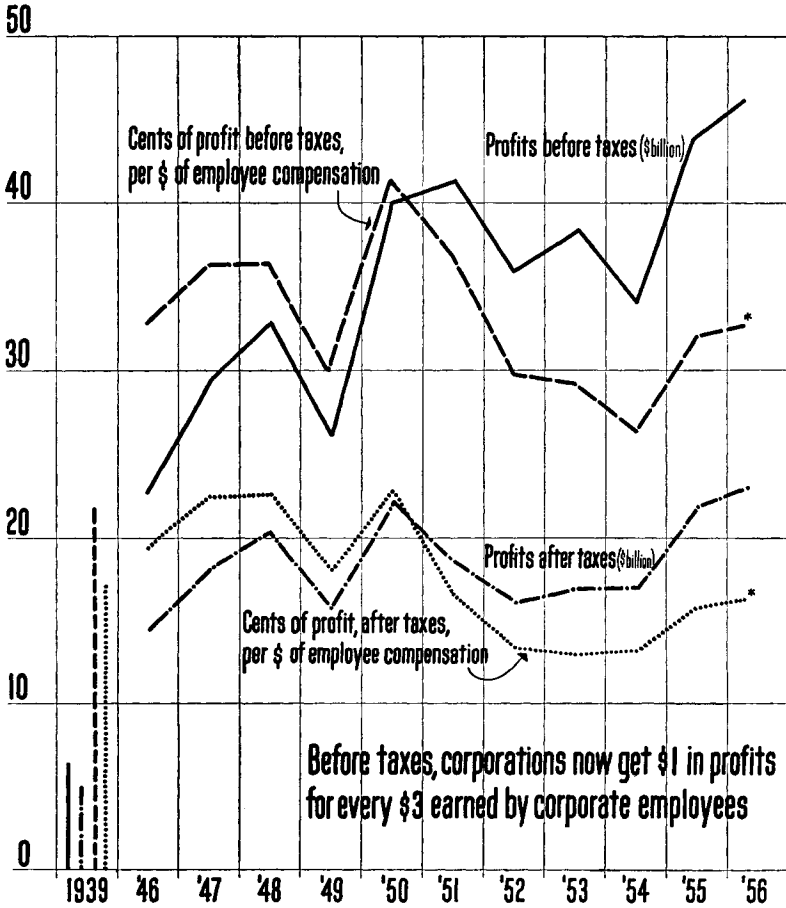
Year	Profits before taxes	Profits after taxes	Profits before taxes, after inventory valuation adjustment
1939.....	6.4	5.0	5.7
1940.....	9.3	6.5	9.1
1941.....	17.0	9.4	14.5
1942.....	20.9	9.5	19.7
1943.....	24.6	10.5	23.8
1944.....	23.3	10.4	23.0
1945.....	19.0	8.3	18.4
1946.....	22.6	13.4	17.3
1947.....	29.5	18.2	23.6
1948.....	32.8	20.3	30.6
1949.....	26.2	15.8	28.1
1950.....	40.0	22.1	35.1
1951.....	41.2	18.7	39.9
1952.....	35.9	16.1	36.9
1953.....	38.3	17.0	37.2
1954.....	34.0	17.0	33.8
1955.....	43.8	21.8	41.8
1956*.....	46.2	23.0	42.8

* Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Department of Commerce.

CHART 13

Corporate Profits & Corporate Payrolls 1939-56



* Estimated

∅ annual rate, seasonally adjusted, 6 mos. ending March 1956

SOURCE: United States Department of Commerce

TABLE 13
CORPORATE PROFITS AND CORPORATE PAYROLLS, 1939-56

Year	Profits		Compensation of employees (\$ Billion)	Cents of corporate profit per dollar of employee compensation	
	Before taxes (\$ Billion)	After taxes		Before taxes	After taxes
1939.....	6.4	5.0	29.3	21.8	17.1
1940.....	9.3	6.5	32.3	28.8	20.1
1941.....	17.0	9.4	41.1	41.4	22.9
1942.....	20.9	9.5	52.3	40.0	18.2
1943.....	24.6	10.5	63.6	38.7	16.5
1944.....	23.3	10.4	66.5	35.0	15.6
1945.....	19.0	8.3	63.5	29.9	13.1
1946.....	22.6	13.4	69.0	32.8	19.4
1947.....	29.5	18.2	81.2	36.3	22.4
1948.....	32.8	20.3	90.0	36.4	22.6
1949.....	26.2	15.8	87.4	30.0	18.1
1950.....	40.0	22.1	96.9	41.3	22.8
1951.....	41.2	18.7	111.9	36.8	16.7
1952.....	35.9	16.1	120.5	29.8	13.4
1953.....	38.3	17.0	131.0	29.2	13.0
1954.....	34.0	17.0	128.8	26.4	13.2
1955.....	43.8	21.8	137.0*	32.0	15.9
1956*.....	46.2	23.0	141.7*	32.6*	16.2*

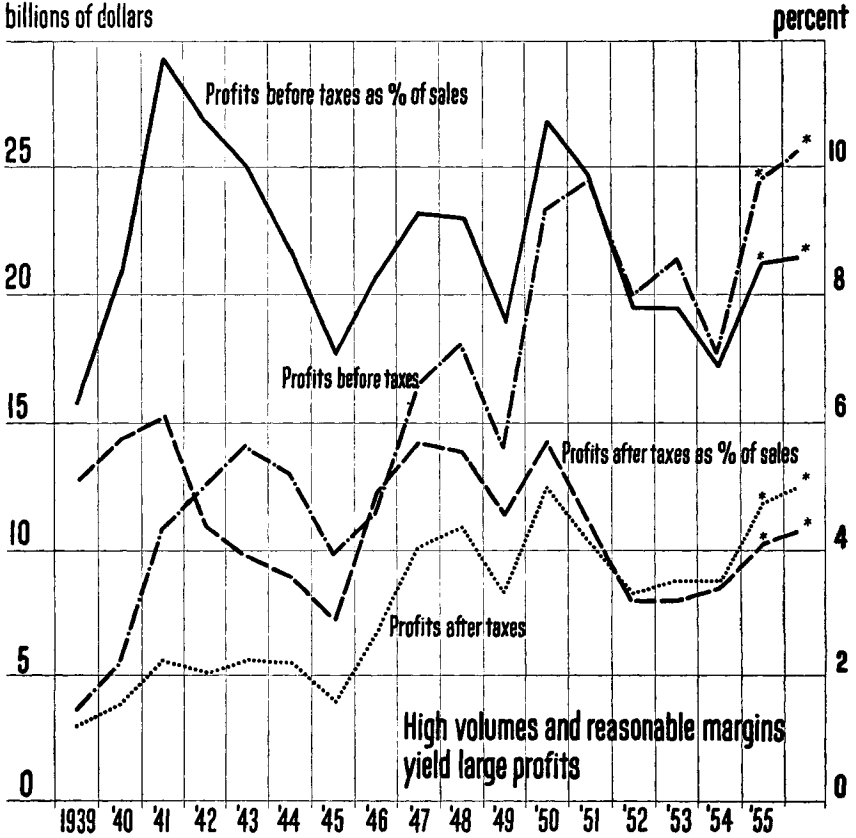
* Estimated.

* Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Department of Commerce.

CHART 14

Corporate Profits & Ratio of Profits to Sales, All Manufacturing Industries 1939-56



* Estimated

% annual rate, 6 mos. ending March 1956

SOURCE: United States Department of Commerce

TABLE 14
CORPORATE PROFITS AND RATIO OF PROFITS TO SALES,
ALL CORPORATE MANUFACTURING INDUSTRIES, 1939-56

Year	Profits before taxes (\$ Billion)	Profits after taxes (\$ Billion)	Ratio to sales (%)	
			Before taxes	After taxes
1939.....	3.6	2.9	6.3	5.1
1940.....	5.5	3.8	8.4	5.8
1941.....	10.8	5.6	11.7	6.1
1942.....	12.4	5.1	10.7	4.4
1943.....	14.2	5.6	10.0	3.9
1944.....	13.2	5.5	8.7	3.6
1945.....	9.9	4.0	7.1	2.9
1946.....	11.4	6.7	8.3	4.9
1947.....	16.5	10.1	9.3	5.7
1948.....	18.1	11.0	9.2	5.6
1949.....	14.1	8.4	7.6	4.6
1950.....	23.3	12.4	10.7	5.7
1951.....	24.5	10.3	9.8	4.1
1952.....	20.0	8.3	7.8	3.2
1953.....	21.4	8.8	7.8	3.2
1954.....	17.8	8.8	6.9	3.4
1955.....	24.4*	11.9*	8.5*	4.1*
1956*.....	25.7*	12.6*	8.6*	4.3*

* Estimated.

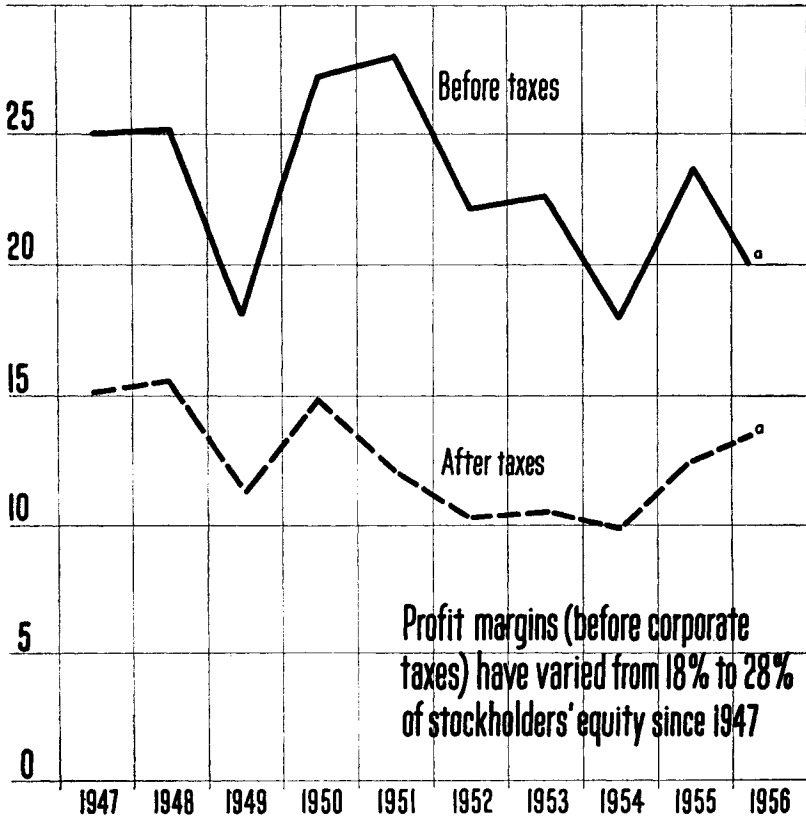
* Annual rate, seasonally adjusted, six months ending March 1956.

SOURCE.—United States Department of Commerce.

CHART 15

Annual Rates of Profit on Stockholders' Equity, All Manufacturing Corporations, 1947-56

30%



% annual rate, 6 mos. ending March 1956

SOURCE: Federal Trade Commission - Securities & Exchange Commission

TABLE 15

**ANNUAL RATES OF PROFITS ON STOCKHOLDERS' EQUITY,
ALL MANUFACTURING CORPORATIONS, 1947-56**

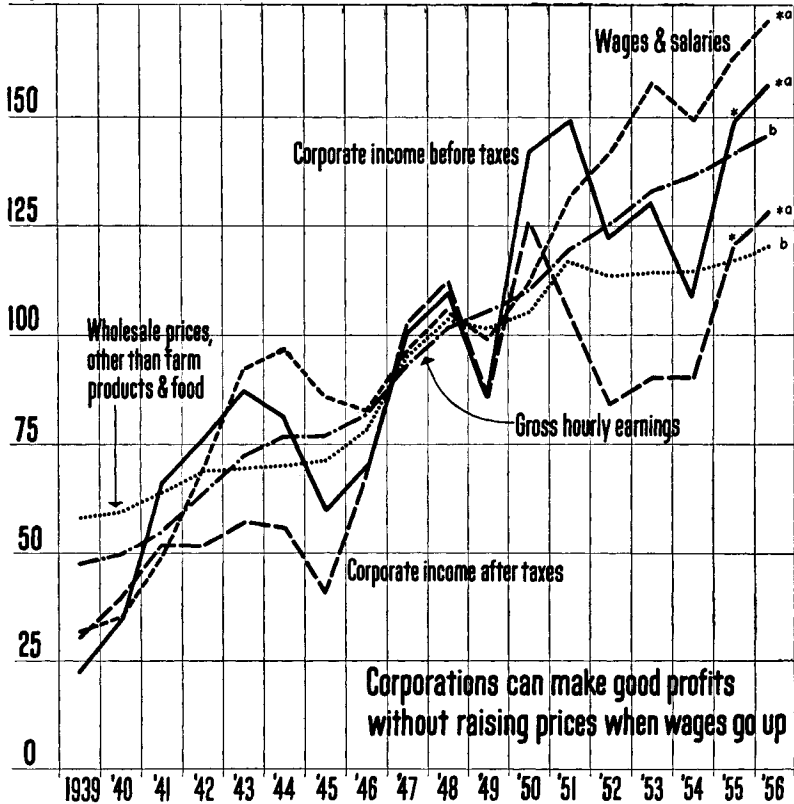
Year	Before taxes (%)	After taxes (%)
1947.....	25.0	15.1
1948.....	25.1	15.6
1949.....	18.1	11.3
1950.....	27.2	14.9
1951.....	28.0	12.1
1952.....	22.1	10.3
1953.....	22.6	10.5
1954.....	18.0	9.9
1955.....	23.8	12.6
1956*.....	25.0	13.5

Annual rate, six months ending March 1956.

SOURCE.—Federal Trade Commission—Securities & Exchange Commission.

CHART 16 Trends of Prices, Profits & Hourly Earnings In Manufacturing Industries 1939-56

175 Index (1947-49=100)



**Corporations can make good profits
without raising prices when wages go up**

* Estimated

^a/ annual rate, seasonally adjusted, 6 mos. ending March 1956 ^b/ average, 6 mos. ending March 1956

SOURCE: United States Departments of Labor and Commerce

TABLE 16
TRENDS OF PRICES, PROFITS AND HOURLY EARNINGS
IN MANUFACTURING INDUSTRIES, 1939-56

(1947-49=100)

Year	Wholesale prices, other than farm products and food	Index of manufacturing corporate income		Index of average gross hourly earnings, manufacturing industries	Index of manufacturing wages and salaries
		Before taxes	After taxes		
1939	58.1	22	30	47.6	30.7
1940	59.4	34	39	49.7	35.2
1941	63.7	66	52	54.9	49.0
1942	68.3	76	52	64.2	69.8
1943	69.3	87	57	72.3	92.3
1944	70.4	81	56	76.7	96.9
1945	71.3	60	41	77.0	86.3
1946	78.3	70	68	81.7	82.4
1947	95.3	101	103	93.1	96.0
1948	103.4	110	112	101.6	104.9
1949	101.3	86	86	105.4	99.1
1950	105.0	142	126	110.2	111.6
1951	115.9	149	105	119.6	131.5
1952	113.2	122	84	125.7	142.1
1953	114.0	130	90	133.2	157.7
1954	114.5	109	90	136.2	149.2
1955	117.0	149*	121*	141.5	162.9
1956	120.0*	157*	128*	145.3	171.5*

* Average, six months ending March 1956.

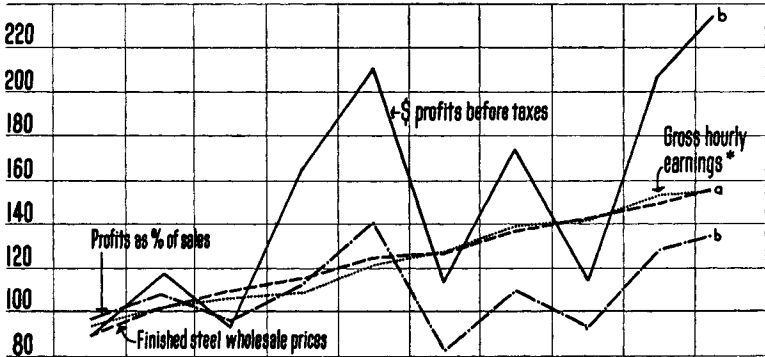
* Estimated.

SOURCE.—United States Department of Labor; United States Department of Commerce.

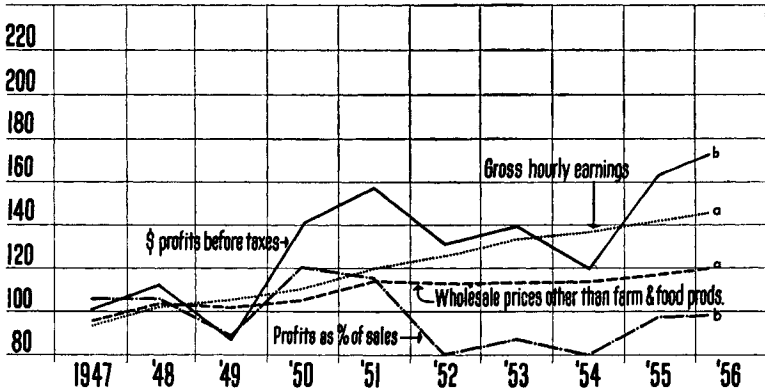
CHART 17

Prices, Wages & Profits, Steel Industry and all Manufacturing Corporations 1947-56 (1947-49=100)

PRIMARY IRON & STEEL INDUSTRY



ALL MANUFACTURING CORPORATIONS



* production workers in blast furnaces, steel works, and rolling mills

◻ monthly average, 6 mos. ending March 1956

◻ annual rate, last quarter 1955

SOURCE: United States Department of Labor; Federal Trade Commission-Securities Exchange Commission

TABLE 17
 PRICES, WAGES AND PROFITS, STEEL INDUSTRY AND ALL MANUFACTURING
 CORPORATIONS, 1947-56

(1947-49=100)

Year	Primary iron and steel industry				All manufacturing corporations			
	Gross hourly earnings ¹	Finished steel wholesale prices	Profits before taxes		Gross hourly earnings	Wholesale prices other than farms and food products	Profits before taxes	
			\$	As % of sales			\$	As % of sales
1947.....	92.5	89.1	89.1	96.5	93.0	95.3	100.6	105.7
1948.....	101.6	101.3	118.0	108.0	101.6	103.4	111.7	105.7
1949.....	105.8	109.7	92.9	95.6	105.4	101.3	87.6	88.6
1950.....	108.7	115.2	165.5	113.3	110.2	105.0	140.9	120.0
1951.....	121.5	124.5	210.3	140.7	119.6	115.9	157.3	116.2
1952.....	128.0	127.2	113.0	82.3	125.7	113.2	131.4	80.0
1953.....	138.9	136.9	173.0	109.7	133.2	114.0	135.9	87.6
1954.....	141.5	142.8	114.3	92.9	136.2	114.5	120.0	80.0
1955.....	152.4	149.5	207.7	128.3	141.5	117.0	163.8	97.1
1956.....	155.0 ^a	155.6 ^a	234.9 ^b	134.5 ^b	145.3 ^a	120.0 ^a	173.5 ^b	98.1 ^b

¹ Production workers in blast furnaces, steel works and rolling mills.

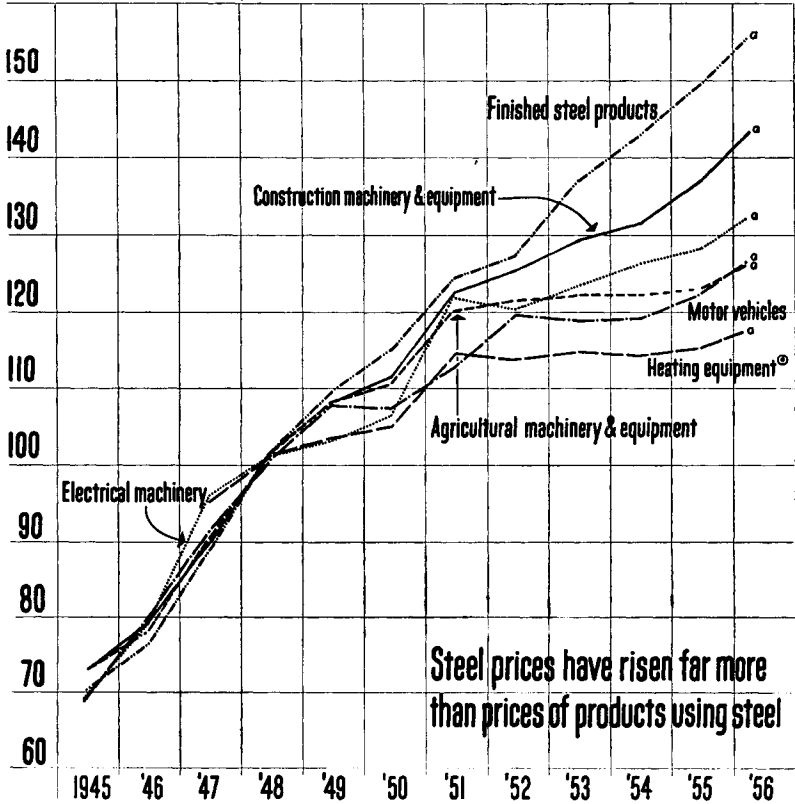
^a Monthly average, six months ending March 1956.

^b Annual rate, last quarter 1955.

SOURCE.—United States Department of Labor; Federal Trade Commission—Securities Exchange Commission.

CHART 18 Wholesale Prices for Finished Steel Products and Steel Using Industries 1945-56

160 Index (1947-49=100)



Steel prices have risen far more than prices of products using steel

[®] comparable data for 1945-46 not available

^{9/} monthly average, 6 mos. ending March 1956

SOURCE: United States Department of Labor

TABLE 18
WHOLESALE PRICES FOR FINISHED STEEL PRODUCTS AND
STEEL USING INDUSTRIES, 1945-56

Year	(1947-49=100)					
	Finished steel products	Agri. mach. & equip.	Construction mach. & equip.	Motor vehicles	Electrical machinery	Heating equip.
1945.....	70.2	72.9	72.9	68.8	68.9	n.a.
1946.....	76.4	78.1	79.2	79.7	78.9	n.a.
1947.....	89.1	90.3	90.0	91.3	96.1	95.3
1948.....	101.3	101.4	101.8	100.8	100.7	101.2
1949.....	109.7	108.3	108.3	107.9	103.2	103.6
1950.....	115.2	110.7	111.5	107.2	106.4	105.1
1951.....	124.5	120.1	123.6	112.9	121.9	114.6
1952.....	127.2	121.6	125.4	119.6	120.3	113.8
1953.....	136.9	122.3	129.3	118.9	123.7	114.8
1954.....	142.8	122.2	131.6	119.3	126.2	114.3
1955.....	149.5	123.2	137.1	122.9	128.2	115.0
1956*.....	155.6	126.5	143.6	126.8	132.2	117.2

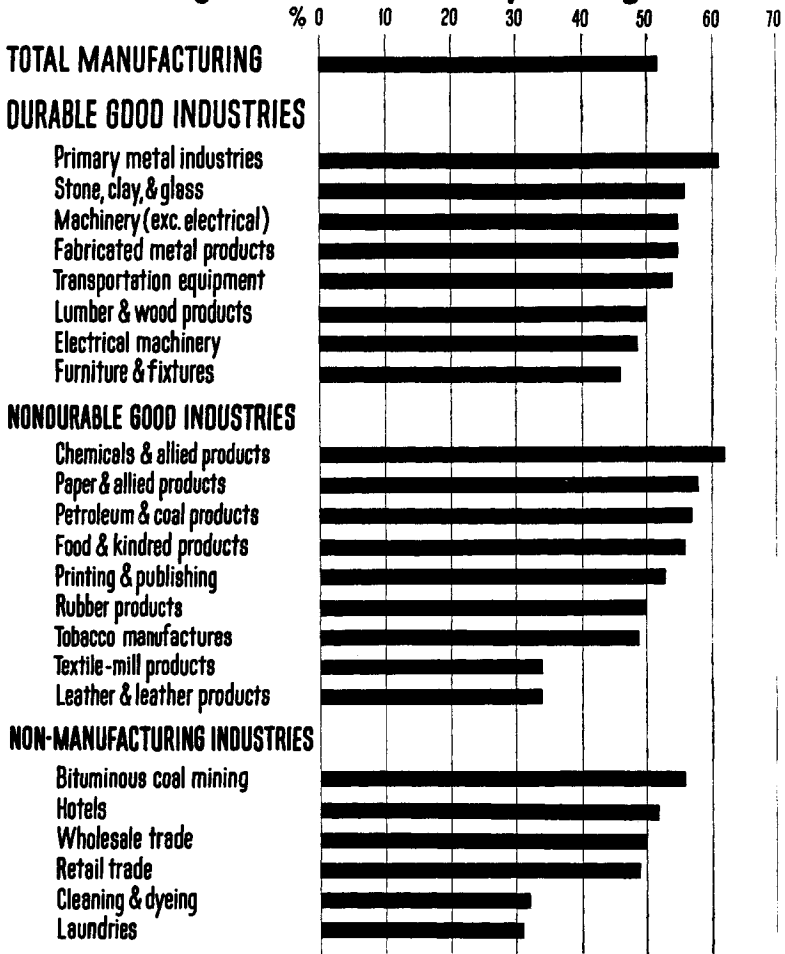
n.a. Not available.

* Monthly average, six months ending March 1956.

SOURCE.—United States Department of Labor.

CHART 19

Percentage Increase in Hourly Earnings 1947-55



SOURCE: U.S. Department of Labor

TABLE 19
INCREASES IN AVERAGE GROSS HOURLY EARNINGS IN MAJOR MANUFACTURING
AND NON-MANUFACTURING GROUPS, SELECTED YEARS, 1947-55

Industry	Average hourly earnings			Cents increase between:			Percent increase between:		
	1947	1951	1955	1947-55	1947-51	1951-55	1947-55	1947-51	1951-55
Total manufacturing.....	\$1.24	\$1.59	\$1.88	\$.64	\$.35	\$.29	51.6	28.2	18.2
Durable-goods industries:									
Lumber & wood products.....	1.13	1.47	1.69	.56	.34	.22	49.6	30.1	15.0
Furniture & fixtures.....	1.10	1.39	1.61	.51	.29	.22	46.4	26.4	15.8
Stone, clay & glass products.....	1.19	1.54	1.85	.66	.35	.31	55.5	29.4	20.1
Primary metal industries.....	1.39	1.81	2.24	.85	.42	.43	61.2	30.2	23.8
Fabricated metal products.....	1.28	1.65	1.98	.70	.37	.33	54.7	28.9	20.0
Machinery (excl. electrical).....	1.35	1.76	2.09	.74	.41	.33	54.8	30.4	18.8
Electrical machinery.....	1.26	1.58	1.88	.62	.32	.30	49.2	25.4	19.0
Transportation equipment.....	1.45	1.85	2.23	.78	.40	.38	53.8	27.6	20.5
Nondurable-goods industries:									
Food & kindred products.....	1.12	1.43	1.75	.63	.31	.32	56.3	27.7	22.4
Tobacco manufactures.....	.90	1.13	1.34	.44	.23	.21	48.9	25.6	18.6
Textile-mill products.....	1.04	1.33	1.39	.35	.29	.06	33.7	27.9	4.5
Paper & allied products.....	1.16	1.52	1.83	.67	.36	.31	57.8	31.0	20.4
Printing & publishing.....	1.54	1.99	2.35	.81	.45	.36	52.6	29.2	18.1
Chemicals & allied products.....	1.23	1.63	1.99	.76	.40	.36	61.8	32.5	22.1
Petroleum & coal products.....	1.50	1.98	2.36	.86	.48	.38	57.3	32.0	19.2
Rubber products.....	1.39	1.69	2.09	.70	.30	.40	50.4	21.6	23.7
Leather & leather products.....	1.05	1.27	1.41	.36	.22	.14	34.3	21.0	11.0
Non-manufacturing industries:									
Bituminous coal mining.....	1.64	2.21	2.56	.92	.57	.35	56.1	34.8	15.8
Wholesale trade.....	1.27	1.58	1.91	.64	.31	.33	50.4	24.4	20.9
Retail trade.....	1.01	1.26	1.50	.49	.25	.24	48.5	24.8	19.0
Laundries.....	.77	.92	1.01	.24	.15	.09	31.2	19.5	9.8
Hotels.....	.65	.82	.99	.34	.17	.17	52.3	26.2	20.7
Cleaning & dyeing.....	.91	1.06	1.20	.29	.15	.14	31.9	16.5	13.2

SOURCE.—United States Department of Labor.

Mr. BRUBAKER. We do not hope that the committee members will look at them carefully. We think they have a tremendous amount of detailed information in them on this question of inflation and steel and the causes for it.

Now we would like to direct your attention very quickly to the conclusions that come from our study. We think if you will examine the study carefully you will find that the facts set forth in that study show, first, that wage increases in steel have not caused even a single steel-price increase since the formation of the steelworkers union 20 years ago. That we say flatly.

Two, wage increases over the years have been moderate and have been well within the capacity of the steel industry to grant and to absorb out of productivity gains and excessive profit margins.

Three, wage increases have been more than earned by steelworkers throughout the union's history, by the constantly and sharply rising productivity, that is, output per man-hour of the workers. The real productivity increases in steel have significantly exceeded the real wages of steelworkers.

Four, the inflation in steel, that is, the rise in steel prices, has arisen because the industry has been determined to widen its already excessive profit margins. It has not only refused to absorb increased wage costs out of increased productivity, as it could well have done, but it has also raised steel prices more than \$3 for every \$1 of increased wages and fringes granted to its employees. It literally makes a net profit—and a very big one—on every wage increase which it grants to the union and to its employees.

Five, if there is any significant relationship in the steel industry between wages, prices, and profits, it is one of coincidence in timing only. The union's wage increases are made the excuse and the occasion for wholly unnecessary and excessive price increases which result in ever-increasing profits. The facts simply do not support the wholly fallacious hypothesis that steel wage increases cause steel price increases.

Let us look briefly at some of the facts shown in our study. These are elaborated much more particularly in this white book which you have.

First, look at profits before taxes. For 1956, the industry and for this purpose we actually used the financial reports of the 25 companies which make up nearly 92 percent of the industry's ingot capacity, are estimated at approximately \$2 billion. You will notice the comparisons below with other prior years. In 1956, profits before taxes are almost on a par with 1955, which was the highest year on record, prior to this last year. They are nearly 200 percent above 1947. They are more than 1,100 percent above 1939. During the first half of 1956, prior to the strike in steel, profits before taxes were running at an annual rate of more than 15 percent above the prior alltime-peak year. There is every reason to believe they would have ended up the year that high except for the strike which was forced upon us.

We also have noted for you that just prior to the strike last year, the steel industry was making a profit before taxes of \$1.52 on every man-hour worked by all employees in the industry. This is nearly 60 percent of the amount which the industry was paying per hour of labor. This should be some measure of the leeway which they had from which to grant wage increases.

Now turn to net profits. They present much the same picture as profits before taxes. Profits for 1956 are estimated at a billion dollars—net profits after all taxes. That is on a par with 1955, which was an alltime peak year. Again, profits after taxes were running at a rate 13 percent during the first half of 1956 above the prior peak year, and they would well have ended up that way but for the strike.

Now let us turn to profit margins briefly. Profit margins in the steel industry have widened sharply in recent years. For all manufacturing industries they have gone in the other direction. They have narrowed. This is evident from an examination of the industry's favorite comparison, profit per dollar of sales. In steel, net profits have risen from 6.2 cents per dollar of sales in 1947 to 7.9 cents in 1955, and early 1956. In all manufacturing they have gone the opposite way, from 5.7 cents in 1947 down to 4 cents in 1955, and an estimated 4.3 in early 1956.

The sounder measure, the rate of return on net worth, or owner's equity, shows much the same picture. Net profits in steel rose from 10.5 percent in 1947 up to 16.1 percent in the first half of 1956. In all manufacturing they went in the opposite direction, down from 15.1 percent in 1947 to 12 percent in the first part of 1956.

Clearly the rates of return on net worth in both steel and all manufacturing are excessive by almost any standard. They are far exceeding the 6-percent rate of return which was once generally accepted as a fair and reasonable rate of return. They would readily permit significant price reductions and still leave more than adequate profit margins. There is little excuse for industry generally, or for the steel industry, to insist on earning 10 to 15 percent as it has done in most peacetime years since 1939—rates of return which would permit the industry to double its investment out of earnings every 7 to 10 years.

On dividends, the industry's owners have done well. The companies were paying dividends to the stockholders at a rate in excess of \$400 million in early 1956. Dividends, however, did not go down when the strike came. They not only paid dividends as usual; they raised the rate of dividends. So that we have a picture here of dividends having increased since 1947 in steel by 229 percent, at the same time that the dividends of all corporations were going up only 86 percent.

On productivity, it is imperative that you have these figures before you. There has been a constantly rising productivity rate in the steel industry in recent years. We have a new study by the Bureau of Labor Statistics, which both the industry and we have cooperated in developing, which shows the figures that we have given you in our statement, a 4.5-percent rise in early 1956, an 11.4-percent rise in 1955, and a total rise of 68.8 percent since 1939.

In contrast with this—and this is a most important figure—the “real” straight time average earnings of steelworkers, also BLS figures, show an increase from 1939 as contrasted with the first 10 months of 1956, of 48.3 percent. So that there has been a “real” lag in straight-time earnings as contrasted with productivity. This is a very simple figure, and it is one that nobody I think can get around, namely, wages in steel simply have not fully kept up with productivity, if you are talking about “real” wages and “real” output.

These are official figures. This ought to settle this controversy of whether wages are going up faster than productivity in steel. We have given you some other demonstrations of this.

I want to urge you greatly to take a look at this white book when you get a chance, at table 16, which lists the price increases in the steel industry since the war. We have detailed them for you year by year, as contrasted with the wage increases that came along at the same time. If anyone can look at that and reach any other conclusion than that which we have reached, I would be very, very much surprised.

Chairman PATMAN. You may insert your entire statement. Thank you very much.

(The statement follows:)

STATEMENT ON WAGES, PRICES, PROFITS, AND INFLATION ON BEHALF OF THE UNITED STEELWORKERS OF AMERICA BY OTIS BRUBAKER, DIRECTOR OF RESEARCH

The steelworkers union is delighted to accept the invitation of the Joint Economic Committee to participate in this panel discussion on the question of the so-called wage-price inflation spiral mentioned prominently in two recent Presidential statements. This panel discussion can be, and we hope it will be, the beginning of a serious investigation by the Joint Economic Committee of the causes of inflation and what can be done about them.

No one wants inflation—or so nearly everyone says. Those few who favor it, or a little of it, fail to appreciate its insidious character and its thoroughly harmful results. Certainly our union, the United Steelworkers of America, does not now, and never has, favored inflation. The members of our union and the retired former members suffer as much as do other members of the public when pay checks and pension checks buy less and less because inflation, i. e., higher prices of food, clothing, shelter, and the other necessities of life, is constantly nibbling away at the “real” buying power of their incomes.

Unfortunately, however, there is much misinformation about inflation and its causes. There is a deliberate, widespread, and systematic attempt in our country by such groups as the National Association of Manufacturers, the chambers of commerce, many newspapers, and other large employers to lay the blame for inflation on the efforts of wage earners and their unions to secure wage and fringe improvements in order to raise the standard of living of the American worker. In fact, so one sided and so prevalent is this propaganda, that some persons who should know better are beginning to have doubts and are wondering if perchance wage increases do contribute to inflation.

The cause of elemental economic education never has needed so badly an assist in getting the facts out on the table for all to see. Congress can do much in this regard if it will search out the facts concerning wages, prices and profits, their roles in our economic system, and assess the blame on those who cause and those who profit from inflation. In fact, if the spotlight of congressional publicity is kept focused on those who would like to raise prices and constantly increase profit margins, it may have a salutary effect in curbing price increases.

We were asked to participate in this panel for the sole purpose of telling the committee what we know concerning wage and price relationships in steel. There are, of course, many facts concerning inflation in the steel industry about which the Steelworkers Union has firsthand knowledge. In order to carry out our collective bargaining responsibilities we must constantly study the industry and its economics. We must and we do know much about its profit margins, about how much it can afford to raise the wages of its employees without raising its prices, about the limits there are on the latitudes of our collective bargaining. This is a major function of the union's research department. We made careful studies in 1956 prior to and during our bargaining sessions. These facts were important in framing our demands on the industry and our settlement with it. Some of this material we prepared for publication with the aid and assistance of Robert Nathan and some of his associates. It was released in late July 1956. Fortunately, the steel strike was settled shortly thereafter and unfortunately, as a result of the settlement, the public lost interest in steel and the facts relating to wages and prices in the industry. In our opinion, the facts of this study deserved more careful and widespread public scrutiny than they received. We

have made that study available to the Joint Economic Committee. While we could not redo that study in the few days following notice of this panel session, we have attempted to bring the more important of the early 1956 figures in the study as much up to date as possible in this brief presentation.

THE UNION'S STUDY OF THE STEEL INDUSTRY AND INFLATION

A. *Our conclusions*

Several important conclusions arise from our study of the facts:

1. Wage increases in steel have not caused even a single steel price increase since the formation of the Steelworkers Union 20 years ago.

2. Wage increases over the years have been moderate and have been well within the capacity of the industry to grant and absorb out of productivity gains and excessive profit margins.

3. Wage increases have been more than earned by steelworkers throughout the union's history by the constantly and sharply rising productivity, i. e. output per man-hour of the workers. The real productivity increases have significantly exceeded the real wage gains of steelworkers.

4. The inflation in steel, i. e. the rise in steel prices, has arisen because the industry has been determined to widen its already excessive profit margins. It has not only refused to absorb increased wage costs out of increased productivity, as it could well have done, but it has also raised steel prices more than \$3.00 for every \$1.00 of increased wages and fringes granted to its employees. It literally makes a net profit, and a big one, on every wage increase it grants.

5. If there is any significant relationship in the steel industry between wages, prices, and profits, it is one of coincidence in timing only. The union's wage increases are made the excuse and occasion for wholly unnecessary and excessive price increases which result in ever increasing profits. The facts simply do not support the wholly fallacious hypothesis that steel wage increases cause steel price increases.

B. *The facts*

1. *Profits.*—Profits before taxes for 1956 for the steel industry (25 companies which in 1956 had 91.8 percent of the industry's ingot capacity) are estimated at about \$2 billion. This rate of profits was on a par with 1955 (\$2,038.5 million), the prior all time peak year—

76 percent higher than 1954 (\$1,133.6 million)

188 percent higher than 1947 (\$694.9 million)

1,168 percent higher than 1939 (\$157.7 million)

The level of profits before taxes was at an annual rate of \$2,350.7 million in first quarter 1956 and \$2,386.4 million in first half 1956. The strike in the third quarter pulled the annual rate down to \$1,814.4 million. But a fourth quarter, which was the equivalent of each of the prestrike first two quarters, should pull the full year up to about \$2 billion, which is on a par with the 1955 level. Except for the strike, profits before taxes in 1956 would have easily been at an all-time high, more than 15 percent above the prior peak of 1955. It is out of these high profits before taxes that wage or other cost increases can be absorbed if the increase in productivity is, in any particular year, insufficient to offset these costs. Obviously an industry can absorb additional costs when its profits are at an all time peak.

The steel industry (25 companies) was making profits before taxes during the first quarter of 1956 just prior to our 1956 wage negotiations of \$1.52 per man-hour worked, by all employees, a profit of more than 60 percent of the amount it paid for each hour of labor. Thus, it could increase hourly rates substantially without endangering its profits, even if it had had to absorb any added wage costs out of profits, which it did not have to do because of rising productivity.

Net profits presented a similar picture. The net profits for the steel industry (the same 25 companies) for 1956 are estimated at \$1 billion. This was on a par with 1955 (\$1,019.4 million), the prior peak year—

70 percent higher than 1954 (\$589.8 million)

154 percent higher than 1947 (\$394.3 million)

691 percent higher than 1939 (\$126.4 million)

The level of net profits was at an annual rate of \$1,153.4 million in the first quarter of 1956 and \$1,190.6 million in the first half. The strike in the third quarter lowered the annual rate to \$920.5 million. The fourth quarter should pull the annual rate up to about \$1 billion, which is on a par with the 1955 level. Except for the strike, net profits in 1956 would have easily set a new record,

more than 13 percent higher than the prior peak in 1955. These high net profits are the direct result of already too high prices and rapidly advancing productivity.

The profit figures discussed above do not fully reveal the profitability of the steel industry.

In recent years the various steel companies have been permitted to depreciate defense facilities at a faster than normal rate. Commonly, this is referred to as rapid amortization. In 1955, 12 of these 25 companies reported rapid amortization charges of \$310 million, of which at least \$250 million was in excess of normal depreciation charges.

This means that, had there been no rapid amortization in 1955, profits before taxes would have been some \$250 million higher than reported and net profits some \$120 million higher. Data are not yet available for 1956, but rapid amortization charges should not differ too significantly from 1955 charges.

2. *Profit margins.*—Profit margins for the steel industry (22 companies) have widened sharply in recent years. For all manufacturing industries they have narrowed. This is evident from an examination of industry's favorite comparison, profit per dollar of sales.

In steel (22 companies): net profits as a share of the sales dollar rose from 6.2 cents in 1947 to 7.9 cents in 1955 and first half 1956

In all manufacturing: Net profits as a share of the sales dollar declined from 5.7 cents in 1947 to 4.0 cents in 1955 and to 4.3 cents in early 1956 (estimated)

This steel rate in 1955 and early 1956 was the peak rate for any recent year except 1950, which was fractionally higher (8.0 cents). The strike in the third quarter brought the 9-month rate down to 6.7 cents, but the fourth quarter should bring it back up to about 7.1 cents, a most creditable profit margin when compared with all manufacturing.

The rate of net profits as a return on net worth (owners' equity) also shows steel¹ running contrary to the general trend in industry. The comparisons show:

In steel (22 companies): Net profits as a rate of return on net worth rose from 10.5 percent in 1947 to 13.8 percent in 1955 and 16.1 percent¹ in first half 1956

In all manufacturing: Net profits as a rate of return on net worth declined from 15.1 percent in 1947 to 12.6 percent in 1955 and 12.0 percent in 1956 (average of first 3 quarters)

The steel rate of return in first quarter 1956 was at a peak for recent years at 15.6 percent. For the first half it rose even further to 16.1 percent. It fell in the third quarter because of the strike to a 9-month level of 12.5 percent. The fourth quarter should bring the rate to about 13.4 percent for the year, a near record rate for recent years despite the 1956 strike.

Clearly the rates of return on net worth in both steel and all manufacturing are excessive by almost any standard. They far exceed the 6 percent return once generally accepted as a fair and reasonable rate of return. They would readily permit significant price reductions and still leave more than adequate profit margins. There is little excuse for industry generally, or the steel industry, to insist on earning 10 to 15 percent as it has done in most peacetime years since 1939—rates of return which permit industry to double its investment out of earnings every 7 to 10 years.

3. *Dividends.*—The steel industry (25 companies) has dealt generously with its stockholders. Cash dividend payments to common-stock holders in first quarter 1956 were at an annual rate of \$412.9 million, a record high. Unlike the workers who lost wages because of the third quarter strike, the stockholders continued to receive dividends as usual. In fact, the annual rate for the first 9 months actually exceeded the first quarter rate. It was \$420.3 million. This was an increase of 229 percent since 1947—a period during which all corporations showed an increase of only 86 percent. In addition to the cash dividends many stockholders also received stock dividends, and nearly all benefited from sharp increases in the equity value of their stockholdings.

4. *Productivity.*—The steelworker has increased his productivity, output per manhour, sharply in recent years:

By 4.5 percent in the first quarter of 1956.

By 11.4 percent in 1955 (a record high for any year).

By 68.8 percent since 1939.

¹The steel rates of return on net worth for 1956 have not been adjusted to reflect the 1956 additions to net worth. These adjustments would not change at all significantly the picture here shown.

These increases in "real" output per hour of work by steelworkers significantly exceed the "real" straight-time earnings increase received by these same steelworkers for each hour of work. For the entire period of more than 16 years, 1939 through part of 1956, "real" productivity in steel rose 68.8 percent (1939 re 1st quarter 1956), whereas "real" straight-time average hourly earnings rose only 48.3 percent (1939 vs. 1st 10 months 1956). Even if allowance is made for "fringe" gains during this period, productivity gains still significantly exceed wage and "fringe" gains together. Obviously steelworkers have not only "earned" their wage and "fringe" improvements over the years, but they have not even received their proportionate share of the productivity gains made in the industry. These are the facts, based on Department of Labor studies, and they are in sharp contrast to the fiction which the industry has attempted to persuade the public to believe. These large gains in productivity mean lower unit labor costs and would permit wage increases without price increases—if prices are set in terms of costs, insofar as possible, instead of in terms of whatever the market will bear.

5. *Steel prices versus wages.*—The entire steel industry has reaped a profit bonanza from the steel price increases of recent years—increases which are out of all proportion to increased costs. Since 1945, there has been 10 rounds of wage increases (including the pension and insurance round in 1949), but there have been 17 rounds of general (base) steel price increases and 4 major increases in price "extras" (including 2 which coincided with base price increases). Thus, there have been an average of 2 price increases for every wage increase—customarily an anticipatory one preceding the wage increase and another one following the wage increase.

The cumulative impact of the price and wage increases since 1945, measured in terms of 1956 operations, meant for the entire steel industry :

Additional revenues-----	<i>Million</i> \$6,572.2
Additional labor cost-----	2,027.9
Total gain-----	-\$4,544.3

Expressed differently this means that, for every \$1 increase in labor "costs"—"costs" which have actually been offset by greater output per man-hour—the steel industry has generated for itself \$3.24 in additional revenues, achieved by reason of its unjustifiably large price increases.

There was criticism of the steel wage and price increases of August 1956 both from industry sources and much of the press. The steel industry used the wage increase, as usual, as the excuse for large steel price increases. This excuse was generally, uncritically, and quite erroneously accepted as fact. The union said at the time, that the steel industry could grant a substantial wage increase and absorb the "cost" without serious reduction in profits. We were willing to, and did, settle our negotiations on a basis which required no price increase. Our 1956 contract provided for a wage increase and other benefits at a cost of approximately 20 cents per hour for the 1st year of the contract. For all 775,000 employees of the steel industry (25 companies), even if no productivity increase is assumed, the gross "cost" of the wage increase for a year would have been \$310 million, the net "cost" \$148.8 million. At the level of profits before taxes and after taxes of the industry in the 1st quarter of 1956 (the latest data available at the time of our negotiations), these figures would have been reduced from \$2,350.7 million and \$1,153.4 million respectively to \$2,040.7 million profits before taxes and \$1,004.6 million net profits. The rate of net profits as a return on net worth would have been 13.6 percent and the net profit per dollar of sales 6.9 cents. These would have been highly satisfactory rates of return.

But productivity was increasing sharply enough to permit absorption of a substantial wage increase without a price increase and without any reduction in profits. Even at a 4-percent rate of productivity gain in the year, output and revenue would have increased by 4 percent (\$349.2 million at the first quarter rate). This amount exceeded the gross "cost" of a 20-cent wage increase by \$39.2 million and the net "cost" by \$18.8 million. Thus, the industry could have granted and absorbed a 20-cent wage increase and still have increased both its profits before taxes and its net profits out of a 4-percent gain in productivity alone. Instead, it chose to provoke a strike, lose some of the productivity gain, lower its profits, but, most importantly, add to inflation by a substantial steel price hike.

The steel price increase in August 1956 was announced as \$8.50 per ton (about 7 percent). This increase was sufficient to offset the "cost" of the wage increase

by nearly \$3 of price increase to every \$1 of wage increase. But it was unnecessary to make any price increase in 1956 since the productivity increase just recorded in 1955 prior to the negotiations was 11.4 percent—an amount more than sufficient to pay for the “cost” of the wage increase—just out of labor’s share of the productivity rise. Apparently the industry is willing to pay much lipservice to the theory that wage increases be limited to productivity gains but is quite unwilling to accept its corollary, that it should not raise its prices when unit wage costs are decreased because of increased output per man-hour.

In recent months, particularly in December 1956 and January 1957, the industry has launched another series of price increases. Many of these increases are in so-called extras and are not reflected in the price indexes maintained by the trade press. The American Metal Market (January 18, 1957) estimated the overall effect of the “extra” increases in structurals at 4½ percent, in plates at 5½ percent, in large pipe 3½ percent, etc. The cumulative impact of the increases has been to raise the BLS Finished Steel Price Index by 1.5 percent already (about \$2.25 per ton)—with more increases in prospect. These December-January price increases have no more justification than did the \$8.50 per ton increase of last August.

While, as indicated, no price increase was necessary to offset the “cost” of the 1956 wage increase, the industry did raise prices by about \$8.50 per ton. Based on the American Iron and Steel Institute’s definition of the basic steel industry and on its first half steel shipments and man-hours for the entire industry, the price increase yielded about \$800 million in additional revenue. The wage increase, which appeared to raise the wage bill by \$285 million, actually “cost” nothing because it was offset by a reduction in unit costs caused by increased productivity. The profit of the industry from this little operation is obvious.

6. *Steel prices vs. materials and other costs.*—Steelmaking costs, other than wages, have not risen nearly as fast as steel prices. The unit cost of materials purchased² in the steel industry rose 30.7 percent between 1947 and December 1956. But steel prices increased 91.3 percent in the same period—an increase of prices re materials costs of 3 to 1.

For years the industry has argued that whenever wages rise, its materials costs increase by a like and identical amount because of the wage increase. This argument is not supported by the facts—even those drawn by the industry from its own financial records. Even if there were coincidence in timing of the increases, it would not be evidence that wage increase caused the materials-cost increase. But there is no such coincidence or cause. United States Steel’s annual report for 1952 disproved any such argument in the following tabulation:

Comparative changes in materials and employment costs in United States Steel Corp.

Period covered	Increase as percent of 1940	
	Employment cost	Cost of materials
	Percent	Percent
January 1941–April 1947.....	56	47
April 1947–July 1948.....	16	42
July 1948–November 1949.....	14	18
November 1949–December 1950.....	19	3
December 1950–July 1952.....	23	24
July 1952–December 1952.....	27	4

Even a cursory examination of the movements of the price of such an important steelmaking material as steel scrap would demonstrate the fallacious nature of any such claim. In the last few months of 1956, according to Steel magazine, steelmaking scrap rose consistently reaching a peak of \$66.17 per ton in mid-December and then fell off to \$59.83 in mid-January 1957. As compared with mid-January 1956, this was an increase of 24.1 percent at the peak and is still

² The index used as a measure of materials costs is the BLS price index of “all commodities other than farm and food products” which the President’s Council of Economic Advisers refers to as “industrial prices.” This index was referred to by a United States Steel Corp. spokesman in testimony before the Temporary National Economic Committee as a close indicator of the movement of prices of the materials purchased by the corporation.

12.2 percent above a year ago. Would anyone be so foolish as to claim that costs of labor in steel scrap procurement and preparation have risen by an amount even approaching this figure? Yet such myths as this pass for fact in the steel industry's public relations. These scrap-price increases are simply the results of another industry, the steel-scrap industry, attempting to emulate the steel industry by increasing its prices as much as it thinks the market will bear. This is the stuff of which inflation—miscalled wage-price inflation—is made.

And now the need for funds for capacity expansion of the industry is advanced seriously as an important "reason" for higher steel prices. Certainly prices should be at a level sufficient to permit maintenance and replacement of existing facilities. But by some perversion of investment theory, it is now argued that the public, the users of steel, should not only pay the steel companies a fair return on their investment but should also pay for expanded capacity through higher prices. The companies would thus avoid the traditional methods of raising capital, such as stock flotation and borrowing, and the stockholders would end up owning new and enlarged capacity without a red cent of additional investment on their part. This alleged "reason" for inflation in steel prices should be soundly condemned by all.

We cannot hope to stop inflation, whether it be in steel prices, scrap prices, auto prices, or the major items which make up the cost of living, until our major industries feel the glare of continuous publicity on their pricing actions. This committee and the Congress could make a great contribution by continuously investigating the facts concerning wages, prices, and profits and by focusing public opinion on unsupportable price increases. Only thus can we learn whether erosive inflation can be prevented in our economy without more drastic steps.

Chairman PATMAN. We next have Mr. Bradford Smith, economist, United States Steel Corp.

STATEMENT OF BRADFORD B. SMITH, ECONOMIST, UNITED STATES STEEL CORP.

Mr. SMITH. Mr. Chairman and gentlemen, it, of course, was not my understanding that this meeting was going to be devoted more or less exclusively to the industry from which I have employment. So I think it would be well at the outset to say that I am not here on this occasion either to expound or to defend the policies of the United States Steel Corp. I am here rather to be of such assistance to the committee as I may in analyzing the great majestic important trends which are occurring in our economy.

I am much disturbed by the forces making for interminable inflation in our land. This concern arises out of the fact that following all of our previous great wars the war-inspired inflationary forces have subsided, after a year or two of readjustment, and given way to periods of relative stability. But that is not true this time as may be seen by a glance at the first chart. On the contrary, in the period since the close of World War II the underlying inflationary forces have increased rather than decreased in power. They seem to be operating like a compound-interest curve, which, if not checked, will eventually carry inflation to astronomical heights.

The contrast between this postwar period and previous postwar periods is prima facie evidence that something new has come to America—some change in the national attitudes, in the legislative and social frameworks within which we conduct our living in this land. Should this indeed be true, then I would suppose that few matters more urgently merit attention if our long-term economic healthiness is to be insured.

My researches disclose that the massive, continuous surge of inflation is most clearly manifest in industrial costs. For over 15 years nothing has stopped it, nor more than temporarily slowed it down.

The consequence to prices is a self-evident proposition; except as offset by increasing productivity, prices have got to go up to cover rising costs, least industry experience widespread bankruptcy. The connection between costs and prices is not, of course, an instantaneous one-to-one affair like closely intermeshed gears. Changing profit or loss margins, varying tax costs, shifting demand trends, and fluctuating levels of production interpose temporary cushions and compressions between costs and prices. But they do not alter the long-term arithmetic, with which I presume this committee is primarily concerned.

Underlying all industrial costs is wage cost. Up and down America's production line, from extraction of raw materials to delivery of finished products, something over three-quarters of all costs are, directly or indirectly, employment costs. Thus if we have wage inflation we cannot escape cost inflation since the first is the biggest part of the second. If we have cost inflation beyond productivity increases we cannot escape rising prices, the latter being but the reflection of the former.

May I say in passing that inflation can be accommodated only within the framework of soft money policies and an expanding money supply. As a matter of fact the money supply has been multiplied $3\frac{1}{3}$ times since 1940. Since monetary restraint has become secondary to maintenance of full employment, and since the committee will deal with the monetary matter tomorrow, I omit further discussion of it in these brief comments.

Our country has been caught up in a persistent and massive wage inflation. It shows, for example, in the records of United States Steel. In the second of the attached charts I show United States Steel's employment cost per employee hour, on the basis 1940 equals 100. Since 1940 the employment cost has increased every year. The average rate of increase is 8.1 percent per annum compounded. This wage inflation is general, as may be noted in chart III, which again shows United States Steel's employment costs and compares them with hourly earnings of wage employees for all manufacturing. The increase in the latter is a little less than in the former largely because the Bureau of Labor Statistics does not include many fringe benefit costs. In the case of United States Steel these have risen from less than 10 cents an hour in 1940 to over 50 cents in 1956. The items are charted on a logarithmic vertical scale to disclose the dangerous compound interest type of trend in wage inflation. Anything increasing at 8 percent per annum doubles every 9 years.

Since the basic wage inflation is general throughout industry it is quite natural that all of United States Steel's other costs per employee hour should pursue the skyward path of its direct employment costs. And so they do, as shown by the other curve back on the second chart. From 1940 to 1956 total costs per employee hour have been multiplied by 3.8 which works out to an increase of 8.8 percent per annum compounded.

With such persistent and large cost inflation, prices must obviously be pushed up. Fortunately the full impact of wage inflation on prices has been moderated by the provision of increasingly efficient tools of production. This may be observed in the fourth quarter chart in which the rise since 1940 in steel prices is compared with the rise in United States Steel's employment costs per hour. You will note while employment costs per hour have been multiplied nearly $3\frac{1}{2}$

times, steel prices have been multiplied only $2\frac{1}{3}$ times. The steel price rise is the equivalent of 5.6 percent per annum compared with the employment cost increase of 8.1 percent. An annual average increase in productive efficiency between 2 and 3 percent would account for the difference, although any such measurement must be surrounded with numerous reservations.

For comparison, two other items appear on this fourth chart: The index of all-commodity prices at wholesale and United States Steel's income as a percent of sales. The latter simply verifies that the price increase is not due to relative profit inflation, since over the period the percentage of profit margin has declined rather than risen. A similar observation is valid for the economy as a whole, as may be observed on page 8 of Economic Indicators, where it is shown that profits have not, since 1950, attained the levels reached in that year and more recently have been declining.

The committee may be interested in the comparative price behavior. I start with 1940 as the last year before the wartime distortions came into the picture. There are three phases. From 1940 to 1946 wholesale prices—along with employment costs—increased over 50 percent, while steel prices did not increase at all until 1945 and by 1946 were only 12 percent above 1940. They were thus relatively deeply depressed and remained so for the next 5-year period up to 1951. During that period both steel and wholesale prices advanced in roughly parallel fashion. From 1951 on steel prices began to catch up with wholesale prices, the latter having experienced a plateau. They are now rising together again. It is interesting that the nonrise of steel prices in the 1940-46 period did not prevent wholesale prices from rising. Equally the readjustment rise in steel prices from 1951 to 1955 did not cause wholesale prices to rise. Steel industry critics, incidentally, are fond of picking a year in the middle or preadjustment period as a base for comparing that industry's subsequent price and profit changes with those of other industries.

This brief analysis illustrates four points I believe to be important for research and policy guidance:

1. It is unlikely that the key to the general inflation problem is to be found in the prices of any one or several industries;
2. The important key to the present inflation problem is to be found in the wage inflation, as the common denominator of all industries' costs;
3. It follows that policy changes which leave the wage inflation untouched will prove futile; while
4. If wage inflation is checked the present prospect of price inflation will vanish.

Thank you.

Chairman PATMAN. Thank you.

Mr. George Hitchings, manager, economic analysis department, Ford Motor Co.

STATEMENT OF GEORGE HITCHINGS, MANAGER, ECONOMIC ANALYSIS DEPARTMENT, FORD MOTOR CO.

Mr. HITCHINGS. The current rise in prices which generally started in mid-1955 is different from the type of inflation that occurred during and immediately after war periods. Those inflations involved a sharp

and sustained increase in prices generated by money demand for goods and services substantially greater than the available supply at existing prices. These inflations were fed by a rapid expansion of the money supply, usually through Government deficit financing. Too rapid an expansion through private credit would, however, have the same effect.

In the past 18 months, the only important areas in which money demand has exceed supply and pushed prices up have been in capital equipment industries and their suppliers. Wholesale prices of finished durable goods used by producers have risen 13 percent since mid-1955. These increases have been concentrated in metals, fabricated metal products, machinery, and equipment. Prices of construction materials have also reflected heavy business construction demand.

Prices of consumer goods have risen much less over the same period. At the wholesale level, prices of consumer goods in total increased only 2½ percent after June 1955. Finished durable goods used by consumers were up about 6½ percent, largely in the passenger car and household furniture segments. For consumer nondurable goods other than food, a moderate steady rise accumulated to 3 percent over the 18 months. Food prices continued to decline in the last half of 1955, but a subsequent increase in 1956 brought them back to their mid-1955 level.

These changes in wholesale prices of consumer goods have been reflected in similar movements at retail. The consumer price index, which includes services as well as the types of consumer goods in the wholesale price index, has risen 3 percent since mid-1955. A decline in food prices in the last half of 1955 kept the rise in the overall index to very modest proportions during that period. In 1956, however, there has been a moderate rise in all segments of the index.

Demand pressures in excess of supplies have not accounted for the rise in consumer prices. Rather, increasing costs of production are responsible for most of the rise in prices of consumer goods and services. An exception is the turn-around in the food component which has resulted in part from policies designed to bring about some recovery in depressed prices at the farm level.

Most of the increase since 1948 in dollar income generated in the manufacturing segment of the economy has been in the form of higher payrolls and Government tax revenues. Corporate profits after taxes (adjusted to eliminate profits or losses from inventory price changes) have stayed at about the same total dollar amount since 1948. In the first 9 months of 1956, these profits amounted to an annual rate of about \$10 billion, compared with \$82 billion for wages and salaries, including supplements to wages and salaries in the form of pensions, insurance, and accident compensation. This total of \$82 billion of employee compensation represents a sharp growth from the \$48.6 billion level in 1948—a growth of about 70 percent.

Although part of this rise in total wages and salaries arose from increased employment, average annual earnings per full-time employee were up 48 percent from 1948 levels. Most of this rise in annual earnings, in turn, stemmed from a 45 percent increase in average hourly earnings. If nonwage fringe benefits were included, the rise would be still greater.

Government tax revenues from corporate income generated in manufacturing industries are much higher than in 1948. They now stand at about \$12 billion, also some 70 percent above the 1948 level. During the upsurge after Korea, Government revenues from this source were temporarily higher because of the excess-profits tax.

By contrast, corporate profits after taxes (adjusted for inventory profits and losses) are not significantly above 1948, 1949, and 1950 levels, despite the substantially higher dollar volume of sales and capital investment. The rate of return on investment for manufacturing corporations, therefore, has been reduced.

Profits after taxes are the proper measure of income available to owners of the business. The stockholders, who are the owners of the business, have available as income only the amount left over after taxes. They, in turn, are taxed on this income just as are the employees on their income. Net profits distributed as dividends are taxed to the recipient. Undistributed profits invested in the business are taxed as capital gains when gains are realized. The proper comparison is between employees and stockholders, rather than with the corporate entity, which is merely the vehicle for producing income.

Although it is desirable for employees to share in the increased income available from the manufacturing operations, it is also necessary to obtain an adequate return on the capital investment because the investment makes possible most of the real gain in employee wages. Furthermore, the buyer of products must be offered a sufficiently attractive price to obtain maximum markets.

Increase in the total pie available for distribution is the primary consideration of economic policy. To maintain a healthy economic growth there must be a proper distribution of income among employees, owners, and consumers. An attempt to garner the total increase in productivity, or more, by either labor or capital results only in price inflation and/or shrinkage of the total market.

In the period since mid-1955, there is evidence that average hourly earnings have outstripped productivity and led to increased costs of production. Such increased costs have resulted in higher prices of manufactured products. Return on investment in manufacturing has declined in this period despite continued high volume operations. In the second quarter of 1956, the rate of return was 12.6 percent after taxes, compared with 13 percent a year earlier and 14.8 percent on the average for 1947-50 (see table E-52 on p. 180 of the January 1957 Economic Report of the President). A further decline occurred in the third quarter, but the extent of decline was exaggerated by the steel strike and by model changeovers in the auto industry. Fourth quarter profits were more in line with rates earlier in the year.

By contrast, average hourly earnings in manufacturing continued to rise in 1956, reaching a level in December that was nearly 10 percent above mid-1955. This increase in wages cannot continue at such a pace without further price increases and/or reduced markets. Although increased hourly earnings make it possible for the recipients to pay the higher prices, those consumers who do not share in rising incomes are less able to buy. Furthermore, the purchasing power of existing savings is reduced.

Increased costs also present problems in business financing (higher working capital requirements and higher expenditures for new plant

and equipment) as well as consumer financing of houses and durable goods. The monetary authorities are faced with the problem of easing bank-reserve positions to permit these higher expenditures or of maintaining such a tight rein that business activity declines.

The key to prices in 1957 will be the extent to which payroll costs rise relative to physical production. Demand pressures in the capital goods segment of the economy will probably ease, as physical volumes level off or decline slightly. There will be adequate productive capacity to meet the probable levels of demand in nearly all major segments of the economy. Continued high levels of capital investment will be required, however, to provide for future growth in the economy and for the improved efficiency—or productivity, as it is often called—so necessary if increased income with price stability is to be achieved.

(Mr. Hitchings later submitted the following:)

Distribution of national income in manufacturing (1948-56)

[Millions of dollars]

	1948	1949	1950	1951	1952	1953	1954	1955	9 months annual rate, 1956 ¹
Wages and salaries.....	46,459	43,860	49,393	58,232	62,918	69,773	65,948	72,132	76,000
Supplements to wages and salaries ²	2,145	2,264	3,142	4,141	4,431	4,928	5,054	5,709	6,100
Corporation income and excess profits tax.....	7,066	5,729	10,905	14,252	11,687	12,325	9,242	12,518	12,200
Corporation profits after tax ³	9,596	9,605	9,293	9,598	8,911	8,201	8,439	10,329	9,800
Unincorporated income ³	1,358	1,294	1,579	1,574	1,330	1,068	796	1,019	1,000
Net interest.....	6	5	-77	-63	41	56	76	98	100
<i>Total income</i>	66,630	62,757	74,235	87,734	89,318	96,351	89,555	101,805	105,100
Memorandum:									
Inventory profits, corporations.....	1,440	-1,194	3,082	662	-640	692	311	1,325	1,800
Inventory profits, unincorporated.....	36	-56	149	4	-24	10	11	37	103
Number of full-time equivalent employees.....	15,285	14,183	14,969	16,122	16,413	17,231	16,024	16,579	16,900
Average annual earnings per full-time employment.....	3,040	3,092	3,300	3,612	3,833	4,049	4,116	4,351	4,500

¹ Breakdown of total income partially estimated. Figures rounded to nearest \$100,000,000.

² Includes insurance, pensions, and accident compensation.

³ After excluding inventory profits or losses.

Average hours and earnings of production workers in manufacturing (1948-56)

	1948	1949	1950	1951	1952	1953	1954	1955	1956
Average weekly hours.....	40.1	39.2	40.5	40.7	40.7	40.5	39.7	40.7	40.5
Average hourly earnings.....	\$1.35	\$1.40	\$1.47	\$1.59	\$1.67	\$1.77	\$1.81	\$1.88	\$1.98
Average weekly earnings.....	\$54.14	\$54.92	\$59.33	\$64.71	\$67.97	\$71.69	\$71.86	\$76.52	\$80.13

Chairman PATNAM. Mr. Nat Weinberg, Director, Research Department, United Auto Workers.

STATEMENT OF NAT WEINBERG, DIRECTOR, RESEARCH DEPARTMENT, UNITED AUTO WORKERS

Mr. WEINBERG. Mr. Chairman and members of the committee, we are most happy to have the opportunity to appear before this committee on the subject of prices. We earnestly hope that following this discussion today the committee will proceed as quickly as possible with a thorough-going and searching investigation of wage-price-profit relationships in leading corporations in certain industries that our union has repeatedly urged since July 1955. There is not time today to present all the evidence that cries aloud for such an investigation of the auto industry, for example. But permit me to cite a few of the pertinent facts.

General Motors and Ford raised their prices in the fall of 1955, using the economic gains won by our members earlier in that year as their major excuse. The cost of those gains to the corporations came to about 20 cents an hour. During the first 9 months of 1955, before prices were raised—but after the gains of the workers had already been largely in effect for 4 months—General Motors profits before taxes came to \$2.93 per hour for every hour worked in its plants by all its 400,000 U. S. factory workers, yielding a return on the stockholders' investment equal on an annual basis to 78.9 percent. After taxes the rate of return was still a fabulous 36.5 percent. In Ford's case, profits per hour were \$3.06, and the rate of return on investment was 57.7 percent before taxes, and 26.1 percent after taxes.

These after-tax profit rates were two to three times the 13 percent average for all U. S. manufacturing corporations during the same period which happened to be a period of generally high profits. Yet General Motors and Ford raised their prices and sought to put the blame for the increases on the gains won by their workers through collective bargaining.

Again in 1956 they raised their prices, this time despite a depressed market and widespread unemployment among the industry's workers.

In the face of this kind of situation, labor and management alike are being exhorted to exercise restraint in their wage and price actions. Exhortation implies that both have been guilty of lack of restraint. We hope this committee will move vigorously to find out whether that is really so in order that the pressure of public opinion may be effectively concentrated where the guilt lies, and the innocent protected against unjust condemnation.

The determination of culpability is in any case the necessary first step toward connection of the situation.

The very fact that exhortation is resorted to in order to restrain inflation points to the unique nature of current increases in the price level. They do not for the most part result from the blind and impersonal operation of market forces. They do not, on the whole, result from abnormally high demand or high production pressing against capacity limits. In fact, recent increases in the physical volume of production have been considerably less than normal; and in industry after industry, prices have been raised in the face of diminishing sales and swollen inventories. Price increases under these circum-

stances are clearly not a reflection of the operation of the law of supply and demand. It can be shown also, and we hope this committee will very soon give us opportunity to show, that in the industries which have contributed significantly to our current inflation, price increases are not the result of cost increases that have squeezed profit margins to an unreasonably small size.

What these price increases do reflect in our opinion is the absence of price competition, and the operation of an "administered price" system. Under this system a few corporations furnishing "price leadership" to industries crucial to the national welfare hold the power to fix prices arbitrarily. They are not subject to the laws of the market place that inhibit the pricing practices of corporations in price-competitive industries.

With respect to these corporations, therefore, the consumer and the Nation are without the protection that market forces afford in industries where price competition prevails. We are prepared to show that many corporations possessing the power to administer prices have abused that power. They have fixed their prices on the basis of what is considered financially desirable for the corporation, without regard to what is desirable and necessary for the Nation as a whole, and for the health and stability of our economy.

We hold strongly to the belief that the pressure of public opinion can minimize or at least reduce the extent of such abuse of pricing power. But the public can be mobilized to an effective expression of opinion only if it is equipped with the facts. General exhortation directed to all and sundry will not do the job. The specific and detailed facts of specific situations, leaving no room for doubt as to whether or not there has been abuse, can create a climate of public opinion which will induce self restraint on the part of those who would otherwise be tempted to abuse that power.

We would like to make two proposals designed to equip the public with the necessary facts. Our union has always believed that economic decisions, particularly those affecting the general welfare, should be made on the basis of economic facts, rather than on the basis of economic power. This holds whether the power involved be the power to shut down a plant and keep it shut down, or the power to extort from consumers any price that a corporation may deem it desirable in its narrow interest to exact.

For ourselves, we of the UAW are willing to be bound by the policy that demands for wage increases and other gains in administered price industries should be confined within the limits of ability to pay, without price increases, of the efficient firm functioning under full employment conditions. This is no new principle for us. We first offered to be bound by it during the General Motors strike of 1945-46 when more than 200,000 of our members struck 113 days for wage increases without price increases. We offered during that strike to reduce our wage demand, justified though we were convinced it was, to whatever the amount—zero if need be—that could be paid by the corporation without an increase in its prices.

Implementation of this policy requires, of course, that the facts on ability to pay be available to us and to the public. Both must have all the information that is necessary to determine beyond a reasonable doubt the size of the economic package that could be granted without

reducing the profits of an efficient firm in a full-employment economy below a reasonable level. Obviously this cannot be a universal policy applicable to all industries. It would be improper, inequitable, and economically unsound to apply it in industries where existing wage levels are substandard. It is unnecessary to apply it in industries where prices are set by competition rather than by corporate fiat. Balancing the obligation we are ready to assume, we propose that a similar obligation be assumed by corporations in a position to administer prices.

Specifically, we propose a statutory mechanism that would assure the public of an adequate flow of essential factual information concerning certain corporate price actions, without involving Government in the task of controlling prices. As we presently visualize it, legislation directed toward this objective would require advance notice and public justification of price increases proposed to be put into effect by any corporation which accounts for more than a specified percentage—perhaps 20 or 25 percent—of the total sales of its industry. Such a corporation would give notice of intention to raise prices to a governmental agency created for that purpose. The agency would thereupon conduct public hearings at which the corporation would be required to present detailed justification based upon its records of the need for the proposed price increase. Its testimony would be subject to cross-examination and its pertinent records open for inspection both by the agency and by representatives of organizations or groups opposing the proposed price increase, including other corporations which purchase goods produced by the firm proposing to raise its prices.

Following the hearing, the agency would promptly publish the contentions of the parties, and the facts as it had determined them. The hearings having been concluded and the notice period having expired, the corporation involved would then be entirely free to raise the price if it so chose. But the public would have the means to determine for itself whether or not the price increase was justified.

These proposals rest on the premise that an effective democracy must be an informed democracy. They impose no compulsion with respect to wage or price actions. They infringe no freedom. They are designed solely to minimize the abuse of freedom through the uninhibited exercise of economic power. They are aimed at encouraging responsibility in the exercise of economic power by removing the veil of secrecy that now conceals facts of vital public interest, and thus shelters the irresponsible.

We most earnestly urge that the members of this committee give these proposals their careful consideration.

Mr. Chairman, I have submitted a longer statement to the staff, and I would like to ask that it be included in the record.

Chairman PATMAN. It will be included in the record.

(The statement follows:)

STATEMENT ON PRICE INCREASES

(By Nat Weinberg, director, research and engineering department)

We are most happy to have the opportunity to appear before this committee on the subject of prices. We earnestly hope that this discussion today marks the beginning of the culmination of our efforts of many months to bring about a thoroughgoing and searching investigation into wage-price-profit relationships in certain industries. In these industries, which are crucial to the welfare of

the economy as a whole, a few leading corporations hold the power to fix prices arbitrarily. They are not subject to the laws of the market place that inhibit other corporations and other industries in pricing their products. With respect to these corporations, the consumer and the Nation are therefore without the protection that market forces afford in industries where competition prevails.

We believe, and we hope we will be given the opportunity to prove, that major corporations which furnish price leadership in a number of industries have abused their power. We believe that the force of public opinion can, to some degree at least, make up for the absence of the protections against such abuse that price competition provides where it exists. We hope that this discussion today is the first step toward marshaling the force of public opinion to induce restraint on the part of those who are responsible for our current inflation.

The members of the UAW have paid heavily in sacrifice for the right to be heard on prices. More than 200,000 of them walked the picket lines for 113 long days in 1945-46 in an effort to win "wage increases without price increases"—in an effort to prevent fulfillment of their legitimate demands from being used as an illegitimate excuse to inflict unjustifiable price increases on American consumers generally.

Since then, our union has repeatedly sought to arouse the Nation to protect itself against excessive prices. Time and time again, we have attempted to call public attention to unjustifiable and extortionate price increases by automobile manufacturers and by corporations in other industries.

We take pride in the belief that we have played some part in bringing this group together today. In July 1955 our union's international executive board called for a congressional investigation of wage-price-profit relationships, with particular emphasis on the auto and steel industries. At that time, the steel industry had already raised its prices for the 18th time during the postwar period. The signs were clear that the leading automobile producers were once again about to raise their prices. As we expected, they did raise prices with the introduction of new models in the fall of 1955.

Since then, further general price increases have been put into effect in both the steel and auto industries, and the steel industry has recently been adding increases on so-called extras and certain base prices to its general price increases of 1955 and 1956.

We urge that, following this general discussion today, preparations be made forthwith to begin a full-scale investigation of such industries as soon as is humanly possible.

We hope that such an investigation will be carefully planned to assure that specific and up-to-date facts about specific price increases will be laid bare. No witness, whether from labor or from management, should be permitted to substitute self-serving public relations declarations for facts and figures. Detailed and specific information should be required on prices, profits, wages, material costs, productivity, and similar matters.

If adequate information is not produced voluntarily, this committee or some other appropriate congressional committee should be prepared to seek from Congress the funds, the staff (including expert accountants) and the subpoena power required to conduct a thorough examination of all pertinent books and records.

The danger of inflation is too real and too important to permit any evasion of the responsibility that rests upon all of us to disclose all information which may be useful in developing a public policy to meet it effectively.

In our considered opinion, a full public airing of the relevant facts concerning specific recent price increases can, by itself, do much to arrest the current inflationary spiral. It would certainly give food for thought to those who might be tempted in the future to increase prices without any justification other than the fact that they want greater profits and can exact them.

This, in our opinion, is all the justification there is for the price increases that have impelled our repeated requests for an investigation. There is not time here to cite all the pertinent evidence. But permit me to mention a few facts with reference to the price leaders in the auto industry.

General Motors and Ford raised their prices in the fall of 1955, using the economic gains won by our members earlier that year as their major excuse. The cost of those gains to the corporations came to about 20 cents an hour. (The precise figure depends on the assumptions made in calculating the cost of certain of the gains.) During the first 9 months of 1955—before prices were raised but after the gains of the workers had already been largely in effect for 4 months—GM's profits before taxes came to \$2.93 per hour for every hour worked in its plants by all its 400,000 United States factory workers; yielding a return

on the stockholders' investment equal, on an annual basis, to 78.9 percent. (After taxes the rate of return was still a fabulous 36.5 percent.) In Ford's case, profits per hour were \$3.06 and the rate of return on investment was 57.7 percent before taxes, and 26.1 percent after taxes.

These after-tax profit rates were 2 to 3 times the 13.1 percent¹ average for all United States manufacturing corporations during the same period, which happened to be a period of generally high profits.

Yet GM and Ford raised their prices and sought to put the blame for the increases on the gains won by their workers through collective bargaining.

In the fall of 1956, these same corporations increased their prices again when they introduced the new 1957 models. Once more, they darkly hinted that wage increases were the cause. Yet the only wage increases their workers had obtained since the price increases of 1955 were the so-called annual-improvement-factor increase and cost-of-living wage adjustments.

By the industry's own admission, the improvement factor provides no basis for price increases. In the words of Mr. Harry Anderson, former vice president of General Motors, it is "repaid in the form of increased production so that in effect you sometimes have a decrease in actual cost for a particular unit."

The cost-of-living wage adjustments similarly do not justify the blame for higher prices which the leading auto corporations seek to fasten upon their workers. Such wage adjustments are merely a reflection of price increases that have taken place before the wage adjustment is made. Ironically, in December 1956, autoworkers obtained a 2-cent per hour cost-of-living adjustment largely because of the higher price tags on the new 1957 car models, which had been introduced a month or two earlier.

Our union has repeatedly made clear its position with respect to cost-of-living wage adjustments. We would much prefer that no occasion should ever arise for cost-of-living wage increases. They come about through no action of the workers but simply because prices have been raised by others over whom the workers have no control. All too often, the price increases which bring about cost-of-living wage increases are put into effect arbitrarily by the same corporations which seek to blame wage increases for their higher prices.

We have emphasized repeatedly that the worker does not gain but actually loses when he receives a cost-of-living wage increase. At most, such adjustments protect him and his family against reductions in the buying power of his current wages. He remains a victim of inflation because he loses out in the buying power of his savings, his insurance, and even of many other benefits won through collective bargaining such as pensions and weekly sickness and accident benefits.

In the absence of cost-of-living wage adjustments, workers would sacrifice their families' living standards so that others might reap inflationary profits: and the consumer purchasing power base upon which economic stability ultimately depends would be seriously undermined. Moreover, industrial conflict would be aggravated and embittered as workers found themselves engaged in repeated struggles merely to regain what the thief of inflation had taken out of the buying power of their wages.

We hear much advice these days to limit our wage demands to amounts commensurate with increases in productivity. But surely those who offer this advice cannot in good conscience refer to money wages. They must mean real wages. For, if applied to money wages in the face of rising prices this advice would mean constant declines in the living standards of workers and their families or, at the very least, a constantly diminishing share for workers in the increasing volume of goods and services that they produce.

There is an abundance of evidence that employers find themselves compelled to raise wages to meet cost of living advances, although often not as promptly and fully as they should, even in the absence of unions. Thus, the responsibility for cost-of-living wage increases cannot be laid at the door of unions. They come about through the action of forces over which unions have no control—specifically, the prior price increasing actions of corporations.

Therefore, if wage increases are to be compared to productivity increases for purposes of determining the influence of unions on the price level, the proper comparison is with real wages and not money wages. On this basis, it is clear beyond all possibility of doubt that the blame for price increases cannot be pinned on labor. It can be shown that the real economic gains of workers in the post-war period, including fringe benefits as well as wage increases, have

¹ FTC-SEC figures adjusted to show percentage return on net worth as of beginning of year for comparison with GM and Ford figures which are calculated on same basis. Before adjustment, the FTC-SEC quarterly figures average 12.7 percent for the year.

not outpaced productivity, although it probably would have been desirable for them to do so.

We hope this committee will call upon the corporations that have been primarily responsible for recent rising price trends to provide it with the basic data from which actual increases in the productivity of their workers can be computed. We are confident that such computations will show that the real wages of their workers have lagged behind rather than exceeded their productivity.

We reject, however, the notion that wage increases must never exceed the size of the productivity increment. This notion assumes implicitly that the existing relationship between wages and productivity is the proper one. It assumes, further, that workers in industries where productivity advances relatively slowly have no claim to a fair share in the increasing fruits of technological advance in the economy as a whole. Moreover, it would require that workers earning substandard wages abandon all hope of raising their families' living standards to generally prevailing levels. Furthermore, we believe it to be a dangerous notion from the standpoint of the long-term health and stability of the economy. The danger flows from the fact that the productivity of capital as well as of labor is increasing. Thus, year by year, it takes less investment than previously to produce more goods with fewer workers. In consequence, the failure of wages to move ahead faster than productivity would lead to a situation of growing imbalance between a greatly augmented power to produce and an increasingly inadequate power to consume.

These considerations of basic economic principles and long-term economic prospects, although definitely relevant, take us far away from the pressing current problem that has brought us together. In order to deal effectively with this problem we must recognize its unique features. We must recognize, specifically, that our current inflation does not, on the whole, result from abnormally high demand and high production rates pressing against capacity limits. In certain bottleneck areas of the economy, like the steel industry, capacity is a problem; but it is an artificially induced problem resulting from the policy of planned scarcity followed by the steel industry in order to maximize its prices and profits while minimizing its risks. Our union has had occasion, in other congressional hearings, to deal with this matter. It would be most instructive, incidentally, for this committee to examine the steel industry's 1947 projections of future steel capacity needs in the light of shortages currently being experienced despite capacity that far exceeds what the steel industry said we would need by this time. The industry still follows a policy of planned scarcity; and that policy supports and reinforces its inflationary price policy.

For the economy as a whole, however, the significant feature of the current inflation is that prices are being increased at a time and in industries where current rates of production are substantially below capacity. In fact, in some industries, notably oil, automobiles, and agricultural implements, prices have been raised at a time when sales were depressed and/or inventories were rising. Price increases under these circumstances are obviously not a reflection of the operation of the law of supply and demand. It can be shown also, and we hope this committee will very soon give us opportunity to show, that in the industries that have contributed significantly to our current inflation, price increases are not the result of cost increases that have squeezed profit margins to an unreasonably small size.

What the price increases do reflect, in our opinion, is the existence of an administered price system which enables certain corporations to fix their prices on the basis of what is considered financially desirable for the corporation and without regard to the needs, the welfare, and the stability of the economy as a whole.

The action of such corporations in raising prices in the face of adverse market conditions is of most direct concern to those of us in the trade union movement for it has grave effects on the employment opportunities of our members. This is evident from the warning given the auto industry by the president of the National Automobile Dealers Association before the increase in prices on 1957 models. This gentleman, Mr. Carl Fribley by name, said that higher price tags "could mean the difference between a 6½- to 7-million-car year or a 5½- to 6-million-car year." Such a difference in sales would reflect itself in a difference of approximately 100,000 jobs in the automobile industry. There is evidence that the effects are already being felt. As of mid-December, 83,000 workers were unemployed in the Detroit area compared to 45,000 in the same month a year earlier.

The administered price system should also, in our opinion, occupy a central place in the attention of this committee. The Joint Economic Committee operates under a statute which has as its goal the achievement and maintenance of maximum employment. It is obvious, however, that full employment policy can be nullified and frustrated in practice by abuse of the power possessed by certain corporations to fix prices administratively. Such abuse results in the siphoning off into a relatively few corporate treasuries of purchasing power required to sustain demand in other areas of the economy. No matter what may be done by Government and private groups to provide the economy with adequate purchasing power, abuses under the administered price system can make their efforts inadequate to sustain full employment.

The existence of the administered price system in crucially important areas of the economy requires all of us to take a fresh look at the problem of inflation. The shibboleths of the free market, competition, supply and demand, no longer have any validity, if they ever did, for those sectors of the economy where prices are now fixed by decisions of a few corporate executives rather than by the impersonal interplay of the forces of the market.

With respect to these areas of the economy, we must find ways to make up for the absence of the restraints imposed by competition. This, it seems to us, is one of the central economic problems of our time. We do not pretend that we have found any final answers to these problems. We do wish, however, to make two proposals which we hope will receive the earnest consideration of this committee and of American citizens generally.

One proposal calls for self-restraint by our union as an organization, although we have not been guilty of exceeding the bounds of sound wage policy. The second proposal calls for self-restraint on the part of corporation possessing the power to administer prices. In both cases, the proposals would buttress self-restraint with the force of public opinion. In both cases, also, the proposals would equip the public with the facts required to measure the degree to which self-restraint had been exercised in conformity with the requirements of the general welfare.

Our union has always believed that economic decisions, and particularly those affecting the general welfare, should be made on the basis of the economic facts rather than on the basis of economic power. This applies whether the power involved be the power to shut down a plant of a corporation and to keep it shut down, or the power to extort from the consumer any price that a corporation may deem it advisable in its narrow interest to impose.

For ourselves, we of the UAW are willing to be bound by the policy that demands for wage increases and other economic gains in administered price industries should be confined within the limits of the ability to pay, without price increases, of the efficient firm functioning under full employment conditions.

This is no new principle for us. We first offered to be bound by it during the General Motors strike of 1945-46 when, as noted, more than 200,000 of our members struck 113 days for "wage increases without price increases." We offered during that strike to reduce our wage demand, justified though we were convinced it was, to whatever the amount—zero if need be—that could be paid by the corporation without an increase in its prices.

Implementation of this policy requires, of course, that the facts on ability to pay be available to us and to the public. Both must have all the information that is necessary to determine beyond a reasonable doubt the size of the economic package that could be granted without reducing the profits of an efficient firm in a full employment economy below a reasonable level.

Obviously this cannot and should not be a universal policy applicable to all industries. It would be improper, inequitable, and economically unsound to apply it in industries where existing wage levels are substandard. In such industries, price increases may be necessary to bring wages up to prevailing levels. But such price increases can and should be offset, thus avoiding a rise in the general price level, by price reductions in industries with excessive profits and in others characterized by rapid technological advance. Similarly, this wage policy, designed for an administered price industry, is impracticable and unnecessary in industries where prices are set by competition rather than by corporate fiat.

Balancing the obligation we are ready to assume to be bound by the economic facts, we propose that a similar obligation be assumed by corporations in a position to administer prices. Specifically, we propose a statutory mechanism that would assure the public of an adequate flow of essential factual information concerning certain corporate price actions without involving Government in the task of controlling prices.

As we presently visualize it, legislation directed toward this objective would require advance notice and public justification of price increases proposed to be put into effect by any corporation which accounts for more than a specified percentage—perhaps 20 or 25 percent—of the total sales of its industry. Such a corporation would give notice of intention to raise prices to a governmental agency created for this purpose. The agency would thereupon conduct public hearings at which the corporation would be required to present detailed justification, based upon its records, of the need for the proposed price increase. Its testimony would be subject to cross-examination and its pertinent records open for inspection both by the agency's staff and by representatives of organizations or groups opposing the proposed price increase, including other corporations which purchase goods produced by the firm proposing to raise its prices.

Following the hearing, the agency would promptly publish the contentions of the parties and the facts as it had determined them. The hearings having been concluded, and the notice period having expired, the corporation involved would then be entirely free to raise the price if it so chose. But the public would have the means to determine for itself whether or not the price increase was justified.

These proposals rest on the premise that an effective democracy must be an informed democracy. They impose no compulsion with respect to wage or price actions. They infringe no freedom. They are designed solely to minimize the abuse of freedom through the uninhibited exercise of economic power. They are aimed at encouraging responsibility in the exercise of economic power by removing the veil of secrecy that now conceals facts of vital public interest and thus shelters the irresponsible.

We most earnestly urge that the members of this committee give these proposals their most careful consideration. We do not claim they are necessarily the best or the only answer to the problem of administered-price inflation. We do hope that consideration of these proposals will yield implementing ideas, necessary modifications and, possibly, better alternatives. We offer these ideas now as a modest contribution toward the development of workable means for the achievement of responsible economic self-restraint on the part of all groups in our population. Such restraint, we believe, is an essential to the health of a democracy that resorts to compulsion with reluctance and only when lack of self-restraint has led to intolerable abuse.

Chairman PATMAN. Mr. Karl Fox, head, department of economics and sociology, Iowa State College.

STATEMENT OF KARL FOX, HEAD, DEPARTMENT OF ECONOMICS AND SOCIOLOGY, IOWA STATE COLLEGE

Mr. Fox. Mr. Chairman, I am going to confine my remarks to things more or less directly related to agriculture. To what extent have agricultural prices contributed to this recent rise in the general price level? To what extent have price increases in other parts of the economy affected the welfare of farm people?

In recent years, United States agriculture has been subjected to a series of shocks and pressures that have caused farm product prices to move oppositely to prices of other goods and services. During the first few months of hostilities in Korea, prices of both farm and industrial products rose sharply. Both sets of prices declined a little during 1951-52, but after August 1952 farm prices fell rapidly while industrial prices leveled off and subsequently increased.

Two factors sparked the initial drop in farm prices. A big increase in cattle marketings dropped cattle prices more than a third between August 1952 and August 1953.

At the same time our exports of farm products were sharply reduced—wheat from 444 million bushels in 1951-52 to 296 million in 1952-53, and cotton from 5.5 million bales in 1951-52 to 3.0 million in 1952-53. Stocks of wheat and cotton began piling up rapidly under

the Government loan program. In 1953, big crops of wheat and cotton were produced on unrestricted acreages, swelling our carry-over by more than 300 million bushels of wheat and 4 million bales of cotton.

In 1954, marketing quotas were applied to wheat and cotton and acreages of these crops were reduced. But most of the acres taken out of wheat and cotton were planted to feed crops, which flooded over into the livestock economy of the Corn Belt and other regions. The resulting low prices and ample supplies of feed led to a rapid increase in livestock production and, among other things, to the ruinously low hog prices of late 1955 and early 1956. By December 1955 prices received by farmers were down to bedrock, 24 percent lower than in August 1952. Prices paid by farmers fell only 3 percent, and the parity ratio fell from 102 down to 80. The decrease in prices paid was small comfort to farmers generally, as it resulted from lower prices for feed and cattle purchased by some farmers from other farmers.

Retail prices of food also declined, though not nearly so much percentage-wise as did prices at the farm level. The decline in food prices permitted a misleading stability in the general level of consumer prices. Thus, the Consumer Price Index stood at 114.3 (1947-49=100) in August 1952 and at 114.6 in February 1956; up only a fraction of 1 percent. But the food price component of this index declined from 116.6 to 108.8 between the 2 months; retail prices of other goods and services evidently increased by 3 or 4 percent.

From February 1956 to November 1956, the retail food price index recovered about 4 points of its earlier decline. With food prices no longer falling, the increase in nonfarm prices was clearly revealed and the Consumer Price Index as a whole rose 3.2 points, about 3 percent, from February to November 1956. Prices received by farmers also arose about 3 percent between the 2 months, but a corresponding increase in prices paid kept the parity ratio at 81 in both months.

Thus, changes in farm prices and incomes during the past 4 or 5 years have been deflationary and have been dominated by special problems peculiar to the agricultural sector. These problems result in part from Government policies and are in part amenable to correction by Government programs. With huge surpluses of wheat, cotton and corn available for sale at prices determined by the Government, the agricultural sector cannot play an active inflationary role in the economy during the next 2 or 3 years.

However, a moderate rise in farm product prices could be induced if production of corn and other feed grains were cut below the level of consumption and export demands. Market prices of feed grains would drift upward from points well below applicable support prices to levels slightly above them; within a year or 2 prices of some livestock products would rise by a similar percentage until normal livestock-feed price relationships were restored.

The effects upon farm people of changes in nonagricultural prices enter via marketing charges on the one hand and production expenses on the other. Farm prices for livestock and other perishable food products are equal to retail prices minus marketing charges. Increases in freight rates, container prices, and labor costs per unit of product handled may be regarded as driving a wedge between farmers and consumers. Such increases have indeed occurred. From 1952

(annual average) to October 1956 the retail cost of the "food market basket" declined about 4 percent. But marketing changes increased 7 percent, and the farmer's return declined 18 percent. The farmers' share of the consumers' food dollar decreased from 47 percent to 40 percent during this period.

Prices received by farmers (times quantities sold) determine gross farm income. Net farm income equals this gross income minus production expenditures. From 1952 to 1955 gross farm income fell nearly \$4 billion. Production expenditures decreased about \$1 billion, due to lower prices for purchased feed and livestock; expenditures for items of nonfarm origin remained about constant, while net farm income fell \$3 billion—over 20 percent. Gross farm income and production expenditures in 1956 are both up slightly from 1955, and net farm income, including Soil Bank payments, is also up a little.

Increases in prices of farm machinery and other items used in production will reduce net farm income unless support prices, based upon the parity index, are increased proportionately. But this effect lags a year behind the increase in prices paid and applies directly to products accounting for less than half of gross farm income. The effect of higher price supports for corn on prices of livestock takes another year or more to materialize. Under current conditions, a general price inflation with no increase in the real incomes of consumers will tend to undermine the real net incomes of farm operators from farming.

On the other hand, an increase in the real income of consumers tends to raise farm prices of livestock and other perishable food products by a somewhat larger percentage, with favorable effects on net farm income and its purchasing power. Thus, farmers have a stake in the maintenance of high employment without price inflation if the two can be reconciled.

Thank you.

Chairman PATMAN. Thank you, sir.

Mr. Albert Rees, associate professor of economics at the University of Chicago.

STATEMENT OF ALBERT REES, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. REES. Mr. Chairman, members of the committee, the rise in prices during 1956 should be viewed against the background of 3 preceding years of extraordinary price stability. The consumer price index has risen slightly more than 3 percent in the past 4 years, during a period when employment has been high and growth has been rapid. This good record was not accidental. It was made possible by generally sound monetary and fiscal policies, in which the administration, the Congress, and the Federal Reserve System can take pride.

Our commitments to maintain high employment means that there is always a potential danger of inflation. However, I doubt whether the price rise of the past year is the beginning of an immediate inflationary movement. The stringency of present monetary policy and the surplus in the cash budget should be sufficient to check any substantial further price rises. If business expenditures for new plant and equipment were to fall from the unprecedented level they have now

reached, which could well happen, I should expect to see prices turn downward.

The portions of the President's state of the Union message dealing with inflation were disappointing to me, particularly so because I have admired the general economic policies of the Eisenhower administration.

An appeal to business and labor for price and wage restraint is no novelty; similar appeals were made by President Truman on several occasions. We have learned that this method of fighting inflation encounters two difficulties.

First, in most areas of a free economy, it won't work. Many businessmen and union leaders will refuse to act against their own interests; other who might be willing to do so will be dissuaded when they see rivals pursuing a more profitable course. It might be added that appeals for restraint are least effective where the economic system is most competitive.

Second, and more important, such appeals, if heeded, can do much harm. In a moment I shall try to explain how this harm is done.

The President said, "Business in its pricing policies should avoid unnecessary price increases, especially at a time like the present when demand in so many areas presses hard on short supplies." This suggests that price increases can only be justified by higher costs. But higher demand may itself be a justification for price increases. Higher prices direct goods where needs are greatest and insure that purchases are reduced most where needs are least. Buyers whose requirements are not urgent will postpone or reduce their demands or turn to substitute commodities. The alternative under voluntary price restraint is for sellers of scarce goods to allot them among eager buyers according to past patronage, or on the basis of friendship, or in exchange for favors.

In other words, where you have a price that will not clear the market and where some form of nonprice rationing would be required to divide goods among buyers, I believe prices increases are justified even if there has been no change in costs. That does not mean, of course, that all price increases are justified.

Such a system—that is, a system of nonprice rationing—discriminates against new and growing firms and against new and growing uses of materials at a time when innovation and growth are badly needed.

Discussion of recent price rises in the press and by business leaders has usually been stated almost entirely in terms of costs and has neglected the role of demand. It is interesting to note that during 1956 the wholesale prices of durable finished producer goods rose 8.3 percent, while the wholesale prices of durable consumer goods rose only 3.8 percent. Changes in the costs of producing these two kinds of goods must have been very similar, but in 1956 the demand for producer goods increased rapidly.

The particular cost whose role is most emphasized is wages, and wage increases are attributed largely to labor unions. Indeed, unions are often thought to be primarily responsible for inflation. As applied to the United States, this view is certainly too simple and probably substantially wrong. First, unions have had less influence on wages, even for their members, than is usually assumed. Since 1939 aver-

age hourly earnings in manufacturing have risen from 63 cents to \$2.05, more than a threefold rise. Most of this rise is surely due to the increase in quantity of money, to rising productivity, and to the high level of demand for labor. I should be surprised if unions are responsible for as much as 10 percent of it, though the dramatic nature of the collective bargaining process often causes them to get credit for much more. Of course, unions have also made important and desirable noneconomic gains for their members, such as the establishment of machinery for handling grievances.

Nor have unions necessarily contributed to inflation to the extent that they have raised the wages of their members. The state of the Union message said:

Wage increases that outrun productivity, however, are an inflationary factor.

This is true in some circumstances, but it need not be true.

Suppose that in a period of price stability wages rise more than productivity in industries that are not experiencing any labor shortage. This creates a nasty dilemma for the Government. If the monetary and fiscal authorities keep aggregate demand high enough to maintain employment in the affected industries, prices will rise. If aggregate demand is restrained or reduced to keep prices stable, either wages in other industries will fall or, more likely, unemployment will increase. The essential point is that any government not controlled by labor unions can choose between the horns of this dilemma. If it chooses to restrain demand, it reduces the extent to which the wage increase will be passed on to consumers in higher prices, and it creates a powerful check to further wage increases.

While the choice between these unpleasant alternatives may someday confront us, I doubt whether it has confronted us as yet. Past price rises, in my opinion, have started with increases in demand. In particular, the price rises of 1956 seem to me to be much more closely related to heavy business investment than to collective bargaining. But regardless of the source of a rise in the general price level, reductions in the rate of growth of the money supply and surpluses in the Federal cash budget are the only sound weapons for combating it.

I have not had time in this statement to touch on the role of productivity in determining particular wages. Since it has been mentioned very frequently here this morning, I might say that productivity in one particular industry should have anything at all to do with the determination of wages in that industry. I think the relationship is a much more general one. If time permits I should like to come back to that point later in the discussion.

Chairman PATMAN. Thank you. Members of the committee are limited as the panel is, so I shall be very brief, and then I shall yield to Senator Watkins.

First, I am going to try something that we have done before, to get the attitude of the members of this fine panel on two questions.

The first question is whether or not you see any signs of a buyer's strike or buyer's resistance to higher prices. If you see any sign of evidence of buyer's resistance to higher prices would you mind indicating by an uplifting of hands? Do you see any signs or any evidence?

I see Mr. Keyserling, Mr. Brubaker, Mr. Weinberg, and Mr. Rees have their hands raised.

Mr. BRUBAKER. I am personally on strike against the higher prices of cars.

Chairman PATMAN. That would be included. I had reference to any industry.

As you know a large part of the capital expenditure for plant and equipment are obtained by higher prices through retained earnings—in fact, last year I think the evidence before this committee disclosed that 67 percent of the capital expenditures was obtained from retained earnings and depreciation. Testimony yesterday disclosed that this year it will probably be 70 percent, as prices are set higher in order to acquire expansion capital. Do you believe that could be one of the principal causes of inflationary danger that we will face in 1957?

Mr. BRUBAKER. I so noted in my statement, the part I did not get to present.

Chairman PATMAN. I do not believe that I will ask any more questions until the other members of the committee have had an opportunity to inquire. I shall now yield to Senator Watkins.

Senator WATKINS. Mr. Chairman, I would like to say that so much was said in a few minutes, I am quite overwhelmed with the statements and contradictory statements. I want to read it and analyze it all and I think I can contribute most at this time by listening.

Chairman PATMAN. Senator Sparkman, of Alabama.

Senator SPARKMAN. Mr. Chairman, perhaps it would be a matter of wisdom for me to follow the example set by Senator Watkins, but a great many questions are raised in my mind by the various, statements.

Since the last statement is freshest on my mind, I think I will start off by asking a question about the price stability that we have had. I notice the statement that we have had remarkable price stability for the period of the last 3 years, and then have had a sharp rise during 1956.

Just for curiosity's sake, I went back to the tables shown in the Consumer Price Index. I would like to ask this question: Is it not true that that stability really started back in the latter part of 1951 or the latter part of 1952, or you might even put it earlier than that? Did it not tie in almost exactly with the decline in farm prices?

Mr. REES. Senator, it is quite true that if you look at wholesale prices—

Senator SPARKMAN. I am looking at consumer prices.

Mr. REES. There was some rise in consumer prices during the period you mention.

Senator SPARKMAN. I wonder if you would turn to page 23 of Economic Indicators and then look on page 25 at the table, Prices Received and Paid by Farmers. It seems to me that there is a remarkable parallel if you look at the graphs and particularly if you look at the index numbers given before the graph in each case.

I notice, for instance, that in 1951 all items stood at 111. That was just about the time that we were working under controls following the terrific price upsurge that resulted from the Korean War. I notice it stood at 111. In 1952 it stood at 113.5; in 1953, 114.5; in 1954, 114.8; in 1955, back to 114.5.

The latter part of that year it started going up, 114.9, 115, and it ended back at 114.7. It maintained pretty close to that level until some time this year.

The index on the farmers' prices follows almost exactly the same pattern except in the inverse.

Mr. REES. Senator, it is true that the rise in the consumer price index during 1952 and 1951 was quite modest, and I think that is also a good record. I did not mean to disparage it in any way.

Senator SPARKMAN. I am not bringing up that question. I want to show that was when we were coming out of the war period because someone else has said that inflation usually results from war.

But I wanted to see if my reasoning is correct that it was accompanied by a loss of prices to the farmer which, in my opinion, made the difference.

Mr. REES. This is certainly an important element in the whole price picture. My feeling here is that the Government's overall monetary and fiscal policy—I am not speaking at the moment about its agricultural policy—ought to be directed toward the stabilization of the general price level and toward high employment.

In this general price level I include agricultural prices. I do not believe there is any way of using monetary and fiscal policy in such a way as to offset price declines in one particular sector of the economy.

I might say that if agricultural prices had remained stable in that period, it is not clear to me that it necessarily follows that the general price level would have risen, because it is quite possible that in those circumstances the prices of industrial commodities would have risen less than they actually did.

Senator SPARKMAN. I wonder if we may go one step further? Farm prices did start to rise in the summer of 1956. Is that not the same time that the general price index started up?

Has not the level of farm prices pretty much followed the trend? I am agreeing with you that you cannot use the fiscal policy of the Government for one single segment of our economy, but on the other hand, I think it is just as important that we not hide our heads in the sand and think that because the farmers of the Nation have borne the burden over these years, we need not be concerned with the inflationary price increases which have occurred.

I am not an economist, but it does not seem to me that we are getting anywhere if we assume we have had overall price stability without taking into consideration the fact that the farmers have pretty well had the burden of the maintenance of that stability.

Mr. REES. I think it would have been healthy if the price movement during that period had been composed of greater stability within both the agricultural and the nonagricultural components, rather than offsetting movement. Given the surpluses of farm products that we have had, it seems to me the only natural and permanent way of achieving that would have been to move resources out of agriculture at a faster rate than we actually did.

I think, though, that questions in this area should really be directed to Mr. Fox, because he knows a great deal more about that than I do.

Senator SPARKMAN. The reason I directed them to you is because I felt that you dealt with that subject in your paper.

By the way, on this question of surpluses, if we go back to the time when this instability began we did not have farm surpluses, did we? Do you remember, at that time we had to borrow on cotton?

I would be glad for anyone to comment on this. May I go on to say we had an embargo on cotton. We could not ship cotton out of this

country, there was such a scarcity. When India wanted wheat, one of the great objections raised to it was the fact that we did not have enough wheat to spare, but India wanted to relieve her famine. It has not been so long.

Mr. KEYSERLING. I want to make some comments on what Senator Sparkman has said, because I think his question promises to direct this inquiry to some things that are very pertinent.

In the first place, it is true that between the middle of 1951 and the middle of 1953 or shortly thereafter, we had a faster rate of economic growth than we have now, fuller utilization of our resources, much fewer surpluses, and much less price inflation, which indicates the first very important point, that the price inflation of today is not the traditional situation generally of supply pressing against demand, but is rather the administered process of raising prices without justification or necessity.

Second, I understood Senator Sparkman to make the point that we have to consider the allocation and use of our resources, as well as the price structure. If I may say something for a minute about that, because I think it is central, the barrage of price and wage statistics that have been flung at us means nothing unless it is put in the framework of what our economy is really trying to do.

Our economy is really trying to do only two things: Use its resources to produce to the maximum, and get that product used to serve our interests as a nation both overseas and at home. Prices and wages are merely the machinery through which we try to so allocate resources that we get maximum production and use it wisely.

In order to test whether the price trends and wage trends are moving in a favorable or unfavorable direction, you have to set them against the pattern of what is happening to the real economy. What is happening to the real economy now is this, basically: Investment in plant and equipment has been moving relatively too fast as against consumption. If you think this is my special statement, any business analyst will tell you that the real problem for the year ahead is that consumption is not growing fast enough. It has grown only 2 percent in real terms over the past year.

As to the question of the buyers' strike——

Senator SPARKMAN. May I interrupt right there?

Mr. KEYSERLING. Yes, sir.

Senator SPARKMAN. Is my memory correct that within recent weeks 2 or 3 of our big industries have announced a cutback in their expansion?

Mr. KEYSERLING. Yes; that is correct. That is caused not by an inadequacy of profits or an inadequacy of funds. It is caused by they, themselves, beginning to sniff the air of an inadequacy of consumers. That is why they are cutting back. That is where the imbalance is.

There was a question about a buyers' strike. Consumers are not on strike. Consumers do not have the money to buy enough to take up our expanding productive capacity. If they were on a buyers' strike, you would not have had the support of the inadequate level of consumer buying in the past year and a half by an utterly irrational credit boom.

Consumers do not borrow more and more to buy with inadequate incomes if they are on strike. This is not a strike proposition. There is just not enough consumer income.

The current trends in prices and wages, respectively, are rationing our resources contrary to our national needs. They are providing relatively too much funds for plant expansion, and relatively too little funds for consumption. From the equitable point—

Senator SPARKMAN. Would you say, relative to the amount which is available for the construction of homes for Americans at reasonable price?

Mr. KEYSERLING. That is also true. That brings us to the second point, that the utilization of our national economic policy, both the budgetary and hard money policy, is also rationing resources contrary to our primary needs as a nation.

The hard money policy is not interfering with the investment boom. It is interfering with the construction of schools. The hard money policy is not interfering with big business. It is interfering with the marginal producer.

The budgetary policy, to the extent that it has been anti-inflationary, has been anti-inflationary at an excessive cost in terms of basic needs. But it has also been inflationary in the short run, because it has built up bottlenecks. In other words, a policy that does not provide enough water, a policy that does not provide enough roads, a policy that does not provide enough schools when the Russians are training skilled workers 4 or 5 times as fast as we are, is inflationary in the short run and deflationary in the long run.

Senator SPARKMAN. Would you go one step further and say, a policy that is starving or threatening to starve small business?

Mr. KEYSERLING. That is also true. I suggest, if I may humbly do so, that this committee look at the Employment Act of 1946 once again, which sets forth in one sentence a simple and adequate criterion of what economic policy is all about, to wit: What are our needed levels of employment, production, and purchasing power to meet our national needs?

That, of course, involves the distribution and disposition of product. If we have enough resources to add 50 to the horsepower of automobiles every year, and say we do not have enough resources to out-pace the Russians, there is something wrong. If we have enough—

Senator SPARKMAN. I hate to break in, but you and I together have used my share of the time.

Chairman PATMAN. This is so interesting, I have been talking to Senator Sparkman about having an afternoon session.

Mr. Kilburn?

Representative KILBURN. This has been very instructive to me. I am a little puzzled, however, by the varying statements of Mr. Smith, Mr. Hitchings, Mr. Weinberg, and Mr. Brubaker. Did you all use the same set of figures?

Mr. WEINBERG. May I make a comment on that? In the case of Mr. Hitchings' presentation, I think it is interesting and significant that he dealt very largely with information on the overall economy and stayed carefully away from information with respect to the Ford Motor Co.

The thing we are concerned about is that our current inflation is not the result of uniform price movements and price policies throughout the economy, but the price practices of a few corporations that happen to be located at strategic crossroads of the economy where they

can exert enormous economic influence. They exert that influence through the price mechanism. To take overall figures for the economy as a whole and to ignore the specific figures pertaining to those corporations serves to obscure the real source of our present price problems.

In that connection, I would like to make one comment with respect to what the chairman of the committee has said. The chairman has referred to the fact that business has been raising capital through its excessive prices. I would like to stress the fact that there is no need for it to raise capital this way, nor is it the proper way to raise capital.

The fact that there is no need is evident from page 135 of the President's Economic Report. There you will find that since 1947 dividend payments have approximately doubled. Since 1950 they have increased by one-third. If corporations were starved for capital, they would not be paying out these dividends to stockholders. They would be retaining more of their earnings for investment.

Then we come to the question of the propriety of this means of raising capital. Traditionally in economic theory it has been believed that the proper way to allocate capital resources as well as other resources was through competition—to go out into the competitive market for capital and sell stocks and bonds.

But business does not do that today. Instead of raising capital among investors, it asks consumers to provide investment funds through excessive prices. However, the consumer gets no equity when he makes the investment. I would feel a little better about this policy, if with every item containing steel that I bought, I received a share of stock or a part of a share of stock in one of the steel corporations. This would make some sense. If I am to supply the investment capital, I should get an equity.

What we are concerned about is the fact that some corporations—not the whole economy, not small business, not the businesses in the competitive industries—but some corporations, controlling tremendous shares of the total market for their industries are able, at will, to fix prices at a level that they think will best serve their own purposes, regardless of what happens to the rest of the economy.

That is why we have been urging repeatedly, since long before this inflation broke out, starting in July 1955, that a thorough investigation be made of the price practices of corporations that are in a position to fix prices, and we hope that such an investigation will be forthcoming.

Representative KILBURN. It is still not clear why you all use this same set of figures to come to so many different conclusions.

Mr. BRUBAKER. May I comment on that?

One of the central figures in Mr. Smith's presentation was this comparison of United States Steel figures between 1940 and 1955, in which he pointed out that there had been an increase, according to his figures, in employee cost per hour during that period of 8.1 percent per year.

Very frankly, I hope there has been an increase in employee cost per hour during that period. It would be a tragic thing if this had not been, because we have had a tremendous increase in production by United States Steel during that period. We have had a tremendous growth in output per man-hour. If wages per man-hour did not go up during that period, it would simply mean that these poor

wage earners in steel would have less and less money with which to buy, with which to consume, as Mr. Keyserling has pointed out.

I think to round out the picture that Mr. Smith has given you, we ought to look at United States Steel's other figures from 1940 to 1955. If you would look at them you would find that their sales have gone up from roughly \$1 billion to more than \$4 billion in that period. Their profits before taxes have gone up from \$128 million to \$736 million. Their net profits have gone up from \$102 million to \$370 million.

Representative KILBURN. Wouldn't their profits naturally follow sales?

Mr. BRUBAKER. Yes, but they not only followed their sales but they went up by sixfold whereas the sales went up only by fourfold.

Representative KILBURN. Are you talking about net profits on their investment?

Mr. BRUBAKER. This was profits before taxes. I have a figure on net profits on investment. Their net profits on investment in 1940 stood at the level of 7½ percent. In 1955, at the end of this 15 years, their profit on investment was 14.3 percent, or almost twice as great.

This is a picture not of inflation caused by increased employment costs. This is a question of inflation caused by an effort to increase their profit margin. The evidence is there. It is from their own figures.

Let me give you two other figures to fill this in, wages and salaries as a percent of the corporation's sales dollar in 1940 versus 1955. In 1940 wages and salaries were 43 percent of the corporation's sales dollar. In 1955 it was only a little over 39 percent. In other words, we are losing ground within the corporation itself and within the industry in terms of the amount of sales dollar that goes to wages.

Representative KILBURN. I don't think that that in a way is a sound argument to me if the difference accounts for expense of technological improvements.

Mr. BRUBAKER. But this is the total amount which they paid for all employment costs. They are saying that these costs have gone up and they imply that somehow this is bad.

Representative KILBURN. I agree with you and with what the President says. Mr. Rees brought out that you ought to keep abreast of productivity. That is my next question to you and to Mr. Weinberg: If the big companies do not raise their prices unduly for other reasons, do you think that the wages should increase only with productivity?

Mr. BRUBAKER. You are asking me an "iffy" question there. I think the answer in terms of our own union is a fairly simple one. It isn't a question of what we think they should or should not do. The question is what has actually happened. I gave you a comparison in my formal statement as to what has actually happened. We are pictured in the press constantly as being a big union that can force wage increases that are out of relationship to productivity. Actually, if you go back and look at the figures since our union was founded, if you go back and take the figures from the base date used in the recent BLS productivity study, the rise in real productivity, the output per man-hour in steel, has been 68.8 percent. The real straight-time earnings which our people have received have risen only 48.3

percent. If you would add to that an allowance for the fringe benefits which have also improved sharply during that period, you would still find that the growth in output per man-hour has been greater than the total increase in real wages and fringes.

This is very simple. Whether we wanted to or whether we didn't, we have not been able to and we have not forced wages and fringe benefits up in our industry faster than productivity has gone up.

Representative KILBURN. It seems to me that there you have an area of agreement while you folks disagree on your analysis of figures.

Mr. BRUBAKER. I don't think so. There is something much more basic than the figures here.

Mr. SMITH. I think I know the figures of my company and the steel industry's fairly well. All I would like to do at this point is to throw in a little facts. Rather than use those I will, if I may, use this same Bureau of Labor Statistics computation to which Mr. Brubaker has referred.

The increase in output per man-hour, so-called productivity, as calculated by the Bureau of Labor Statistics, has averaged from 1939 to 1955, I believe their calculation was 2.8 percent per annum. This compares with the 8.1 percent increase in the cost per employee-hour.

Chairman PATMAN. Mr. Bolling.

Representative BOLLING. I would like to hear what Mr. Rees has to say on that question.

Mr. REES. Thank you, Mr. Bolling.

Representative KILBURN. So would I.

Mr. REES. I don't want to comment on the figures of output per man-hour versus employment costs in the steel industry. I am not familiar with those figures for recent years. But I do want to say that I don't think you can arrive at a sound wage policy by making that particular kind of comparison. To the extent that productivity has any bearing on wages, it has to be the productivity of the economy as a whole and cannot be the productivity of the particular industry.

To illustrate it very simply, suppose you had an industry whose productivity was increasing by leaps and bounds because this was a rapidly growing industry and one employing a lot of new technology. Suppose we had applied these standards to the television industry starting in 1946. You would have choked off the growth of that industry. The workers in that industry are entitled to some of the productivity gains but they surely are not entitled to all of them in that kind of situation. Something has to be passed on to the consumer in the form of lower prices.

In addition, where you are getting heavy investment in an industry, output per man-hour is rather a bad measure of productivity. The measure you want, which is a hard one to find and much more difficult to compute and that is why we don't use it very much, is output per unit of input, wherein that input you include not only labor input but also inputs of capital and other resources.

We can turn that around. Suppose we applied this kind of standard to an industry which because of its nature is not subject to rapid technological progress. I am a teacher. It takes 1 teacher to teach 30 to 35 students. I assume it did 100 or 150 or 200 years ago. At least there is no measurable way of demonstrating that teachers' productivity has gone up. I think you could say the same about Congressmen. They may be more productive now than they were at

the foundation of the Republic, but we certainly haven't any statistics to prove it.

Senator WATKINS. You might check on the number and kind of bills that we introduce. I think we have shown some progress.

Mr. REES. All I intend to do by this little joke is to show that if we want some of these industries to survive which are not subject to rapid technological progress, and we don't want all their labor bid away by other kinds of employment, we have got to let the people who work in these industries share in the growth of our economy, and in doing that it means that we cannot give the people in the rapidly growing industries, either the workers or the owners, the full fruits of progress in those industries. That is why this discussion of the relation between wages and output per man-hour in the steel industry is likely to be misleading, because I don't think either side can prove its case by reference to these figures.

Representative BOLLING. I would like to get off on a slightly different tack, if I might, and I know there are other people who would like to comment on this. I would like to ask Mr. Rees what criterion should be used in determining a rate of return on investment that constitutes a reasonable level.

Mr. REES. This gets us back in terms of ability to pay as a criterion of wage increases. This is one that Mr. Weinberg has mentioned. I would disagree on that one, too, Mr. Bolling. I don't believe that proper wage levels can be determined by ability to pay, and therefore if you are concerned about wage-price relationships I would not want to get into the kind of determination of a fair rate of return that one gets into, say, in setting public utility rates.

Again, the obvious way of demonstrating this is to take the concern which is losing money. If one of the automobile producers or any other company is losing money, unions will be very reluctant to say that that is a reason for a wage cut and quite rightly so because these workers are worth just as much, their services are just as valuable, their needs are just as great, whether the company is profitable or not.

Perhaps I haven't answered your question, but I don't believe that it should be part of Government policy to determine a fair rate of return outside of the regulated industries. I surely would not want to say what a fair one is. It would have to be higher for risky industries than it is for regulated industries, which are by and large very safe industries in which to invest.

Representative BOLLING. In other words, you would not want even to say that you thought 20 percent on investment was a fair rate of return?

Mr. REES. As an overall rate of return for the whole economy it would certainly seem excessive, but if we have a particular industry where our needs for investment are very great and that industry is risky and the only way we can attract investment into that industry is to offer it 20 percent, I could conceive of circumstances in which I might regard that as fair.

Representative BOLLING. There are representatives here from either side of two industries. For purposes of illustration, what would they say would be a fair rate of return in the automobile industry or the steel industry?

Mr. REES. Mr. Bolling, I just don't feel competent to answer that question, sir. I will have to decline to.

Mr. HITCHINGS. I would like an opportunity to comment since the auto industry has been mentioned specifically. Like Mr. Smith, I assumed that the present hearing was directed toward a broad inquiry into prices for the economy as a whole rather than a specific investigation of the auto industry or the steel industry or any other.

Representative BOLLING. We are not attempting to do that. Let us be very clear.

Mr. HITCHINGS. I agree with Mr. Rees that profits and productivity of a particular company or industry should not be the controlling criteria for establishing wage rates in that company or industry. Furthermore, the facts for the auto industry do not support the extravagant claims made as to increases in profits and productivity relative to wages.

When periods of like unit volume are compared (and this is the only proper comparison for price-cost-profit relationships), dollar payrolls have advanced while profits have not. This is illustrated in a comparison for our own company of 1956 with 1954 and 1950, in each of which years unit volume amounted to about 2 million vehicles. The year 1956 is a proper base because it was neither exceptionally high nor low.

Employee payrolls (including supplemental benefits) in 1956 were 13 percent above 1954 and 83 percent above 1950. Part of this total represented increased hourly and salaried man-hours, but the cost per hour worked by hourly employees was up 11 percent and 43 percent over 1954 and 1950, respectively.

By contrast, the profit position deteriorated. Total profits in 1956 were about the same as 1954 and slightly below the 1950 level. Since invested capital at the beginning of 1956 was 29 percent above 1954 and virtually double that of 1950, the return on investment declined substantially. Furthermore, the purchasing power of total profits was less than in 1954 and 1950 after adjustment for higher prices of goods and services purchased by the corporation and its stockholders. Such was not the case for employee compensation.

Similarly, there are no facts to support the exaggerated claims of productivity increases. There are no adequate measures of comparable input and output for a company such as ours. A simple comparison of hourly worker man-hours per unit of finished output contains many flaws. It fails to include in input the other factors of production and it also fails to distinguish changes in the type of output. Furthermore, changes in the ratio cannot be ascribed to the labor factor.

To the extent that the simple ratio of hourly worker man-hours to vehicle output is used, however, it shows no improvement in 1956 over 1954 and some deterioration from 1950.

Chairman PATMAN. Dr. Talle, would you like to ask some questions?

Representative TALLE. Mr. Chairman, I will forego questions at the moment.

Chairman PATMAN. Senator O'Mahoney?

Senator O'MAHONEY. I came too late to add anything to this panel discussion, not knowing what has been said.

Chairman PATMAN. We are back to Senator Sparkman.

Senator SPARKMAN. I was just going to suggest to Senator O'Mahoney that he could question very well on the two papers presented here with somewhat conflicting views related to the steel industry. As

I recall, it was Senator O'Mahoney who conducted the study that we made back in about 1948 when there was a similar wage rise in steel followed by the still greater price rise in steel, and tried to determine the extent to which the price raise was justified by the wage rise. I am sure you remember that quite well.

I may say, remembering the difficulty we had in reconciling such figures as have been given here by the two different sides, I can easily see the confusion which sometimes develops, but I believe that there was a pretty fair showing made in those hearings and certainly in things that have happened since then to lend some justification to the feeling that many of us have—and I have heard Senator O'Mahoney state it many times—that there is a rather large area of administered prices in some of the big industries.

Senator O'MAHONEY. There isn't any doubt about that, Senator, and I would say offhand that price increases when administered by large companies are just like taxes imposed upon the people by Government for the support of the Government. The United States Steel Co. increases the price of steel, as I see it, for the purpose of getting what should be gotten from investment capital markets instead. This is the habit of many corporations now. Internal financing of big companies is made possible by the huge profits which are kept undistributed and are plowed back into the industry. Then whenever labor seeks to have an increase in wages in order to create the market, speaking in terms of consumer economics, for all industries, the result is that the steel company has very frankly increased the price to the public to balance whatever increase in wage has been granted, instead of taking it out of profits or of going to the market to borrow or seek the investment. I think there was a very great contrast between the financing of the American Telephone & Telegraph during the past year and the financing of United States Steel. American Telephone & Telegraph went into the money market to get the money by inducing new stockholders to put up the cash, capital investment for the expansion of plant. United States Steel sought to get the money for the expansion of plant not in the capital market but in the profit market by increasing its price.

Senator SPARKMAN. Our chairman is going to have to leave in a short time. I would like to yield the balance of my time to him.

Chairman PATMAN. Thank you, sir. I want to make just one observation, Senator O'Mahoney.

Over the years I have noticed more and more of expansion capital is obtained from retained earnings and depreciation. To me that is an alarming trend. It is contrary to our private enterprise system, if I understand it correctly. I would like to be set right if I am wrong about it.

Here is the way I understand it: It is all right for a concern that has the power to fix its own prices through administered pricing to charge a sufficient price to take care of wage costs, products and services bought for use in the business, interest, all kinds of taxes, local, net profit, dividends, and even some surplus—but anything in excess of that amount seems to me should not be taken from the consumer in actual prices because it compels the consumer to make an involuntary investment in that concern for which he receives no return. Any returns go to the stockholders.

In other words, if an automobile company adds \$100 to the price of each car for expansion capital—and I suspect that is probably a fair amount to estimate, but I am not sure about it—that company takes that \$100 away from the consumer and uses it for itself. That doesn't seem to me to be exactly right.

We find that in 1957, when \$40 billion will be spent for plant and equipment, 70 percent of that money will come from retained earnings and depreciation and it is mostly the large firms who can use this method of financing. How can little fellows survive in the face of that competition?

Representative KILBURN. Mr. Chairman, don't you think any prudent company should have a backlog to take care of a few lean years?

Chairman PATMAN. Surely. I said it was appropriate to set aside a reasonable amount for surplus for lean years, but this is not for lean years. This is for plant and equipment which is taking money away from the consumer and using it as investment capital.

Senator SPARKMAN. We will announce at this time that there will be a meeting at 2 o'clock. Before you go, Mr. Chairman, I would like to say I have been intending to ask the panel to discuss the question which we have just been developing. I believe Mr. Weinberg suggested it a while ago. There is this reservation: It is virtually impossible for small business, businesses wanting to borrow, we will say, under a million dollar, to utilize the securities market. So it seems to me that as long as we don't have credit availability in our existing setup, there ought to be some plan by which they could obtain money.

Dr. Talle, are you ready to ask some questions?

Representative TALLE. Thank you, Mr. Chairman. I will not have time to question. I must go to the floor because we meet at 12. I am sorry.

Senator SPARKMAN. Senator Watkins.

Senator WATKINS. I want to ask Mr. Smith what he wished to say when he had his hand up a moment ago.

Mr. SMITH. Senator Watkins, I believe it is Mr. Hitchings who had his hand up.

Mr. HITCHINGS. Yes, I would like to comment on this matter of pricing to raise capital.

The objective in pricing by business firms is to cover costs and provide a return on their investment. The ability to realize such a price depends, however, on demand for the firms' products. Depreciation of existing plant and equipment is a part of the cost of doing business which must be recovered in the sale of the product. In order to keep capital equipment intact, these depreciation allowances are quite properly reinvested in new plant and equipment. The consumer is merely paying for the cost of facilities used in the production process just as he pays for the materials and labor used to produce the finished product.

If business firms are to expand and provide the necessary growth in jobs and in per capita standards of living, there must be sufficient profit remaining after costs are met to provide an incentive for increased capital investment in the business. This capital investment can be accomplished either through withholding a portion of the profits for reinvestment in the business or paying the full amount in dividends and raising the additional capital from external sources.

There is nothing wrong with either method. It is solely a matter of the extent to which management and the stockholders prefer to retain earnings directly for additional capital investment in the business.

Price, coupled with the quantity of goods sold, determines the amount of income available to those who made the production possible—the employees who provided the labor, the lenders who provided borrowed money, and the owners who provided the capital. Pricing should be considered in relation to the adequacy of total receipts to cover these costs and provide sufficient profits after taxes to serve as an incentive for necessary expansion of the business. The extent to which income is spent or invested by the various recipients has no bearing on the validity of the prices.

Senator O'MAHONEY. May I interrupt you. What do you mean by management and stockholders preferring to retain earnings?

Mr. HITCHINGS. Management makes the recommendation to the stockholders.

The stockholders are the ones who have the voting power.

Senator O'MAHONEY. But in many companies there are stockholders who have no voting power, particularly the Ford Company.

Mr. BRUBAKER. A distant democracy in most of them, anyway.

Mr. HITCHINGS. In some companies that is correct.

Senator O'MAHONEY. Isn't it a fact in the Ford Company that the management is retained by a minority of the stockholders, family and the management, the managerial group?

Mr. HITCHINGS. The public stock has voting rights, too.

Senator O'MAHONEY. Some, but there is nonvoting stock, is there not?

Mr. HITCHINGS. I would have to check with our people who are here.

Senator O'MAHONEY. It is a factor in this whole matter of price.

Mr. HITCHINGS. The Ford Foundation, I am informed, is the only one which holds any nonvoting stock. Any stock which has been offered to the public of course has voting rights. The original stock issued to the Ford Foundation, a nonprofit enterprise, is nonvoting stock. At that time there was no public stock, but when the Ford Foundation offered that stock publicly it was changed to voting stock.

Mr. BRUBAKER. Could we hear from the steel industry on the same question that you asked?

Senator SPARKMAN. Senator Watkins.

Senator WATKINS. I want to find out if there is anything illegal or immoral or uneconomic about getting some of the capital to run a business out of profits.

Mr. HITCHINGS. No.

Senator WATKINS. There has been the intimation here that the consumer should not make any contribution.

Mr. HITCHINGS. I wasn't making any moral judgment at all. All I was saying is that the pricing is not set on the basis of getting profits to plow back for new expansion. That is not the pricing procedure. The pricing procedure is to cover your costs, of which depreciation is one. The decision is made at the time of capital expansion program, which is over and above depreciation allowances, as to how that would be financed. If it is financed in part, for example, out of not paying out all of the money in dividends, this is a perfectly proper procedure.

Small companies have grown into big companies by the use of that procedure, as I believe Senator Sparkman himself pointed out.

I am not taking any moral position as to whether the price should or should not cover capital expansion. All I am saying is that it is not taken into consideration in the pricing of business firms of which I am aware.

Mr. BRUBAKER. May I give my answer to that question?

Senator WATKINS. As a matter of fact, the Ford Co. has grown largely by turning profits back into investment.

Mr. HITCHINGS. That is correct.

Senator WATKINS. And that is true of nearly every firm that has made any great success in this country.

Mr. HITCHINGS. That is right. A small business grows into a larger business primarily through reinvestment of retained net profits.

Senator WATKINS. The gentleman from the steelworkers. I do not mean to neglect him.

Mr. BRUBAKER. I would like to comment very briefly on this question.

Mr. Rees earlier avoided answering a question from Congressman Bolling on what was a fair rate of return for steel and autos and so on, on the ground presumably that these are risk industries in which you have to have some kind of freedom to set profits wherever you need to set them or want to set them, and prices accordingly. Actually—and I am sure Senator O'Mahoney will remember, too—it was not so many years ago that the steel industry in testifying before him kept pointing out that steel was a prince and pauper industry, that it had such drastic ups and downs that they just had to be free to make a lot one year so they could make up for the years next time when they didn't make anything.

This has not been true for the last 15 years in this industry, and I don't think there is any reason to expect it to be true. As a result, we have had a rate of return on net worth in the industry in that 15 years that has been more than 10 percent in most years. This is a good return, certainly, for an industry which is no longer a real risk industry in the sense that it might once have claimed it was.

When you reach the point where there is no longer serious risk involved in your investment, it then does become, I think, frankly, immoral, Senator Watkins, for an industry to say "We think we ought to raise the prices to everybody so that we can tap them for some investment funds," and for the industry not to say that we will go to our stockholders who have an investment, that we will go to the profits that they have made as a return on their investment, to their dividends and even to the retained capital that might be a fair return on their investment and ask them for funds, but instead to say that we will go to the consumers who don't own any of this and say "You have got to contribute to this business, too."

The steel industry has been very blunt in the last several years now in saying "We are setting our prices higher than we think they need to be because we want to take money out of the consumer's pocket for investment purposes, and not give him any stock for it." I think that is immoral.

Senator WATKINS. The point I had in mind with respect to the obtaining of capital was sort of sidestepped. Mr. Smith, would you like to make any statement on whether in a free competitive enterprise

you have any right to use not only the profits but the increased profits in order to make a business grow. I thought that was the way the American enterprise system did grow.

Mr. SMITH. Senator Watkins, I think you have correctly portrayed the history of our great country. Throughout its entire span the traditional, customary, and accepted way for a company to grow and better serve the community, its employees, and itself is to plow back its earnings, so called.

Money is miscible. You can't tell which particular dollar received from the customer is going to go here or going to go there. But I think in order to get some proportions in here we should recall that the total dividends paid in this country are running along about a \$12 billion annual rate, I believe, against the disposable income of \$288 billion. I am rather personally grateful that instead of paying this money all out in dividends these various companies are making provision for the future by taking some of that money which might otherwise be paid out in dividends and using it to improve the tools of production, to provide jobs in the process of it, to provide the working capital without which you cannot have those jobs. That is the way our country has grown.

I think what Senator Sparkman said is very relevant. I don't know how in the world so-called small business could ever grow if we developed in this country the notion that every bit of expansion had to come from going outside and borrowing or selling stock.

Senator WATKINS. I would like to get your response to another query which is in my mind since the gentleman from the steel union made his statement that there is not any risk to amount to anything in the steel business. I happen to live in a community where we have a steel industry. We are worried, I think rightly so, about this unusual demand caused by an artificial situation, planning for defense for our peace, security and liberty. What would happen to us with an expanded steel industry if we suddenly found some way to get nations to get along together and the demand for defense purposes became a thing of the past?

Mr. BRUBAKER. I will tell you where the risk is.

Senator WATKINS. Just a moment. I want to get the other gentleman's view. You have stated that there is very little risk.

Mr. SMITH. I take it it is the hope of everyone in the land, certainly it is my hope, that the business ups and downs can be smoothed out. This is the beginning of 1957. Two and a half years ago the steel industry was down to an operating rate of 62 percent. The notion that the steel industry just automatically is going to go on forever is a notion which we like to play with and we dream about and hope for, but you are up against the hard realities of running a business which does experience ups and down.

Senator WATKINS. We would like to have a guaranty that the Geneva Steel Mills would continue operating.

Mr. BRUBAKER. How much return did you make on your investment in 1954, Bradford? Let's get it on the table.

Senator WATKINS. Have you finished your statement, Mr. Smith?

Mr. SMITH. If you wish me to, I will answer Mr. Brubaker's question.

Senator WATKINS. I have no objection but I really want to get the answers to mine.

Mr. SMITH. The answer is very simple, that I don't have time to compute a meaningless figure.

Mr. BRUBAKER. I will tell you what it is if you want to know.

Mr. SMITH. Because the book values of properties which were purchased 25 or more years ago are no proper basis for measuring whether or not an income today is adequate. I think that is something with which the committee members are quite thoroughly familiar.

Mr. BRUBAKER. May I comment on that?

Senator WATKINS. With the Committee's permission. I think I have used my 10 minutes.

Senator SPARKMAN. We are on Senator O'Mahoney's time now.

Senator O'MAHONEY. Mr. Smith, let me ask you, if you know, what proportion of the Government expenditures for defense go to United States Steel. Before you answer let me call your attention to a known fact. The proportion of Government expenditures for defense far exceeds any other expenditure of any kind. Any economic judgment which may be made in this time of war and preparation for war cannot be based upon the normal facts of a peacetime economy because we do not have a peacetime economy. Now can you answer my question?

Mr. SMITH. Senator, I didn't expect that we were going to have such detailed questions of United States Steel when I came to this meeting. I thought it was a somewhat broader inquiry, so I don't happen to have the exact figures with me. But I do recollect that the steel-industry direct shipments for defense purposes of late have been very, very small, something less than 10 percent. However, sir, that is not what you are getting at because undoubtedly there is a good deal of steel which indirectly goes to defense purposes—our customers, for example.

Senator SPARKMAN. I wonder if I might throw in a statistic there, as given by the Office of Defense Mobilization, that during 1955, 1.8 percent of the steel went into defense production.

Senator O'MAHONEY. That surprises me, frankly, because I thought it would be much greater.

Senator SPARKMAN. A very, very small percentage. I will say to Senator Watkins I believe there is a good healthy economy at Geneva.

Senator WATKINS. It hasn't been very long ago that it was doubtful whether we could get any buyer to go out there and take that plant and operate it. It wasn't until Korea and the heavy demand for steel caused by the economy to sustain a war effort or a prospective war effort that we had any assurance that the plant would be operated.

Senator SPARKMAN. I may state an analogous situation which occurred toward the end of World War II. Down in the Tennessee Valley we were pretty much alarmed, wondering how in the world we would dispose of all of that power, but we have never had enough at any one time.

Senator O'MAHONEY. May I proceed?

Senator SPARKMAN. Please do.

Senator O'MAHONEY. I am anxious to elicit such information as we can from these gentlemen. I like the idea—I initiated it, as a matter of fact—of getting the experts to come before the committee to debate with one another for the information of the committee.

Mr. SMITH. May I say that I remember that occasion. It was many years ago, and I was present.

Senator O'MAHONEY. Professor Backman, you indicated you wanted to say something.

Mr. BACKMAN. Thank you, Senator.

The chairman suggested that there was something contrary to the private-enterprise system in the internal financing of business, and I think several members of the panel have already effectively scotched that idea. The fact remains that most of these figures which are used on rate of return by industry, whether it is all manufacturing or steel or autos or railroads or any other industry, are completely meaningless. They are completely meaningless because they relate an inflated volume of earnings and usually an over-inflated volume of earnings in terms of what they really are to a much deflated base of net worth.

I mean simply this: If you have a plant which cost you \$10 million 20 years ago and today that plant would cost you \$40 million to replace, you are relating today's earnings to what is left of that \$10 million, but more important, when it comes to your earnings all—

Senator O'MAHONEY. Who would want to replace a 20-year-old mill at the stage of technological progress which we now have achieved?

Mr. BACKMAN. You wouldn't want to replace the exact mill where you have had technological progress, but you would want to replace its equivalent presumably in producing power, and I use the word "mill" broadly, not to refer to steel. In some industries you would not even have that type of technology. If you tried to replace textile mills you would not get quite the same degree of technological development that you would, say, in electronics. So actually when the company looks at its income statement, it finds a reported level of profits after taxes, part of which it must withhold in order to replace the plant which has been used up. Part of these so-called returns on net worth are not profits at all. They are merely that part of your earnings that you could not use for tax purposes in the calculation of taxes.

Senator O'MAHONEY. I understand there are two aspects of this which you apparently mean to be discussing as one. Mr. Hitchings drew the correct division between undistributed earnings or depreciation reserves which are a natural cost of business, because they are set aside in order to replace capital. There is another factor which I think Mr. Hitchings had in his mind, and that is when a business seeks to expand, the same situation in which so many businesses ask for rapid tax amortization. This is expansion. This is not replacement in the sense of depreciation accounting. This is expansion by new capital. The fact that a profitable company can internally finance its expansion is represented to us as being one of the reasons why small competitors are driven out of competition, and the concentration of business or production in the United States is proceeding at an amazing rate.

Mr. BACKMAN. My comment, Senator, is this: Part of what we call retained earnings in effect are the depreciation charges you are not permitted to charge off because of the tax law. Part of these retained earnings are used for expansion, as you suggest. I go one step further. If the companies who have these retained earnings had chosen to distribute them all as dividends, as they could have chosen, and in

some industries that choice is made, particularly in industries like the utilities—American Telephone would be an illustration where 80 percent or more of the earnings are distributed—if the choice is made to distribute the earnings then you may go into the capital market to raise the funds needed for further expansion. But if the stockholder foregoes obtaining those funds and either obtains nothing or obtains another piece of paper called a stock dividend, then that choice has been made. Those moneys were not earned for the purpose of raising capital to finance expansion. They were the profits that they derived from cost-price relationships, however they may fall.

As Dr. Rees very correctly pointed out, if these prices go up because demand is large, that is a perfectly proper reason for a price rise, because in our free competitive economy we allocate resources not by Government edict but by determining who will pay what and how much.

So fundamentally you can't ignore that point.

Senator O'MAHOONEY. You interest me by using the phrase "our free competitive economy." If you were sitting on the Judiciary Committee, as I do, which has jurisdiction over antitrust matters, if you were to receive the recommendations of the Department of Justice, of the Federal Trade Commission, and of the President of the United States for more effective laws to prevent the stream of mergers which is constantly reducing the number of competitors in industry, you would not speak of free competitive enterprise as an existing thing. As a matter of fact, it is a rapidly diminishing situation. I don't want to seem to be trying to put any special company or any special group at a disadvantage here. I am only thinking of the system that we think we have but which is disappearing.

Mr. BACKMAN. I don't agree with that statement, Senator. I think we must distinguish between the number of competitors and the degree of competition. In some of the industries where competitors have been reduced in number we have some of the most severe competition in our economy. The automobile industry is one illustration of that tendency. Our problem is not a question of how many competitors we have, but how many alternatives we have. If there is an alternative to steel in the form of aluminum or an alternative to aluminum in the form of copper or plastics or any other type of material, this is just as important a type of competition as the competition which may arise because there are a number of producers.

Senator O'MAHOONEY. May I suggest to you, Mr. Backman, since you refer to the automobile industry, that because of the competition of the giants, General Motors, Ford and Chrysler, all of the little fellows have been driven to the wall, including even Studebaker, the former head of which has been most active in advising in public affairs.

When you have a few giants fighting one another, is there not more danger to the people as a whole than if you have a hundred small operators competing legitimately?

Mr. BACKMAN. As a theoretical question under some conditions the answer would be yes, but I think in the automobile industry you will find it wasn't the three or four large companies who drove the smaller companies to the wall, rather, it was the American consumer who didn't want to buy their products.

Senator O'MAHOONEY. We have had clearly indicated that General Motors in some instances restrained itself from going as far as it could

have gone very easily in internal financing to narrow the field of competition further. As a matter of fact, Chrysler was on the ropes last year when Congress passed the law which induced a little sympathy on the part of the big fellows.

Senator WATKINS. Senator, it isn't monopoly so much that hurts the people—it sounds to me like it is too much competition.

Senator O'MAHOONEY. Competition will drive them out, of course.

Senator SPARKMAN. I would like at this point, in order for you gentlemen to be thinking over this between now and 2 o'clock, to read into the record excerpts from two fine speeches. One of them was made by Mr. Roger M. Blough, chairman of the board, United States Steel Corp. I think you would like to hear this. You are familiar with it, I am sure.

And the sole remaining method—the last resort—is by raising prices from time to time in this highly competitive industry as circumstances require and permit. In the absence of more realistic treatment of depreciation, there simply is no other course.

Mr. Blough says:

* * * To keep this Nation's present supply of steel intact and supply it with the steel capacity it needs for economic growth and military protection in this continuing inflationary economy means higher steel prices in the future. * * *

Now I want to read a statement which was made by Mr. Ben Fairless, who formerly was president of United States Steel and later chairman of the board and now president, I believe, of the American Iron and Steel Institute. He says:

So I come, finally, to financing through the sale of new stock. This is a historical American way, and a completely appropriate means of acquiring funds for financing new facilities or expanding old ones.

I hope that we may have some more discussion of this this afternoon.

The committee stands in recess until 2 o'clock.

(Whereupon, at 12:30 p. m. the committee was recessed, to reconvene at 2:00 p. m. the same day.)

AFTER RECESS

Senator SPARKMAN. Let the committee come to order.

I think we better get started, because some members of the panel, I understand, would like to get away at a reasonably early hour. Perhaps I could ask a question or two now, and save the general discussion for a little later.

When you speak of depreciation and using depreciation funds, is that affected by rapid amortization?

Mr. SMITH. Mr. Chairman, the two statements from which you quoted this morning deal very specifically with the problem of the inadequacy of depreciation under accounting conventions and tax law. I think they are quite informative. If it is agreeable to you, I would like to have them reproduced in the record, because they are so explanatory with respect to that matter.

Senator SPARKMAN. You are talking about the two speeches?

Mr. SMITH. Yes, one by Mr. Blough and one by Mr. Fairless. They were not dealing with the expansion of the industry, but they were dealing with the stay-even problem, which is a rather serious one.

Senator SPARKMAN. The subject of one of them was specifically "Steel's Depreciation Problem" by Mr. Fairless and the other was Mr. Blough on "What Price for Enough Steel?"

I suppose that means at what price would we have enough steel.

Mr. SMITH. That was his statement to the stockholders some time ago.

Senator SPARKMAN. However, the statement that I read in each instance is pretty specific as to dealing with plant expansion. In fact, it uses the term. I quote again from Mr. Fairless. He said,

So I come finally to financing through the sale of new stock. This is the historical American way and a completely appropriate means of acquiring funds for financing new facilities or expanding old ones.

Again, Mr. Blough said, where he speaks of replacements and expansion of facilities and stepping up production and so forth, and what the needs will be—

Thus we need \$500 million, but in future years on the basis of last year's record we would have only \$360 million. That leaves us \$140 million short—and so forth, and then he tells how it can be financed. He makes the statement:

The sole remaining method, the last resort, is by raising prices from time to time in this highly competitive industry as circumstances require and permit. In the absence of a more realistic treatment of depreciation, there simply is no other course.

In both instances, as I understand it, they were talking about the requirements for plant expansion. I think it would be very good to place both speeches in their entirety in the record and without objection I will be glad to do that.

(The speeches follow:)

WHAT PRICE. ENOUGH STEEL?¹

(By Roger M. Blough, chairman of the board, United States Steel Corp.)

It is customary for the chairman to report to you on the progress which your corporation has made since last year; and to discuss with you some of the problems which we see ahead.

For me this is a happy assignment, because—as you know—last year was an outstanding, and in many respects, a record-breaking year for United States Steel. Moreover, if the results of our operations for the first quarter of 1956 can be regarded as a reliable criterion, the present year should also prove to be a good one.

From the standpoint of service to its customers and to the Nation, your corporation enjoyed its most productive year in 1955. Shipments of steel products reached a record-breaking 25½ million tons. Total sales topped the \$4 billion mark for the first time in our history, and were nearly 4 times as great dollar-wise as they were just 15 years ago in 1940.

Wages and benefits for our employees reached a new all-time high—not only in terms of dollars, but in purchasing power as well. Payments to our suppliers of goods and services also exceeded all previous records; while amounts reserved for taxes were the largest in any peacetime year, and almost equalled the record level established in the excess profits tax year of 1951.

Beyond establishing these records, however, United States Steel moved in various other ways to meet the growing needs of a growing nation. It embarked upon a program of expansion which is presently designed to add about 2½ million tons to its steelmaking capacity in the next 2½ years or so. Similarly, it expanded its cement capacity to help meet the pressing shortage in that field. It also continued its persistent and successful search for new sources of iron ore and other vital raw materials. It developed new and improved products;

¹ Formal remarks at the annual meeting of stockholders, Stevens Institute of Technology, Hoboken, N. J., May 7, 1956.

and began the production of plastic pipe. In the field of coal chemicals, it started construction of a new anhydrous ammonia plant at Geneva, Utah. And most important of all, perhaps, it has now completed its new center for fundamental and applied research at Monroeville, Pa.

In all, its capital expenditures for these and other improvements amounted to \$240 million. This was a relatively modest sum compared to the years 1952 and 1953 when we were building Fairless works and developing Cerro Bolivar; but it appears even more modest in comparison to the heavy capital outlays that will confront us in the years immediately ahead. At present, the amount required to complete the projects which have already been authorized for the replacement, modernization, and improvement of our facilities is about \$600 million.

So this, in a nutshell, is the story of the contribution which your corporation has made to the welfare and security of America during the year; and all of us, stockholders, employees, and management alike, have, I think, a right to be pleased with it. On the strength of this record, moreover, it would be reasonable, I suppose, to expect that our profits should have reflected this increased service to the Nation. And, happily, they did.

Measured in terms of dollars, our earnings were the largest in our history. So, too, were the dividends paid to the shareowners, and the sums reinvested in the enterprise.

After payment of taxes, profits per common share were \$6.44. The taxes themselves were \$8.65; and the dividend was \$2.30. So you will note that for every \$2 we earned as income, almost \$3 was paid for the support of Government.

But measuring profits in terms of dollars alone is a good deal like measuring dress-goods with a rubber yardstick; for this method makes no allowance for the shrinkage in the value of the dollar, for the increased volume and quality of production, or for the heavy investment that has been made in new facilities.

So in order to get a truer comparison of our profits over the years, we must measure them as a percentage of sales; and on that basis we find that out of each dollar which our customers spent with us last year, we were able to keep 9 cents in profits. This was a welcome improvement over the 6 cents we earned the year before; but it certainly did not break records. In fact, by these standards, 1955 was only the 26th best year in our corporate history. Let me hasten to add, however, that it was still the best year we have had since 1940; and by any standards of measurement, I think you will agree that it was a good year for United States Steel.

I am glad to report, moreover, that thus far 1956 has been an even better year. During the first quarter, we operated at 98 percent of capacity. And production and sales both reached new highs.

Comparing these results with those for the first quarter of last year we find that sales were up 26 percent to a total of \$1,100 million. Expenses, of course, mounted also. Employment costs rose 23 percent. And other charges, including purchased goods and services, provision for wear and exhaustion of facilities, interest payments, and taxes, increased by 26 percent.

The resulting profit in the first quarter was \$104 million which amounted to \$1.83 per common share, compared to \$1.25 in the corresponding quarter of last year. This represented a return of 9.5 percent on sales.

As you probably know, the board of directors, at its last meeting, declared dividends of \$1.75 per share on the preferred, and 65 cents on the common stock, which was the same rate that prevailed in the previous quarter.

To these simple statistics, I should add, perhaps, that both demand and production moved on a rising scale through the period; and that this upward trend has continued thus far into the current quarter, which promises, at present, to be the most active in our history.

But as we look beyond this point, and plan for the years ahead, I must tell you frankly that we are confronted by some disturbing facts which cannot be ignored.

First among these is the fact that despite the rapid expansion of our steel-making capacity in recent years, we still cannot meet all the demands of our customers. And since this same condition prevails throughout the industry, there are presently and prospectively painful shortages of certain steel products in America today.

Second is the fact that while our company has just enjoyed its most prosperous year since 1940, our profits—at their present level—could neither support nor finance the heavy capital expenditures that we must make in future years if we are to play our full part in providing the steel that this Nation will need.

Third is the fact that we are confronted this month with wage demands which, if granted even in part, would—in the absence of a compensating price increase—seriously reduce our present profit level, and would thus compound the financial problems we must face in the future.

And fourth is the fact that many thoughtful people—in Government and elsewhere—are already gravely concerned by the seemingly endless wage-price spiral which has persisted, not only in steel, but in all American industries since the beginning of World War II. These people feel, and I share their feeling, that we cannot go on forever paying more and more each year for the same article—whether it be a bottle of milk, a loaf of bread, or a pound of steel.

Now at this point I must say that there is probably no industry in America today which understands the evils of inflation more fully than the steel industry does; for it would be difficult, I am sure, to find any industry which has felt the effects of inflation more severely than has ours. Inflation, in fact, is the primary root from which our present financial problems have sprung.

We, in the management of United States Steel, realize, of course, that no one company, no one industry, or no one labor union can stop inflation. We also recognize, however, our clear responsibility to avoid, wherever possible, those courses of action which would stimulate inflation further.

So in the limited time that remains to me here today, I would like to discuss this whole financial problem with you, as simply and as briefly as I can. And I would like to analyze that problem in the light of the varied and sometimes conflicting responsibilities which we, in management, bear toward our shareholders, our employees, our customers, and to the Nation as a whole.

Now it is obvious, of course, that America must always have enough steel to provide for its economic growth and to insure its national defense. And the primary responsibility of our corporation, as I see it, is to contribute, as fully as possible, to an ample supply of steel. That is our business and there is no better reason for our existence.

But to play our full part in meeting America's steel requirements means that United States Steel is going to have to expand its capacity by an average of at least 1 million tons each year for the next 10 years, according to the most careful estimates we can prepare at this time. And that, of course, we feel is conservative.

Before we can even talk about expansion, however, we must first arrange to keep our present facilities intact. We must replace those that wear out, and modernize those that become obsolete. And this, today, is our most difficult problem. This is where inflation has hurt us the most.

Without inflation, replacement costs would present no serious problem; for they would be handled, almost automatically, by what we call normal depreciation. Now I realize that financial problems like depreciation are hard to explain to those who are not constantly working with such matters; but let me try to illustrate it this way:

When a machine is used to produce steel—or anything else—it wears out a little each year. In other words, it depreciates. So if we buy a machine that will last for 25 years, and if the machine costs us \$25 million, it will wear out at the rate of a million dollars' worth each year. Thus the Federal tax laws permit us to recover a million dollars a year, on the average, on this machine as a cost of doing business. And at the end of the 25 years, when the machine wears out, we have got our \$25 million back through this process of normal depreciation. So theoretically we can buy a new machine with it.

But that's where Old Man Inflation steps in. During the past 10 years alone, our plant and equipment costs have more than doubled. So \$25 million won't begin to pay for the new machine. Let me give you an actual example of this problem as we face it today:

Back in 1930 we built an open hearth plant which cost about \$10 million. Today it will cost us about \$64 million to replace that plant. Through depreciation we have recovered the original \$10 million that we spent on this facility. The remaining \$54 million, however, will have to come out of our profits—our profits after taxes.

But in order to earn \$54 million in profits after taxes, we have to earn \$112½ million before taxes. And last year it took the profit on 600 million of the dollars we received from our customers—about one-seventh of our total sales—to pay for that one open hearth plant.

So every penny of profit we made on one-seventh of our total sales last year will be wiped out in replacing this open hearth. And that, of course, is only one facility. We have many other furnaces, mills, and machines which must be replaced each year.

In this connection, however, I should point out that many new facilities we buy today are better and more productive than the old ones they replace; and the new open hearth shop I have just described will produce about one-third more steel than the present one does. But taking this into full account, it will still cost more than $4\frac{1}{2}$ times as much, per ton of capacity, as the original facility did.

Thus you see that a substantial part of our profits are not real profits in the sense that they can be used to pay dividends, or to provide for expansion and growth, or to serve any of the other functions that a profit is supposed to perform. They are what I would call phantom profits destined for replacement, profits which are eaten up by inflation almost before we get them. They cannot finance progress. We must use them just to stand still.

So bearing this fact in mind, let us look now at the financial picture we face in the future:

Our engineers tell us that during the next 5 years we will have to spend an average of \$350 million each year on replacement alone. That is at present construction costs. To serve the needs of our customers and the Nation, we must also expand our capacity by a million tons annually. That will cost another \$150 million a year by the most conservative estimates. Thus our total capital requirements will come to half a billion dollars a year. That's how much we shall need.

Now, how much do we have? Well, our reinvested profits last year amounted to \$220 million—the largest such sum in our history. In addition to that, we recovered through normal depreciation about \$140 million. Add these together and you have about \$360 million. Now, under some wartime emergency legislation enacted by Congress we also received last year another \$145 million of special depreciation, called amortization, but this relief will disappear within the next 2 years or so, after which we will have only our normal depreciation and reinvested profits on which to rely.

Thus we need \$500 million. But in future years—on the basis of last year's record—we would have only \$360 million. That leaves us \$140 million short—even if the cost of new facilities does not continue to rise as it has in the past 10 years. If it does, we will be \$240 million short. And in that case, we would not even be able to replace all of our present facilities as they wear out—let alone expand. Moreover, we must recognize, I think, that we will not always be operating at full capacity as we did last year, nor will we always have such substantial amounts to reinvest in the business.

So there are the cold, hard facts of the matter. There is the problem that has to be solved. Inflation has taken its toll. And we must all be prepared to do everything in our power to stop its devastating course. To the problems which past inflation has left with us—and in light of the possibility that even if slowed, inflation will continue to some degree—I see only two possible solutions.

The first and most logical of these is to attack this whole replacement problem at its source and to cure its fundamental cause. But that can only be done by Government; for the root of the difficulty—as I have said—lies in the inadequacy of the normal depreciation provisions of the law. The time has come, I think, when Congress should face up squarely to the fact that these depreciation provisions no longer serve the purpose for which they were intended. It is time to reappraise this law and to revise it realistically.

In this connection, I should remind you, perhaps, that 2 years ago Congress recognized the inadequacy of the depreciation provisions of the present tax law, and made revisions which were designed to ease the burden caused by inflated replacement costs. But these fall far short of meeting the needs of industries such as steel.

The Government has also twice recognized the inadequacy of this law in the past—once at the outset of World War II and again during the recent Korean conflict. In order to provide for the rapid expansion of defense facilities of all kinds, Congress enacted special legislation permitting American industry to depreciate such facilities over a period of 5 years instead of the usual 20 or 25. It was this special legislation which enabled the steel industry—among others—to perform the miracles of expansion that it has performed in recent years, and to meet the heavy capital demands that this program of expansion entailed.

But the relief accorded by these laws was only temporary; and in the case of United States Steel it will largely disappear within the next 2 years, as I have said.

So it seems to me that the best solution to that problem lies in a prompt and realistic revision of the depreciation laws—a revision that is already long overdue. And failing that, the only other possible solution is for us to recognize frankly that what we thought was a good profit last year—and it was a good profit—will be woefully inadequate to finance our replacement and any appreciable part of our expansion needs in the years ahead. So if we are to keep pace, as we must, with the growing demand for steel in this Nation, we shall need to add to that profit substantially.

This can be done in two ways :

First by increased efficiency of operations and consequent cost reduction ; and I wish I had time today to tell you of the great strides that your company is constantly making in that direction. Unfortunately, however, I do not. I can only remind you that there are rigid limits not only upon the rapidity with which such economies can be effected, but also upon the total savings that can be made in this fashion. And obviously there is no practical prospect of meeting our future capital requirements by this method alone.

And the sole remaining method—the last resort—is by raising prices from time to time in this highly competitive industry as circumstances require and permit. In the absence of a more realistic treatment of depreciation, there simply is no other course.

So in the light of these facts, let us look for one final moment at the conflicting responsibilities of which I spoke at the outset of this discussion. To keep this Nation's present supply of steel intact and supply it with the steel capacity it needs for its economic growth and military protection in this continuing inflationary economy means higher steel prices in the future. But higher steel prices along with the higher prices for other industrial commodities we have all been experiencing, is simply further evidence of the inflation of which I have been speaking.

Inflation is not in the public interest. But an ample steel supply is. Where, then, does our responsibility lie?

And as a corollary of this question, I would pose you another : Which condition is likely to produce the lowest steel prices in the end—a plentiful supply of the commodity or a critical shortage of it?

Our friends, the farmers, should be able to give us the answer to that one. But when we talk of inflation, there are other conflicting responsibilities to be reckoned with, also. For while labor friends who are here today may differ, many informed people in this country believe that continually larger annual rounds of wage increases have become a major cause of inflation.

We know, of course, that if we trace the average product from the raw material to the finished article—and if we eliminate taxes from the picture—we find that labor accounts for from 75 to 85 percent of all costs. So it would seem logical and inevitable that repeated increases in wages must naturally exert a strongly inflationary influence upon prices generally. And our own financial records over the years will clearly support that fact.

Therefore, we recognize that we have a definite responsibility to keep within bounds the annual wage changes which we have been experiencing. Yet we also have a responsibility to meet, to the best of our ability, the proper needs and aspirations of our employees. And to the Nation as a whole we have a further responsibility to avoid, if possible, a strike that would choke off the supply of steel and bring serious financial hardship to the workers and owners in hundreds of plants that depend on that steel supply.

These then are some of the serious responsibilities which rest on the management of United States Steel as we look to the future today. But we face them with courage and confidence, for we do not bear them alone. We know that they rest also upon our stockholders, upon our employees and their union representatives, upon our customers, and upon the thoughtful and farsighted men in Government who bear an even greater share of this burden of inflation. And if all of us together can meet our respective responsibilities with patience, understanding and restraint—and perhaps even a little wisdom—there is no doubt in my mind that any problems of the future will be fully solved in the enduring interest of the Nation as a whole.

And meanwhile, let me simply assure you that so far as the management of United States Steel is concerned, we shall do everything in our power to help provide America with an adequate supply of steel at all times—steel of the highest possible quality at the lowest possible price.

STEEL'S DEPRECIATION PROBLEM

by

BENJAMIN F. FAIRLESS, *President*
American Iron and Steel Institute

*At the 64th General Meeting of American Iron and Steel Institute,
Hotel Waldorf-Astoria, New York City,
May 24, 1956*

STEEL'S DEPRECIATION PROBLEM

BY BENJAMIN F. FAIRLESS

President, American Iron and Steel Institute

THIS is the first opportunity I have had to meet so many members of American Iron and Steel Institute face to face since my election as President just one year ago. I can assure you it gives me great pleasure.

I have enjoyed my job at the Institute this past year. Also I have learned a lot. For one thing, I have seen at first hand the many valuable services the Institute is constantly performing for its members.

After seeing the wheels in motion, it is my opinion that no great industry anywhere is served by a more smoothly running and competent organization. I would like to take credit for this, if I could. But, with Max Howell and George Rose sitting right here on the platform, I hardly see how I can get away with it. As long as they are listening in, I might as well confess that I have had it pretty easy, with most of the Institute's really tough work being left in their capable hands. This has left me more or less free to observe and ponder the developments and problems of the industry.

Also, of course, we have had the benefit of the momentum which Walter Tower has given this organization. I know I speak for all of you here when I say that this industry will always be greatly indebted to Walter for the devotion and

organizing genius he gave to the Institute for so many years.

The past year has been notable for steel in many ways. It has been a year of new accomplishments, new records and continuing expansion. Historically, it has marked a great milestone in the life of our industry. As we meet here today, we have just completed the first century of the steel age. We are at the 100th anniversary of the Bessemer Process and the Kelly Process — the first having been patented in 1856 and the latter in 1857.

When William Kelly first proposed his theory, we are told, his father-in-law concluded he was crazy and wanted a doctor to treat him as a mental patient. We can be happy that his father-in-law failed, because we might otherwise be laboring under a very troublesome precedent. If, for example, every one in this industry who dreams in terms of new processes and better techniques were being held under observation today, this meeting would have neither an audience nor a speaker.

From practically nowhere in 1856, this country in 1889 forged ahead of Great Britain to become the world's leading steel producer and today America produces, each year, more than 8000 times as much steel as it did just a century ago.

War records notwithstanding, the greatest eras of growth for the steel industry have been in times of peace. And just as wartimes bring the steel industry its serious problems, so also does the steel industry have important peacetime problems. It is one of those problems that I want to discuss with you now, and to help clarify it we will project some charts on the screen.

Every one here realizes that the steel industry has a duty to keep itself efficient. That means it has got to maintain its existing capacity in good shape even before it thinks about expanding it to keep up with the growth of the country. The job of replacing the equipment as it wears out or becomes obsolete is a good-sized one just by itself. Since facilities have an average life of about twenty-five years in the steel industry, the normal

replacement job, all by itself, amounts to about 4 per cent of our total plant each year. That does not look very big, but I assure you it is bigger than it looks — especially if you stop to think that all the expansion job that has been done in the industry over the last ten years, amounts to just a little less than $3\frac{1}{2}$ per cent a year.

So what the Red Queen said to Alice is really true in our industry. She said: "It takes all the running you can do to keep in the same place. If you want to get somewhere else you must run twice as fast as that."

As we look ahead it is becoming increasingly clear that there are going to be a lot of problems encountered in just staying even. These problems ought not to exist, but the simple fact is that they do. The regular depreciation allowed under the tax laws ought, of course, to be sufficient to cover these stay-even requirements. But the truth is that they are not. The purpose of depreciation is to recover over the lives of facilities the dollars originally invested in them. The dollars when recovered are presumed to be sufficient to buy enough equipment to keep even with the wearing out of existing equipment. And they would be, if there were stability in the buying power of the dollar.

But the simple fact is that the buying power of the dollar has not been stable. We have had 15 years of continuous cost inflation; and facilities for the steel industry now cost immensely more than they used to. There is no official index measuring the price changes of the facilities the steel industry buys. But the index of construction cost — as published in the *Engineering News Record* — gives what we regard as a pretty fair indication of the cost trend.

Here is a chart (see Chart 1) of that index showing the cost, year by year, from 1940 to 1955. The year 1940 is taken as 100; and you will note that it took \$2.73, in 1955, to buy what could be bought for \$1.00 in 1940. But the regular depre-

ciation we are allowed for a facility built in 1940 is based on the \$1.00 spent in 1940 instead of the \$2.73 or more it now takes to replace it. The difference is regarded as profit and is taxed as such.

You will also note that there was no year in which the cost failed to rise; and that since World War II the increase has been very rapid. Over the fifteen-year period the rate was approximately 7 per cent per annum compounded.

Now I have already shown you the inadequacy of the present-day regular depreciation on a facility built in 1940. By using this 7-per-cent-per-annum figure, we can get an indication of the over-all inadequacy of depreciation on facilities which have a life of 25 years, and which have been bought in equal physical amounts each year. Each year, of course, the cost of equipment rises by 7 per cent over its cost in the preceding year, and hence — as each year goes by — the depreciation on a facility built in an earlier year becomes less and less adequate. If we add it up for all the facilities, over all the years, it comes out that for each \$1.00 of so-called regular depreciation that we get, we actually need \$2.15 in order just to stay even. In short, to recover purchasing power under these assumptions, our regular depreciation allowance needs to be multiplied by 2.15.

There are two reasons why this 2.15 is so shockingly large. First, there is the high 7 per cent compound rate of price inflation. Second, the long life of facilities in the steel industry gives this high rate a long time to compound. If the average life of facilities were ten years, instead of twenty-five, the multiple of 2.15 would drop to 1.42 as you see in the line marked 7 per cent on this chart. If the life averaged only five years — the multiple would drop to 1.22 (see Chart 2).

Now while this multiple of 2.15 has been worked out on a theoretical basis, it closely approximates the actual facts in the steel industry today as shown in this next chart (see Chart 3). Thus it is estimated that at 1955 prices the industry must

spend somewhere between a billion and 1.2 billion dollars a year for facilities in order to stay even. This does not include anything for major capacity expansion. Ten years ago the corresponding estimate was from \$400 to \$500 million. Call it \$450 million. These are, of course, estimates. They are, however, based on what I know and on what I have heard; and I think that they are accurate enough to illustrate the matter.

Part of the reason for the big increase that has occurred in the stay-even cost over the past ten years is that capacity was expanded. There is more plant to be kept up. Taking this into account the rise in the stay-even cost has been in the range of from about 5 to 7 per cent a year. These are rates of increase approaching those given by the index of construction costs. I think also that each one of you can find corroboration in the records of your own companies. If you figure out what your depreciation would currently be if there never had been any accelerated amortization, I think you will find that such depreciation would prove to be only about one-half or less of what your engineers tell you has to be spent if you are to stay even.

The multiple of 2.15 which applies to the steel industry is undoubtedly larger than that which would be necessary in many other industries that are not so heavily invested in *long-life* facilities. But this only means that industries like ours are caught in an extremely inequitable and unfair situation, because our capital is more heavily taxed away as it turns over more slowly through depreciation.

It is possible to obtain some mathematical indication of the extent of that inequity by observing the wide variation in the rates of turnover of gross property in different companies in differing industries. If the turnover is high, the deficiency in present-day depreciation is correspondingly less severe. This chart (see Chart 4) illustrates the rate of turnover in 41 companies, in various industries, by showing the number of times their gross property account must be multiplied in order to

equal their sales. You will note that the multiples range from 14.1 to 0.6; and that the figures for several steel companies are way down near the bottom, in the range from 1.6 to 0.9. So it is apparent that the burden on the steel companies is comparatively heavy.

This next chart (see Chart 5) simply lists the names of the companies which were represented by the array of bars in the preceding exhibit. They are listed in the order of highest to lowest turnover rate of gross property.

Thus far I have been dealing with the cost inflation we have already experienced. If we could suppose that this cost inflation had now come to an end I would be less concerned about the erosion of capital, which results from the imposition of high income taxes on what is really depreciation.

But I cannot prudently make such an assumption; for the steel industry's own records clearly show how persistent the course of cost inflation has been.

In this chart (see Chart 6) you can see what has been happening, year by year, since 1940. It shows the industry's employment costs per employee hour, and its total costs per employee hour. In both instances the cost in 1940 has been taken as 100. From 1940 to 1955 the employment cost increase has been at the average compound rate of 7.5 per cent per year.

I know that you are all familiar with the fact that for all industry combined, employment costs represent something more than three-quarters of all costs. So as inflation persists in the nation's employment costs, a paralleling inflation is to be expected in our other costs, such as purchased products and services, wear and exhaustion, and taxes. Certainly our records display, as you may see from the chart, that our total costs per employee hour have fully kept pace with the steady rise in employment costs. To provide a man with an hour of work and to supply him with all the things necessary to do his work now costs three and a quarter times as much as it did in 1940.

You will note that throughout this entire period there has been no combination of circumstances, in any year, under which employment costs failed to increase. It, therefore, seems probable that cost inflation will continue; and I think we must assume that it will. This conclusion is fortified if we look at the two basic roots of the new peacetime cost inflation that has been fastened upon us. The first root is the presence of industry-wide labor unions whose power has been clearly demonstrated over the years.

The other root is the national policy which, in effect, requires the Federal Reserve Board to create what might easily prove to be inflationary monetary conditions whenever any serious unemployment threatens. This tends to remove the normal competitive forces that might otherwise serve to check unduly mounting employment costs. That the Federal Reserve Board has so skillfully administered this difficult responsibility of moderating inflation and avoiding serious unemployment is something of which we should all be appreciative.

Both of these roots are deeply imbedded in the law, and in public attitudes of the times. Swift changes with respect to them are not prudently to be anticipated; and we have got to learn how to live with them.

With this background of continuing cost inflation in mind, I now want to look ahead briefly to the next five years. I have already estimated that the industry must spend from a billion to 1.2 billion dollars — call it 1.1 billion a year — if it is to provide itself with new facilities as fast as existing facilities are wearing out or becoming obsolete. This is the average amount per year for the next five years; and it assumes that there will be no further inflation whatever in the cost of constructing such facilities.

But, as I have already shown, we cannot safely assume that the underlying cost inflation will be halted. Should construction costs continue to rise at the average 7 per cent per annum

rate, then we are talking about bigger figures later on. Five years at 7 per cent compounded means a 40 per cent bigger figure. And instead of 1.1 billion, we shall need 1.5 billion dollars five years hence.

In this next chart (see Chart 7), the top line of the area shows the step-up, year by year, of the estimated stay-even expenditures. In the lower part of the chart, the dark area shows the estimated amounts which the industry will recover, through depreciation, for wear and exhaustion of its facilities. These amounts are also adjusted upwards to recognize the inflated costs of new facilities added during the period.

The area between the two lines shows the dramatic deficiency in wear and exhaustion that is to be encountered. The chart tells us that in 1960 the industry will need nearly twice as much as it gets out of wear and exhaustion *just to stay even*. The aggregate deficiency for the five years is about 3 billion dollars.

Today, of course, we have amortization under certificates of necessity. This amortization on new facilities helps to fill the present gap. When it is added to regular depreciation it gives, temporarily, a truer total of wear and exhaustion on all facilities based on current dollar purchasing power. But when that amortization begins to disappear in 1958-59 the inadequacy of wear and exhaustion amounts will be aggravated.

This next chart (see Chart 8) shows the prospective decline in rapid amortization for the steel industry, and on this same chart is shown the estimated decline for all corporations in the country. The dropping out of amortization will sharply emphasize the inadequacy of wear and exhaustion in the steel industry at the very time when it should be increasing to be realistic; and so the funds necessary for replacement must be obtained from some other source.

In the absence of adequate wear and exhaustion the other standard internal source of funds for keeping even is income

reinvested, and the standard external sources are borrowing money and selling new stock.

To the extent that reinvested income is used for this purpose, such income becomes unavailable for providing needed working capital, for paying off existing debt, and for use in connection with expanding capacity. And, in any event, \$2 before taxes is required to do the job of \$1 of wear and exhaustion.

I turn next to borrowing as a means of financing capital expenditures (see Chart 9). Although borrowing for profitable expansion may sometimes be justified, borrowing to cover the erosion of capital is one of the best ways I know of "going broke" in a hurry. We also are confronted by the simple fact that most steel companies just do not have the capacity to borrow, on top of their existing debts, enough money to do the job in this kind of a situation. A third fallacy in borrowing to stay even is that although interest paid is deductible for tax purposes, it is only out of profits after taxes that debt can be paid off. Moreover, debts have a curious habit of coming due at the very times when it is hardest to find the cash with which to pay them. Indebtedness is not good for companies in the "up-and-down" durable goods industries.

On this matter of borrowing there are a few other sobering facts to bear in mind. We know that a brand new integrated steel plant would today cost at least \$300 per ton of ingot capacity, or roughly \$400 per ton of finished steel capacity. The average steel company's earning rate of approximately 8 per cent on sales works out to something like \$10 a ton of finished steel. This is equivalent to 2½ per cent on the \$400 a ton investment. To earn that much assumes, moreover, that the new plant would be operated at full capacity all the time. It also happens to be true that one can get more than a 2½ per cent yield today, in high-grade, fully tax-exempt, municipal bonds.

So I come, finally, to financing through the sale of new stock (see Chart 10). This is the historical American way, and a completely appropriate means, of acquiring funds for financing new facilities or expanding old ones. It should be reserved for such purposes; for if money is secured through stock sales merely to cover the erosion of existing assets, it only results in the dilution of the stockholders' equity.

From this presentation of the facts and prospects, I think it is apparent that the problem of financing the stay-even requirements in the steel industry, let alone that of finding funds for expansion, is a most serious one. That problem is greatly aggravated for companies like those in the steel industry which must be heavily invested in long-term facilities, by the heavy taxation of that which is really depreciation, but which under tax law is considered taxable income.

We are not, of course, the only ones aware of this perplexing problem. The Congress has from time to time provided certain depreciation expedients. Thus, during World War II and the Korean conflict, there was legislation to provide "accelerated amortization" on part of the cost of new defense facilities. This permitted the taxpayer to take greater depreciation in the early years of a facility's life. With 60 per cent of a twenty-five year facility subject to amortization, and with the balance subject to regular depreciation at 4 per cent per year, the recovery of the original expenditure amounts to 68 per cent in the first five years (see Chart 11).

This has helped temporarily to give a truer total of depreciation on all facilities based on current dollar values. But it automatically guarantees something of a future crisis. Thus when the amortization runs out the situation becomes worse than it was before the amortization provisions were enacted, because the remaining depreciation to be taken in the future is, of course, much less than it would otherwise have been.

In an attempt to stave off this crisis the Revenue Act of 1954

provided two alternative methods of determining depreciation for tax purposes: the sum-of-the-digits method and the declining-balance method. I do not wish to be grudging in my recognition of the fact that these new methods can prove helpful, but the simple truth is that on twenty-five year facilities they do, as you may see in this next chart, only about half the job that accelerated amortization does and at the very time when more of a job is becoming necessary. No one should deceive himself in this matter. Accelerated amortization is very helpful in a temporary sense, but it does not do the whole job. And even if we finally got to the point where *every* property item was being written off in five years, we would still be short of depreciation. As I showed you in a previous chart, the recovery would still have to be multiplied by 1.22 to give us equivalent buying power under a 7 per cent per annum cost inflation rate.

Other countries have done a better legislative job of recognizing the realities of depreciation during cost inflation. France recognized the depreciation problem by taking steps, shown in this next chart (see Chart 12), to permit revaluation of certain assets and liabilities. This was first permitted in 1946 and the law was revised several times, the last revision being five years ago. Under this last revision, the cost of fixed assets purchased in 1914 or earlier can be multiplied for depreciation purposes by 194.4. For ensuing years this multiple is graduated downward until it reaches 1.3 for the year 1950. These are the amounts by which so-called regular depreciation may be multiplied to get the amounts deductible for tax purposes. In addition the first year's depreciation may be taken at twice the normal rate for new plant and equipment, and for items of equipment acquired for modernization 10 per cent of the cost may be written off on delivery.

In Great Britain the reducing or declining-balance method is considered the normal depreciation method, with the straight-line method an alternative. Both methods are based on original

cost. The annual rate for coke ovens is approximately 16 per cent of the remaining balance; and for iron and steel manufacturing the rate is 9 per cent. In addition, there is an initial allowance of 10 per cent on industrial buildings and 20 per cent for plant and machines. These are taken the first year in conjunction with established rates for various types of fixed assets. Thus, in Britain, the depreciation allowed in the first year on coke facilities is 35.6 per cent, and on iron and steel facilities 29.4 per cent. In the second and succeeding years the depreciation allowed on coke facilities is 16 per cent of the remaining balance. For iron and steel facilities it is 9 per cent (see Chart 13).

In Canada, the declining-balance system was adopted in 1949 with specific maximum rates for various groups of fixed assets. For coke ovens, blast furnaces and steelmaking facilities the depreciation allowed for tax purposes is 20 per cent per annum. At this rate 49 per cent of original cost is recovered in the first three years and a residual value of 10 per cent is reached in eleven years. Other manufacturing facilities may be depreciated at 6 and 8 per cent; and other classes of property may be depreciated at from 4 to 40 per cent rates (see Chart 14).

In addition, special accelerated depreciation beginning in 1951 can be claimed on assets essential to defense for which a certificate of eligibility is obtained from the Minister of Defense Production. This amounts to 70 per cent over a four-year period for four classes of assets and 50 per cent over the same period for a fifth class.

My purpose in these remarks has been to bring to your attention the grave problem of financing stay-even requirements and to show you the part that insufficient depreciation plays in that problem. A heavy responsibility weighs upon us and its weight is increased because of the great tax inequity existing between industries heavily invested in long-term facilities and those who

turn over their facilities quickly. Part of our responsibility is to stem as much as we can the inflationary rise in the nation's underlying employment costs. That would prove a service to every one in the land, perhaps most of all to those who work for wages and look forward to pensions. It would reduce the magnitude of our stay-even problem.

The other part of our responsibility is to seek prompt legislative treatment of the problem; and—pending that treatment—to promote a wide-spread understanding of the facts; so that when legislative treatment is given it will be a good and just treatment.

I must also point out to you that time is running out. Please look again at this chart (see Chart 15) you have already seen. Note the decline in the amortization that will take place in the next two or three years. As that decline proceeds, industry's problem of adequate depreciation will get worse. Thus the need for prompt action is becoming increasingly urgent, and opportunity is fleeting. We had better not miss the boat.

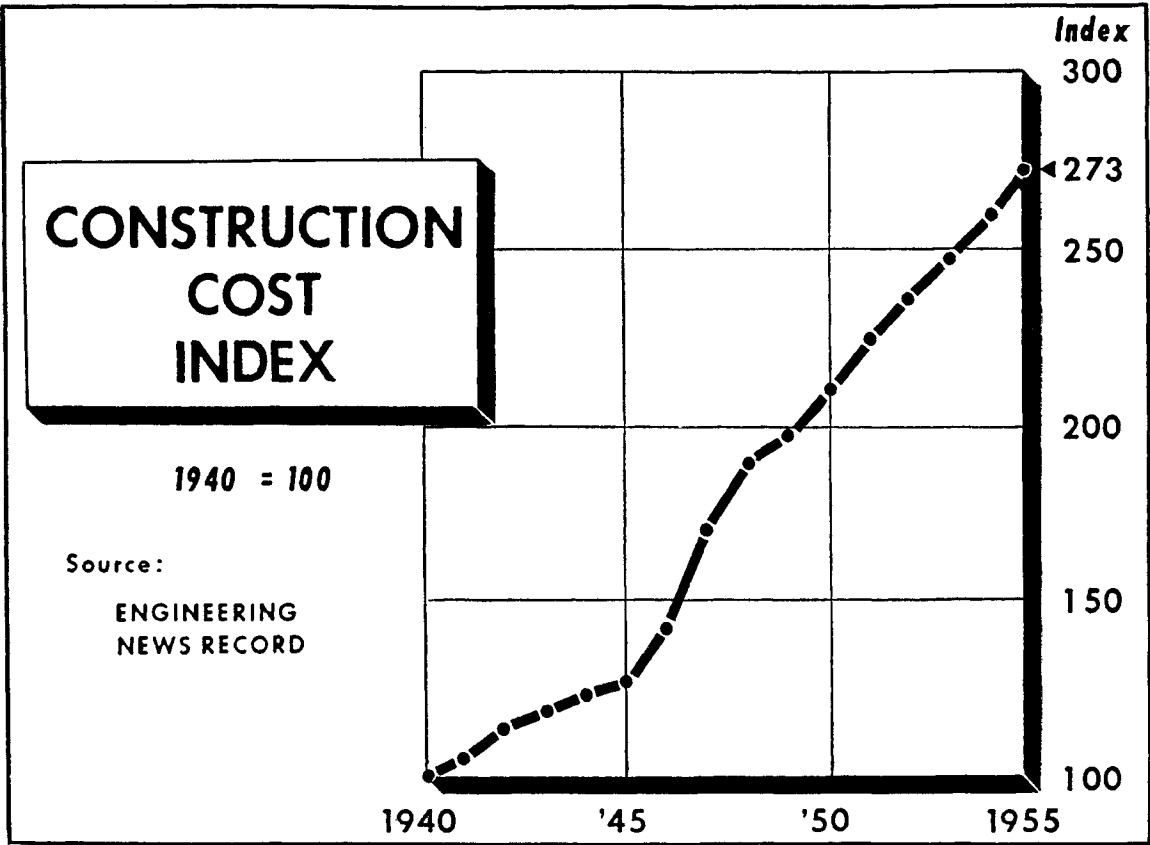


CHART 1

**EXTENT TO WHICH DEPRECIATION ON HISTORICAL DOLLAR
MUST BE MULTIPLIED TO RECOVER
CONSTANT PURCHASING POWER**

RATE OF INFLATION	FACTOR		
	5 - YEAR LIFE	10 - YEAR LIFE	25 - YEAR LIFE
5 %	1.16 Times	1.30 Times	1.77 Times
6 %	1.19 "	1.36 "	1.96 "
7 %	1.22 "	1.42 "	2.15 "
8 %	1.25 "	1.49 "	2.34 "

CHART 2

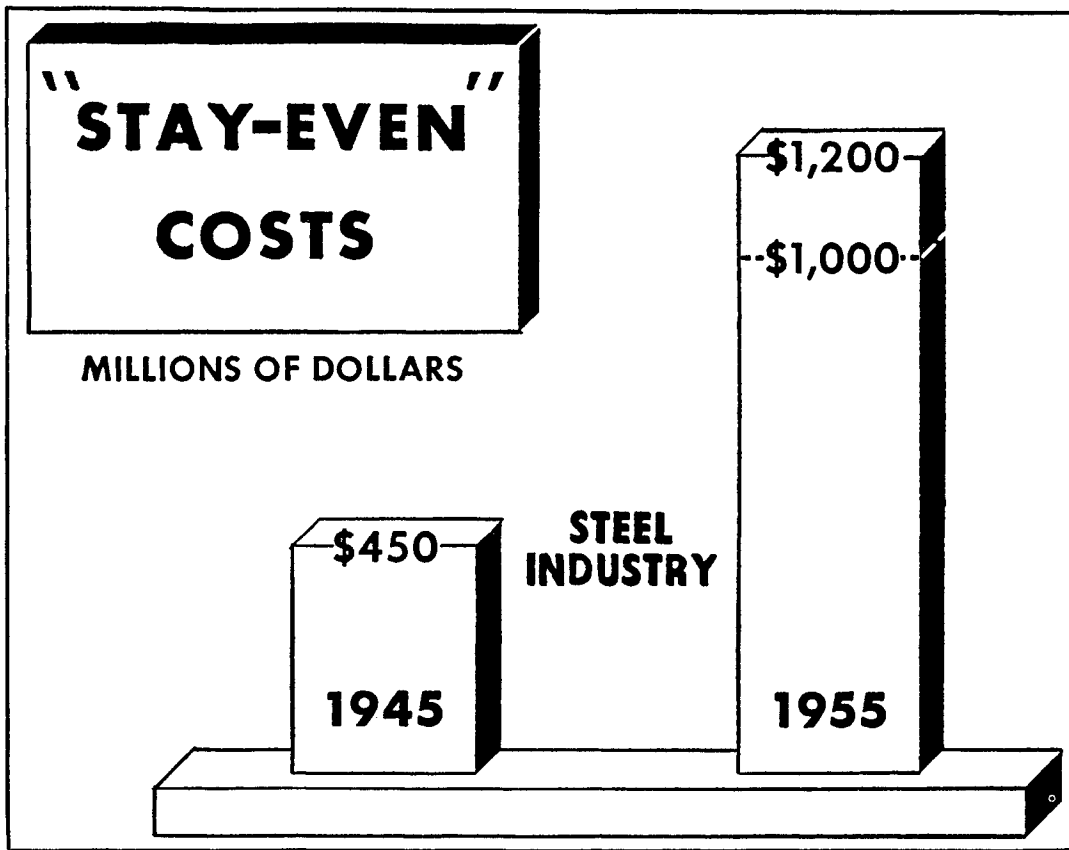


CHART 3

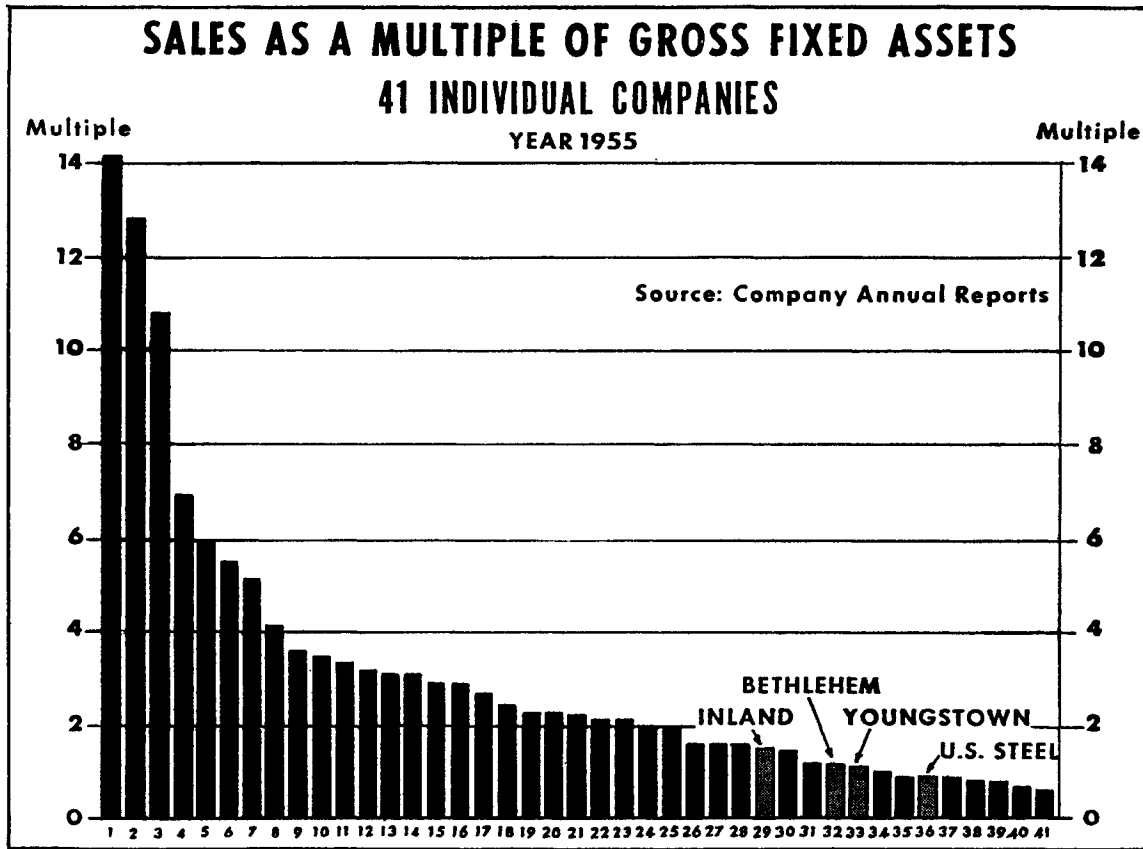


CHART 4

SALES AS A MULTIPLE OF GROSS FIXED ASSETS

41 Individual Companies

Year 1955

Company	Rank	Multiple	Company	Rank	Multiple
Douglas Aircraft Company	1	14.1	International Harvester Company	22	2.2
American Tobacco Company	2	12.8	Armstrong Cork Company	23	2.1
McGraw-Hill Publishing Company	3	10.8	Burlington Industries, Inc.	24	2.1
Curtiss-Wright Corporation	4	6.9	Corn Products Refining Company	25	2.0
Swift & Company	5	6.0	Pittsburgh Plate Glass Company	26	1.7
Standard Brands, Inc.	6	5.5	International Paper Company	27	1.6
Chrysler Corporation	7	5.1	Johns-Manville Corporation	28	1.6
Radio Corporation of America	8	4.2	Inland Steel Company	29	1.6
National Distillers Products	9	3.6	Eastman Kodak Company	30	1.5
Blaw-Knox Company	10	3.5	Kennecott Copper Corporation	31	1.3
Borden Company	11	3.5	Bethlehem Steel Corporation	32	1.3
Newport News Shipbuilding & Dry Dock Co.	12	3.2	Youngstown Sheet & Tube Company	33	1.2
General Motors Corporation	13	3.2	Standard Oil Co of New Jersey	34	1.1
Colgate-Palmolive Corporation	14	3.2	Union Carbide and Carbon Corporation	35	1.0
Continental Baking Company	15	3.0	U. S. Steel Corporation	36	.9
General Electric Company	16	2.9	International Business Machines	37	.9
Goodyear Tire & Rubber Company	17	2.7	Allied Chemical & Dye Corporation	38	.8
Continental Can Company	18	2.6	Socony Mobile Oil Company	39	.8
U. S. Rubber Company	19	2.4	Marquette Cement Mfg. Company	40	.7
Coca-Cola Company	20	2.4	Celanese Corporation	41	.6
Budd Company	21	2.2			

SOURCE: COMPANY ANNUAL REPORTS

CHART 5

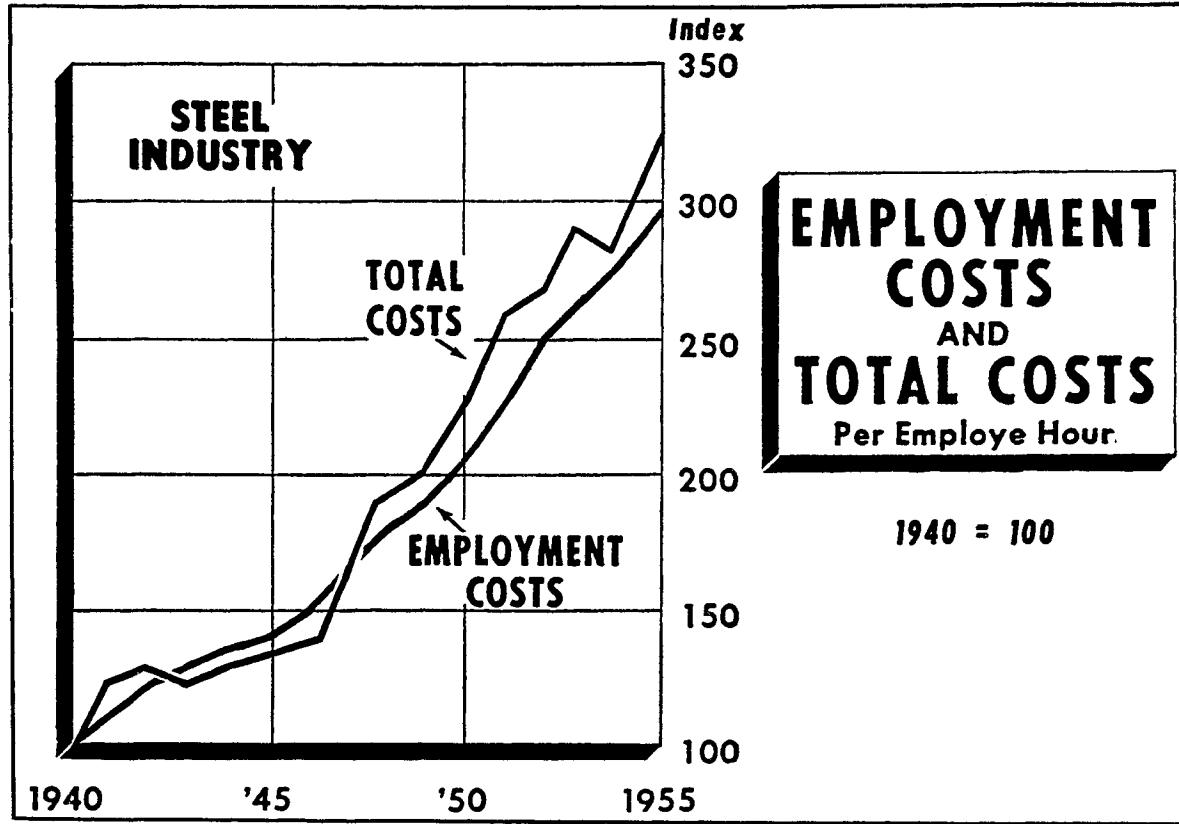


CHART 6

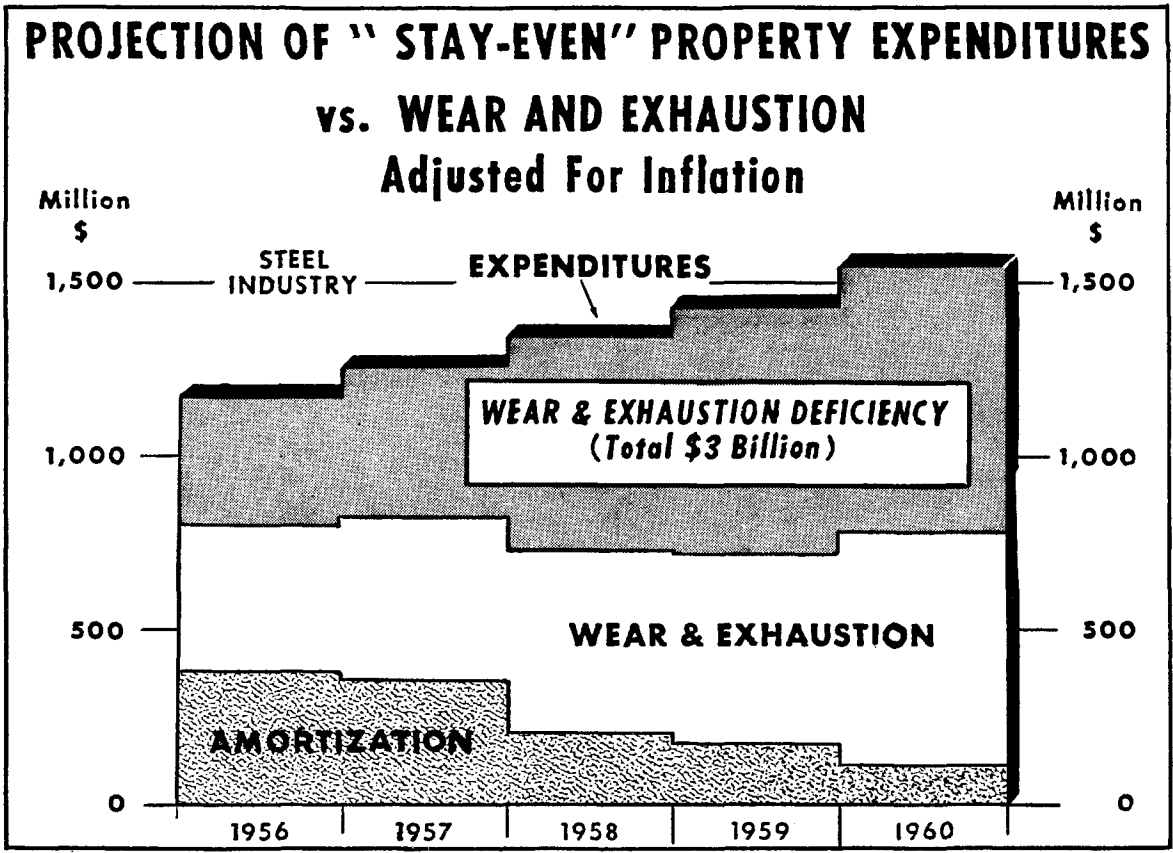


CHART 7

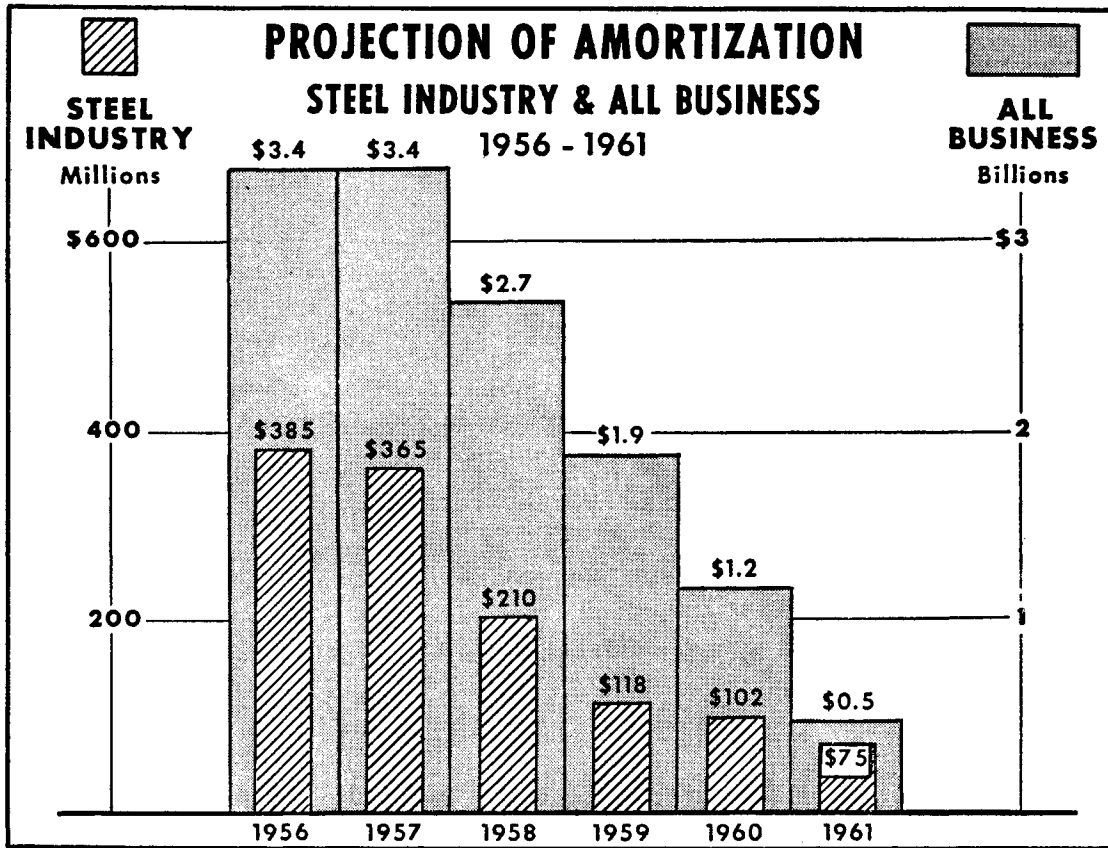


CHART 8

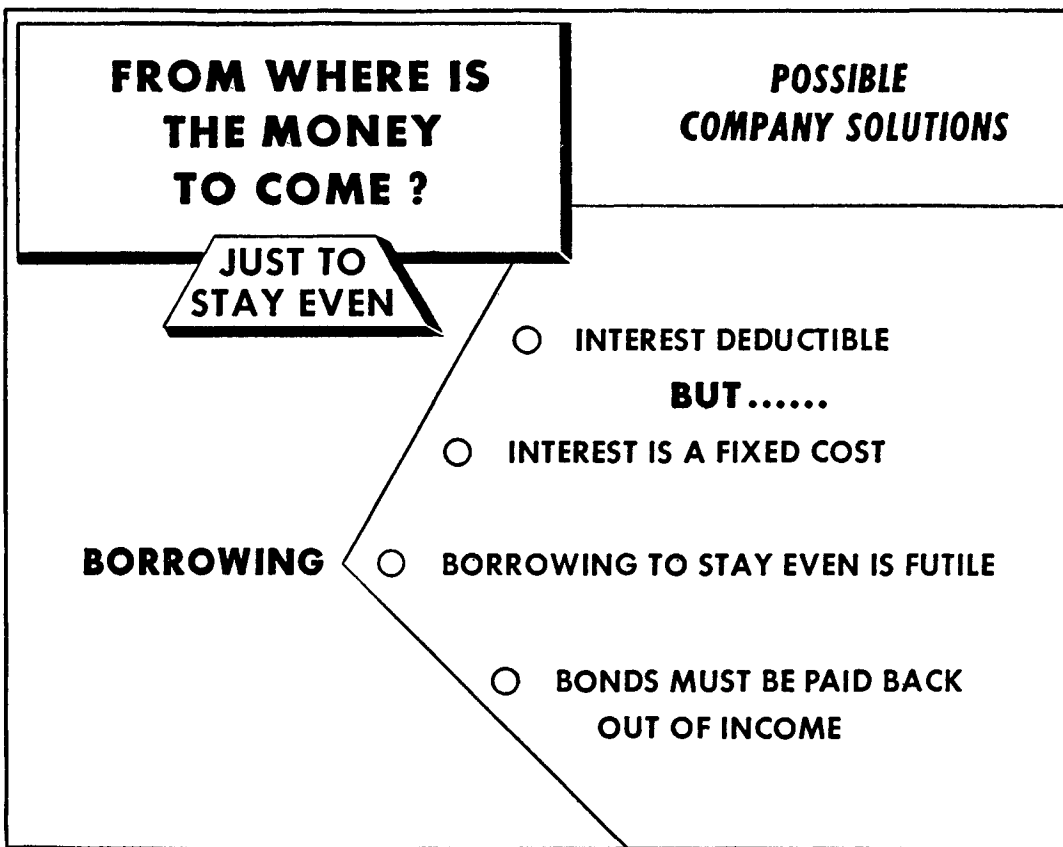


CHART 9

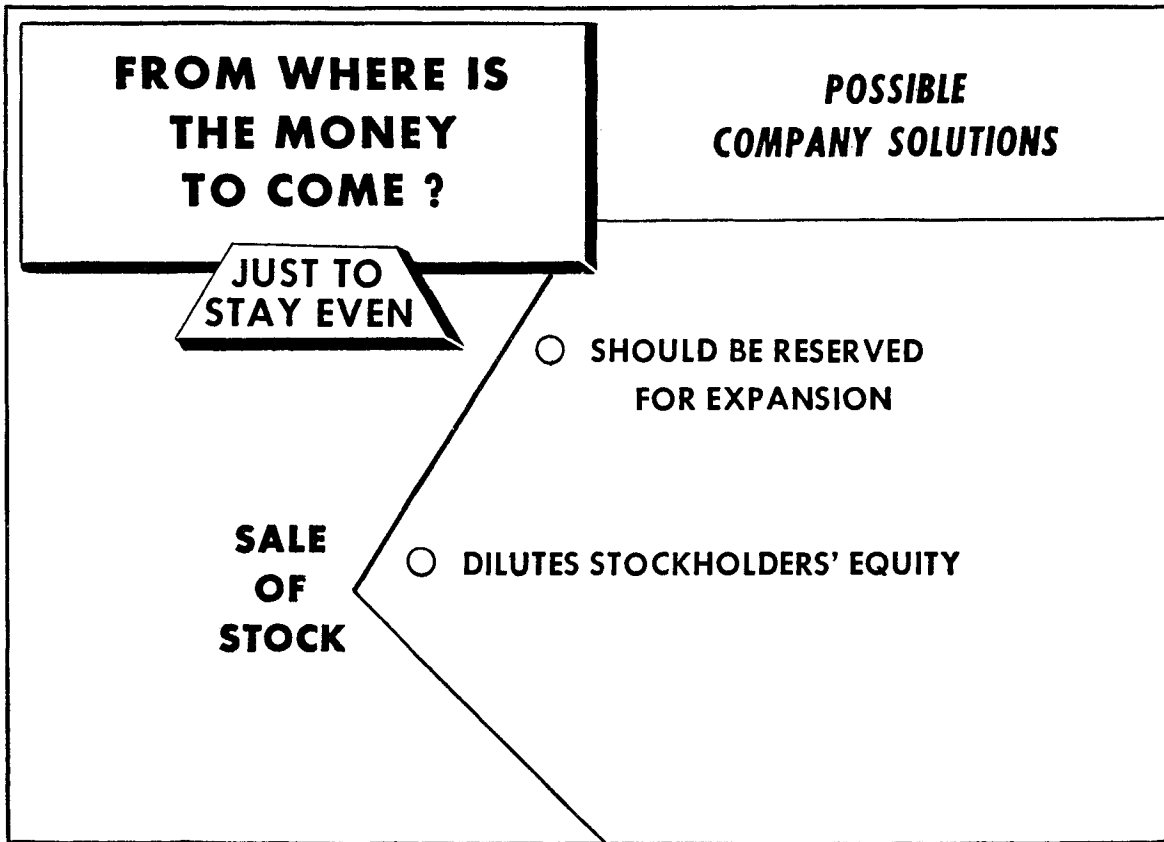
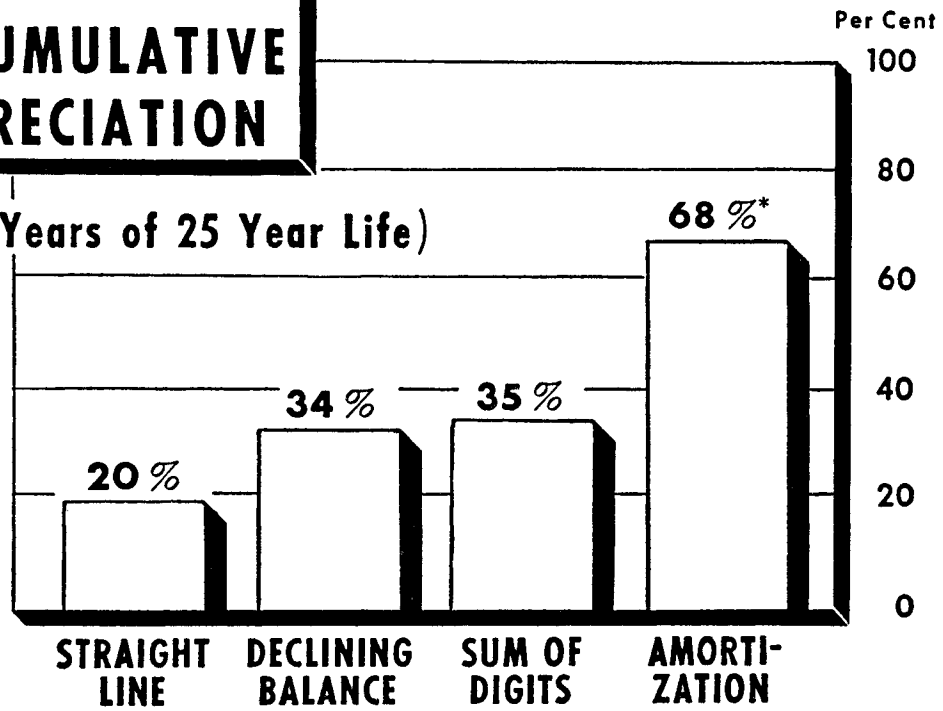


CHART 10

COMPARISON OF CUMULATIVE DEPRECIATION

(First 5 Years of 25 Year Life)



*Assumes 60% of Cost Subject To Amortization

CHART 11

LEGISLATIVE DEPRECIATION SOLUTIONS	FRANCE
<p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p>	<p>REVALUATION FACTORS</p> <p>- By Years of Acquisition</p> <p style="padding-left: 40px;">e.g. 1914 & Earlier - 194.4 Times Original Cost</p> <p style="padding-left: 40px;">1950 - - - 1.3 Times Original Cost</p> <p>NEW PLANT AND EQUIPMENT</p> <p style="padding-left: 40px;">1st. Year - Twice Normal Rate.</p> <p>MODERNIZATION</p> <p style="padding-left: 40px;">10% of Cost Written Off Immediately on Delivery.</p>

CHART 12

**LEGISLATIVE
DEPRECIATION
SOLUTIONS**

GREAT BRITAIN



DECLINING BALANCE METHOD - ORIGINAL COST

Coke Ovens & Auxiliaries . . . 16 %

Iron & Steel Manufacture . . . 9 %

Plus - Initial Year Allowance

Industrial Buildings . . . 10 %

Plant & Machinery . . . 20 %



ALTERNATIVE - STRAIGHT LINE METHOD

CHART 13

LEGISLATIVE DEPRECIATION SOLUTIONS	CANADA
✓	<p>DECLINING BALANCE METHOD - ORIGINAL COST</p> <p>Coke Ovens, Blast Furnaces & Steel Making Facilities . . . 20 % Manufacturing Facilities . . . 6 & 8 % Other Classes 4 - 40 %</p>
✓	<p>EXPANSION CERTIFIED BY MINISTER OF DEFENSE</p> <p>50 or 70% of Original Cost Over Four Years</p>

CHART 14

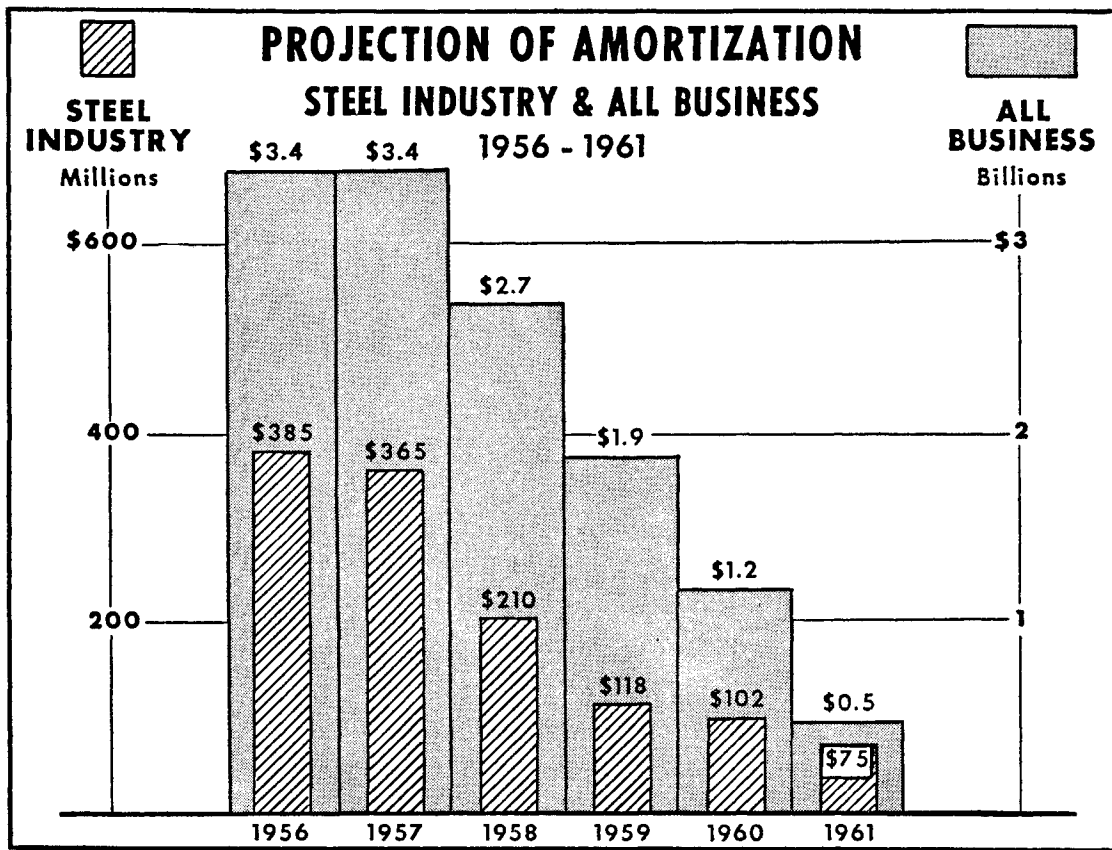


CHART 15

Senator SPARKMAN. I still would like an answer to this question. I think it was either Mr. Backman or Mr. Hitchings raised the point this morning when they spoke about using funds that had been set aside to take care of depreciation. So the specific question that I ask—it may be elementary but I do not know the answer to it—is, when you set aside funds for depreciation, if you have one of these rapid depreciation allowances, do you include in your depreciation funds the additional amount set aside by reason of that rapid depreciation?

Mr. BRUBAKER. The simple answer is yes. Nearly all companies do it.

Senator SPARKMAN. All of that is called depreciation.

Mr. BRUBAKER. Then they also keep extra money which they call retained profits. It is over and above depreciation and normal retained profits that Mr. Blough and Mr. Fairless want extra profits in order to do more expansion.

Mr. BACKMAN. I think the answer is that manufacturing companies generally set these funds aside as depreciation. But when you come to utilities and railroads under the accounting conventions now in force in most States, and before the Interstate Commerce Commission, these funds, while available, are not set up exactly the same way as they do in the manufacturing companies. They take what would be the normal depreciation in calculating their profits for the stockholders' report, but take the accelerated depreciation in connection with tax returns.

Senator SPARKMAN. Yes. I had thought that probably was the general practice.

Mr. BACKMAN. That is followed primarily with electric utilities and regulated utility companies and railroads, while manufacturing companies are not in that same position because they do not have to come before a regulatory agency to ask for price adjustments with the agency trying to avoid what may be excessive building up of prices. This is one of the problems they are concerned with. But in both cases cash is set aside in almost the same sense as money is used to buy raw materials or to pay for labor. The using up of these machines is just as much a cost of business as is the cost of raw materials and labor.

Senator SPARKMAN. As I understand in the case of rapid depreciation, you are really depreciating more rapidly than you use up the machines. That is exactly the point I was thinking about. If you count the whole thing in against 1 year's operations, a few years hence when you get out from under that load, is there going to be a price reduction?

Mr. BACKMAN. At that later date the depreciation charge is not included in your cost, and it is also not included as a deduction from your before-tax earnings. So you have a higher tax to pay.

Senator SPARKMAN. There should be a net profit accruing to the company.

Mr. BRUBAKER. The theory is quite right.

Senator SPARKMAN. The thing I hopefully look for but never see is when the adjustment is coming the other way.

Mr. BACKMAN. There is no net profit accruing to the company, Senator Sparkman, unless there is a change in tax rates. Today you get a large deduction in calculating taxes and tomorrow you get no

deduction. So if tax rates should remain the same over the life of this property—let us say 20 years—the overall amount that the company saves in taxes in the first 5 years is paid out in extra taxes in the last 15 years. If taxes go down, there is some gain. If they go up, there is not a gain, and we saw that after World War II.

Mr. WEINBERG. Mr. Chairman, may I make a comment on that?

Senator SPARKMAN. All right.

Mr. WEINBERG. I think it should be clear that corporations charge not only the additional depreciation allowed under the tax laws, but they also use various other devices such as charging "extraordinary" depreciation and obsolescence and so on. I would like to refer you to some testimony that Mr. Montgomery of UAW introduced before the Flanders Subcommittee on Profits some years ago, listing specific companies and outlining the practices they followed in this connection. I think the basic point with respect to prices is this: As companies charge extra depreciation, and particularly as they are permitted to charge it under the tax laws, their profits apparently are reduced. This apparent reduction in the profit margin creates a further excuse for price increases and those price increases are retained even after the properties are fully depreciated. So the consumer gets it twice—as a taxpayer because he has to make up for the loss of revenues, and as a consumer in the price he has to pay for the product.

I would also like to make a couple of other comments with respect to depreciation.

First, I take it from the two quotations you have put into the record that by Mr. Fairless' definition, the method of raising capital advocated by Mr. Blough would not be the American way.

Second, Mr. Backman has referred earlier today to depreciation charges not being a proper measure of actual depreciation because they are expressed in terms of a depreciated dollar. We would be pleased to see a little consistency in looking at this depreciated dollar. We have heard a lot of statements about wages outpacing productivity in the economy. In Mr. Backman's statement he talks on page 2 about increases in labor costs in excess of gains in productivity. But the proper measure is whether real wages have outpaced productivity. We know as a historical fact that when the cost of living rises, wages follow the rise in the cost of living, and do not precede it. Under the cost-of-living escalator agreements that many unions have today, the price increase comes first, and the wage increase follows, and the wage increase at best merely compensates for the increase in the cost of living.

The valid comparison, the proper comparison, is between real wages and productivity and it seems to me that those who advocate that unions exercise restraint in their wage demands and not outpace productivity must in good conscience be referring only to real wages, because to ask labor to refrain from seeking wage increases in the face of a rising cost of living is to ask workers to accept a constantly declining standard of living and a constantly diminishing share in the total product of our national economy.

I think it can be demonstrated, and if any of the gentlemen here have evidence to the contrary I would like to see them produce it, that both in the economy as a whole and in the major industries that we are talking about, real wages have not outpaced productivity but have lagged behind productivity in the postwar period as a whole. It may

be possible to say that in a given year real wages may have moved ahead of productivity. But to confine the comparison to a single year implies that any inequity that may have been perpetrated in the past is to be perpetuated into the future.

Looking at it over the whole postwar period, I think it can be demonstrated that wage increases plus fringe benefits expressed in real terms have lagged behind the real increase of the product the workers involved have been producing.

Mr. BACKMAN. Mr. Chairman, I would like to register a very strong dissent to that last statement. In the first place, this question of proper comparisons between wages and productivity has been raised a number of times today. I agree with Professor Rees in the sort of comparisons he made and the qualifications he made concerning those comparisons. There are not many economists, apart from those who are fighting some particular battle—I don't say this with any invidious meaning, but I am talking now about economists generally—who insist that real wages should be compared with productivity except for one reason: To see whether workers have participated in the expansion in real goods and services in the economy. There is no meaningful comparison between real wages and productivity of an industry for the purpose of seeing whether workers are getting more or less than the productivity of their industry. That comparison is not meaningful. The only significant comparison for that purpose is the comparison between what happened to money wages and what happened to the number of units that are turned out, because it is the increase in money wages which results in this large increase in unit costs.

I do not want to take the time of the committee to develop this point at length, but I would appreciate having an opportunity to file a study that I made of these comparisons at this point in the record, if I may.

Senator SPARKMAN. Without objection, that will be done.
(The information follows:)

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WAGE-PRODUCTIVITY COMPARISONS

Jules Backman

The economic issue of distributing the gains from increased productivity has long been a vital one at almost every level of labor-management relations. Appropriate measures of productivity and of earnings, particularly at company and industry levels, are technical matters on which there is no common agreement, even among disinterested students of labor relations and collective bargaining. The author of this article argues for a broad definition of labor income, calls attention to the effects of structural change on productivity measures, and examines the applicability of several different wage-productivity comparisons to different situations.

Jules Backman has devoted much of his research to wage-price relationships. He is professor of economics, New York University.—EDITOR.

In recent years, the relationship between changes in wages and productivity has received increased attention in wage determination. Although changes in productivity long have been among the factors considered in collective bargaining over wages,¹ major impetus was given to this criterion by the GM-UAW contract in 1948. Under this agreement, provision was made for the "annual improvement factor" which was designed to enable employees to share automatically in the increasing productivity of our economy. Initially, the rate of increase was estimated at 2 percent. However, in the 1950 contract, an adjustment was made so that the wage increase was based upon a 2.5-percent annual rate of increase.

¹ Arthur M. Ross, *Productivity and Wage Control*, *Industrial and Labor Relations Review*, vol. 7, No. 2 (January 1954), pp. 179-182. See particularly the citations in footnotes 5 and 6, p. 179.

Since the first GM agreement, annual improvement clauses have been incorporated in the balance of the contracts with the automobile industry, and such contracts also cover a number of workers in closely related industries. Although most companies in other industries did not incorporate automatic productivity adjustments in their collective bargaining agreements, productivity has become a much more widely discussed criterion than was previously the case.²

The increased use of productivity-wage change comparisons makes it necessary to consider how these comparisons may be made properly. A number of questions arise which must be given careful answers. What are the proper productivity figures to use to show national trends? What wage data should be used for comparative purposes? To what extent should other labor compensation be included in the wage totals? Should comparisons be made with money wages or with real wages, and what is the relative significance of each type of comparison? What significance should be given to changes in productivity and wages within an industry? Is it proper to compare real wages of an industry with productivity changes in that industry?

The foregoing questions do not represent academic exercises. They reflect the types of problems which have developed in collective bargaining. A number of these questions have been subject to public debate in steel wage cases³ and railroad wage cases,⁴ to mention but two important examples. In the large literature which has developed on productivity, however, little attention has been given to the problem of proper comparisons. In the following brief survey, the significance of various types of comparisons is discussed.

WAGE SUPPLEMENTS AND PRODUCTIVITY COMPARISONS

Comparisons usually are made between changes in average hourly earnings⁵ and productivity. Because of the widespread introduction of so-called fringes and wage supplements in recent years, however, it is desirable to use a concept of labor costs which is broader than average hourly earnings. It should be noted that some of the so-called fringes are reflected in the data for average hourly earnings. Included in this category are paid vacations, paid holidays, shift differentials, paid lunch periods, paid rest periods, travel time, and cal-in pay. In all of these instances, both the hours paid for and the amounts paid are included in determining average hourly earnings. Since hours paid for are also used in calculating output per man-hour, these types of fringes do not create distortions in the wage-productivity comparisons.

A number of important wage supplements are, however, not reflected in average hourly earnings. Included in this category are such outlays as payments for pensions, insurance, health and welfare, social security, and workmen's compensation. A recent study of 529 large companies showed that in 1953 these payments accounted for 9.2 percent of their total payrolls.⁶

The cost of wage supplements may increase as a result of either of two developments; increases in hourly earnings, and the adoption of new programs or the expansion of old ones. The first type of increase is found where the cost is a percentage of wages. Illustrations include the rise in social security payments as a result of the increase in taxable earnings up to \$3,600 annually, or as the result of an increase in the payroll tax, and the increase in pension costs where they are a percentage of salaries and wages. This type of development would not affect short-term comparisons between changes in relative costs and in productivity, but it would affect comparisons with labor costs prior to the adoption of the social security system or the pension program.

The second type of increase reflects the adoption of new programs. The widespread introduction of pension and health and welfare plans starting in 1949-50 and the increase in taxable earnings under social security provide illustrations. Similarly, any widespread introduction of disability plans or of the guaranteed wage would fall into this category.

² For a comprehensive survey, see Jules Backman, *The Economics of Annual Improvement Wage Increases* (New York: New York University Schools of Business, 1952).

³ See particularly the hearings before the 1949 Steel Industry Board and before a special panel of the Wage Stabilization Board (case No. D-18-C) in January-February 1952.

⁴ See the various hearings before Presidential emergency boards and particularly the hearings before Paul Guthrie, the referee appointed by the President, in the so-called productivity case in January 1953.

⁵ Since productivity data usually are expressed in terms of man-hours, weekly and annual wage data are not directly comparable.

⁶ *Fringe Benefits, 1953* (Washington: Chamber of Commerce of the United States, April 1954), p. 5.

A third type of supplement may result in a lower relative cost as wages rise. In this category would be any costs which are set in terms of cents per hour. As hourly wages, the relative importance of such benefits declines. The payment of a designated cents per hour for health and welfare plans provides a case in point. Similarly, when wages exceed \$3,600 a year, old-age security taxes become fixed amounts which decrease in relative importance as earnings continue to rise. However, periodic changes in the cost of such programs may alter this situation significantly.

The United States Department of Commerce includes in its national income statistics, annual estimates of supplements to wages and salaries. In 1952, the total was \$9,585 million and included the following items (table I) :

TABLE I.—*Supplements to wages and salaries, 1952*

	<i>Millions of dollars</i>
Total supplements to wages and salaries.....	9, 585
Employer contributions for social insurance.....	4, 847
Old-age and survivors insurance.....	1, 782
State unemployment insurance.....	1, 351
Federal unemployment tax.....	275
Railroad retirement insurance.....	319
Railroad unemployment insurance.....	25
Federal civilian employee retirement systems.....	334
State and local employee retirement systems.....	620
Cash sickness compensation funds.....	3
Government life insurance.....	138
Other labor income.....	4, 738
Compensation for injuries.....	885
Employer contributions to private pension and welfare funds.....	3, 436
Pay of military reservists.....	283
Other.....	134

Source : U. S. Department of Commerce, Survey of Current Business, July 1953, p. 24.

For all industries, wage supplements were equal to 5.2 percent of total wages and salaries in 1952;⁷ for manufacturing industries alone, the ratio was 6.3 percent. For particular industries and groups, the ratios vary widely as the illustrations in table II show.

Clearly, the labor cost-productivity comparisons may be significantly affected by the inclusion or exclusion of wage supplements in many key industries.

Since many of these supplements have become relatively important only recently, for example, pensions and welfare payments; longer-term comparisons, which often are the significant ones, may be distorted by the failure to include these items in the total labor bill. The change in relative importance of wage supplements since 1929, for all industries, is shown in table III.

The relatively small rise from 4.5 to 5.2 percent in the ratio of total supplements to total wages and salaries between 1939 and 1952 reflects the decline in relative importance of employer contributions to social security. In 1939, such contributions were 3.4 percent of the total wage bill, while in 1952 the ratio was only 2.6 percent. This decline reflected primarily a decrease in the relative importance of unemployment insurance payments from 2.1 to 0.9 percent of total wages and salaries. The combination of lower tax rates under merit rating and the increase in the proportion of wages above taxable limits accounts for this decline. Similarly, although the old-age and survivors insurance tax rate doubled, the relative importance of these contributions rose only from 0.6 percent in 1939 to 1 percent in 1952, as more wages and salaries rose above \$3,600, the upper limit of taxable wages.

⁷The proportion is smaller than shown in the Chamber of Commerce of the United States study because the U. S. Department of Commerce totals include all companies—large and small—and also reflect Government and farming where the payments are relatively smaller than for large companies in private industries.

TABLE II.—*Relative importance of wage supplements, selected industries, 1952*

<i>Industry or industry group</i>	<i>Supplements as percent of total wages and salaries</i>
Products of petroleum and coal.....	18.5
Bituminous and other soft coal mining.....	13.7
Telephone, telegraph, and related services.....	10.3
Tobacco manufactures.....	9.0
Iron and steel and their products, including ordnance.....	8.0
Railroads.....	7.3
All manufacturing.....	6.3
Apparel and other finished fabric products.....	5.9
Nonferrous metals and their products.....	5.3
Textile-mill products.....	4.9
Wholesale and retail trade.....	3.7
Services.....	2.7
State and local-government enterprises.....	1.8
Farms.....	1.0

Source: Derived from Survey of Current Business, July 1953, p. 16.

TABLE III.—*Wages and salaries and supplements, 1929, 1939, 1952*

	Wages and salaries (billions)	Supplements	
		Amount	Percent of total wages and salaries
1929.....	50.2	0.6	1.2
1939.....	45.7	2.1	4.5
1952.....	183.6	9.6	5.2

Source: U. S. Department of Commerce, National Income, 1951 edition, Washington, 1951, pp. 160-163, and Survey of Current Business, July 1953, p. 16.

Long-term changes in outlays for labor which exclude wage supplements thus tend to understate the relative rise in labor costs. For example, average hourly earnings of railroad workers rose by 190.7 percent from 1929 to the end of 1953; average hourly earnings plus payroll taxes rose by 206.5 percent. In making wage-productivity comparisons, therefore, wage supplements must be included in the wage total. Changes in total wage costs per man-hour rather than average hourly earnings provide the proper comparison with changes in productivity.

EFFECT OF STRUCTURAL CHANGES IN EMPLOYMENT

It is important to emphasize that data showing changes in national productivity are still in the "production stage." Such data usually are derived from estimates of deflated gross national product and estimates of total man-hours. Both series involve a number of educated guesses, even for current estimates. The data for earlier years are much less satisfactory.⁸

The deflated-value data for productivity, even for the private sector, must consequently be used with caution as a basis for wage adjustments. Thus, the United States Department of Commerce warns:

"* * * shifts of workers from industries in which gross product per unit of labor is relatively low to industries in which it is higher will lead to an increase in the overall measures of production even if no increase in production occurs within the individual industries. This characteristic of constant-dollar gross national produce should particularly be kept in mind in studies of productivity."⁹

A classic illustration of such a shift is the long-term movement of the labor force from agriculture to manufacturing and other industries characterized by

⁸ For a brief survey of the limitations of basic productivity statistics, see Backman, op. cit., pp. 6-11.

⁹ U. S. Department of Commerce, National Income and Product of the United States, 1929-50 (Washington: U. S. Government Printing Office, 1951), p. 142.

higher real product per man-hour. According to the United States Department of Commerce:

"Since real product per man-hour is two-thirds less in farming than in the private nonfarm sector, this shift would in itself have caused an appreciable increase—*approximately one-half of a percentage point*—in the average annual rate of growth in real private product per man-hour, even had there been no improvement in productivity in the two sectors separately."¹⁰ [Italics added.]

John Kendrick estimates that the long-term trend in productivity, excluding the influence of the farm to nonfarm shift in employment, shows an average annual rate of increase of only 1.84 percent. Thus, he estimates the annual influence of the shift from farm to nonfarm on productivity at one-quarter of 1 percentage point.¹¹

The same process takes place in a war or an armament period because millions of workers shift from agriculture and other low-value industries, such as domestic service, retail trade, and hotels, into relatively high-value industries, such as electronics, aircraft, and heavy machinery.

One significant illustration will point up this situation. Productivity and wages in the durable goods industries usually tend to be greater than in the nondurable goods industries. For example, in September 1953, average hourly earnings were \$1.90 and \$1.63 respectively. The shift in employment from 1939 to September 1953 was as follows:

TABLE IV.—*Employment in durable goods and nondurable goods industries, 1939 and September 1953*

	1939		September 1953	
	<i>In thousands</i>	<i>Percent of total</i>	<i>In thousands</i>	<i>Percent of total</i>
Durable goods.....	4, 683	46. 5	9, 955	57. 8
Nondurable goods.....	5, 394	53. 5	7, 266	42. 2
All manufacturing.....	10, 078	100. 0	17, 221	100. 0

The relative importance of the durable-goods industries rose from 46.5 percent of the employment in all manufacturing industries in 1939 to 57.8 percent in September 1953. Obviously, this shift in resources to higher value sectors of the economy added to the gain in average national productivity in the same manner as the shift from the farm to the nonfarm sectors.

Similarly, the average hourly earnings for all manufacturing industries rise when workers shift to higher paying industries—even though no individual industry raises its wage rates. For example, average hourly earnings for all manufacturing industries in September 1953 were about 3 cents an hour higher than they would have been if the 1939 distribution of durable-nondurable employment had prevailed in September 1953.¹² This 3 cents was equal to almost 5 percent of the average hourly earnings in 1939. To this extent, the change in average hourly earnings in manufacturing industries reflected a shift in the "man-hour mix" rather than higher wage rates in specific industries. To the extent that this shift to the durable-goods industries also resulted in an increase in productivity in manufacturing industries, it has been reflected in part or in whole in the higher average hourly earnings in all manufacturing industries even though the components of the index have shown a somewhat smaller increase in wages.

Where gains in national productivity arise from shifts within the labor force, such gains do not necessarily improve the ability of the specific industrial sectors to meet higher wage costs. To the extent that workers shift from low-value (usually low-wage) sectors of the economy to high-value (usually high-wage) sectors, they participate in the accompanying rise in national productivity—although that participation may not be proportionate. To the extent that such shifts are a factor in productivity increases, the latter do not make

¹⁰ Survey of Current Business, January 1951, p. 7.

¹¹ John Kendrick, National Productivity and Its Long-Term Projection, a paper before the conference on research in income and wealth, National Bureau of Economic Research, May 1951, p. 29 (mimeograph).

¹² If allowance were made for the shifts among industries within the durable and nondurable goods categories, the net impact of the shift would have been different than shown.

it possible to pay proportionately higher wage rates to those previously employed in the higher value areas.

The precise impact of a shift of workers from low-wage to high-wage industries will be influenced by the accompanying price and income effects. Increases in output in the expanding sectors of the economy usually have been accompanied by decreases in the relative prices of their products. These relative price reductions have been necessary to dispose of the expanding supply of goods and they have been facilitated by the decreases in costs attending the introduction of technological improvements and the economies of large-scale production. Similarly, the increases in incomes attending such a shift in resources will have an impact upon total demand which might be accompanied by an expansion in output for the entire economy and thus set the stage for general wage increases. However, this latter effect usually will be unimportant in the short run, except where a major shift in the use of resources takes place in a war or defense economy.

The ratio of wages to value output per hour varies widely among industries.¹² The actual result of any shift among industries also would be affected by varying ratios of these two factors as well as by relative levels of and changes in productivity. As a general rule, the industries with higher productivity tend to pay higher wages. A shift of employment to industries with higher wage productivity will be reflected in a rise in total output per man-hour for all industries.

Because of the tendencies noted above, productivity comparisons with wages or labor costs in specific industries should exclude, to the extent possible, the effect of interindustry shifts of workers on trends of national productivity.

As the foregoing discussion shows, the customary wage-national productivity comparisons tend to understate the increase in labor costs and to overstate the raise in productivity which is available for distribution. It should be emphasized that the resulting distortion increases in magnitude as the period of comparison is lengthened. These factors would have little significance in connection with comparisons that cover one or a few years—but such comparisons are not too meaningful in using the productivity criterion.

TYPES OF WAGE-PRODUCTIVITY COMPARISONS

Adjustments to purify the basic data are not the only problems encountered in wage-productivity comparisons. It is also important to consider which measures provide valid comparisons. Here the choices are between money wages and real wages, and between national, industry, and company productivity. Statics are useful only to answer specific questions. In this connection, there are several types of comparisons that may be made between wages and productivity. The more important are the following:

1. Real wages (including supplements) in the economy, in an industry or a company may be compared with productivity changes for the entire economy. This comparison is designed to determine whether or not workers in that industry or company have shared in the national gains in productivity with the accompanying improvement in living standards which may accompany such gains. This is the objective sought under the GM-UAW contract.

2. Total money wages (plus supplements) paid in the economy may be compared with changes in physical productivity in the economy in order to determine the trend of unit labor costs for the entire economy.

3. Money wages (plus supplements) in a particular industry (or a company) may be compared with physical productivity in that industry (or company) in order to determine the trend of unit labor costs in that industry (or company). If money wages rise more than physical productivity, then labor costs rise, and vice versa. These estimates of unit wage costs are a frequently used control tool in American industry.

4. Money wages (plus supplements) may be compared with so-called value productivity, such as gross sales or revenues per man-hour in order to determine whether workers have shared fully in the expansion in sales revenues within the industry. Sales revenues reflect the combined impact of changes in volume, price, and productivity.

Each of the above comparisons has validity and is designed to answer the specific questions indicated.

¹² Because the company or industry has a greater value output per man-hour, it does not necessarily follow that its increase in productivity is greater than in other industries.

Wage-productivity comparisons on a national basis—that is, for the entire economic system—are correctly drawn on a real-wage basis. At an industry (or company) level, wage-productivity comparisons—that is, using an industry's record of productivity and the real wages of its employees—are not very meaningful. This distinction was noted by the Steel Industry Board in the 1949 wage case,¹⁴ when it stated:

"The union's contention was based on the notion that, because the productivity index is a physical or 'real' one, the earnings index must be stated in similar terms. On this point we agree with the union. The difficulty is that there is in fact no available measure of labor's share in the increased physical productivity of any particular industry. It would be incorrect to do as the union urges; namely, to deflate the index of money average hourly earnings with the general cost-of-living index, which in part measures labor's (and other groups') contribution to the national output of all products and not only of steel. *It is only in respect to the economy as a whole that the real average hourly earnings of labor can validly be compared with an index of man-hour productivity; then both indexes apply to all labor.*

"In any event the companies were correct in contending that the union's emphasis on the change in man-hour productivity from 1939 to 1948 and 1949 was misplaced. Because the rate of operation is such an important factor in productivity, valid comparisons can be made only for years of similar rates of operation, such as 1941 and 1948.

Using as the proper base the period 1940-41 for comparison with the first quarter of 1949, and *finding that the rise in steelworkers' real hourly earnings approximately matched the rise in labor productivity for the economy as a whole during that period, we conclude that the union failed to establish that labor's share of the steel industry's output has become inequitable.*" [Italics added.]¹⁵

The fundamental defect of comparisons between real wages and productivity within an industry is that such comparisons ignore the changing position of a company or an industry in the national economy. In a dynamic economy, the relative value of an industry's services, as reflected in the prices for its products or services, changes over time. Under some conditions, it may become more valuable; under other conditions, it may become less valuable. The cost-of-living index is a composite measure of prices, with some groups of prices changing less than the average while others change more. Industries in a mature or declining phase may have braked their price increases, even under inflationary conditions, in order to retain their limited markets (for example, railroad rates). Other industries may have found it necessary to go counter to the national price pattern to penetrate broader markets (for example, television receivers). These diverse changes in prices alter price relationships and affect the exchange position of industries. These price relationships, as well as productivity changes must be kept in mind.

One figure which reflects the full impact of productivity and other changes in a company's position is total sales. These may be reduced to a man-hour basis for direct comparisons with changes in average hourly labor costs. The ability of an industry's products to command those of other industries in the market place is reflected in relative price changes. It is the failure to allow for this factor that makes invalid the comparison of changes in an industry's real wages with changes in its productivity—even though both figures are in physical terms.

To illustrate: Assume that 1 revenue-ton-mile of railroad service could buy 1 unit of product of all other industries in 1939. Further, assume that the price of revenue-ton-miles has risen 50 percent and the price in outside industries has risen by 100 percent. Under these circumstances, it would now take 1½ revenue-ton-miles to buy 1 unit of goods and services of outside industries (200 divided by 150). The actual changes in revenue per ton-mile in the railroads and prices in outside industries have not been much different from the hypothetical figures used in this illustration. Thus, from 1939 through 1953, revenue per ton-mile rose 51.9 percent (revenue per passenger-mile, 44.5 percent), as compared with a rise of 122 percent for all wholesale prices and about 90 percent for the Consumer Price Index. Because of this smaller rise in prices for railroad services in 1953, it required more railroad service to buy a given amount of the goods and services of other industries than was the case before World War II.

¹⁴ Similar comparisons often are presented by the unions in railroad wage cases.

¹⁵ Report to the President of the United States on the labor dispute in the basic steel industry, by the Steel Industry Board, submitted September 10, 1949, pp. 44-45.

While a deflation of money wage costs by the cost-of-living index reduces that figure to real wage costs, no adjustment is made in the figures for physical productivity to compensate for changes in the exchange value of the products. It is apparent, however, that the relative value of each unit produced changes as price relationships between that industry and other industries change. Consequently, changes in an industry's productivity do not provide any guide as to what it can or should do with wages.

Where an industry has several groups of employees who are represented by different unions, attempts sometimes are made to compare the alleged productivity gains of a designated group of employees with changes in their wages. This would not be important in industries which have contracts with CIO unions representing all employees. Such presentations sometimes are made in the railroad industry where the operating and nonoperating employees often make separate demands upon the carriers. In support of these demands, or in rejecting them, productivity changes may be estimated for one group of workers. This is done by relating total output to the number of man-hours paid for or worked by the segment of the total labor force involved in the proceeding.

There is no way in which the total gains in productivity attributable to the efforts of a particular group of employees can be measured.²⁶ All employees in a company or an industry contribute as a team to the productivity gains recorded. On the railroads, for example, the switchmen, maintenance men, shop crafts, signalmen, engineers, firemen, conductors, officeworkers, and others must work as a team. All are required if the railroad is to operate. The end result in the form of service rendered and of productivity gains reflects their combined efforts, as well as the contributions of capital investment and the efforts of management. It is with the industry's or company's changes in total productivity, therefore, that the proper wage comparison of any particular group of workers is made, not with the changes in their productivity alone.

CONCLUSION

Comparisons between changes in productivity and wages must be made with great care. Productivity data usually are approximate rather than precise, and, because of interindustry shifts, tend to overstate the gain available for distribution as wages. The hourly earnings data customarily used, on the other hand, are inadequate because they fail to allow for the other factors which contribute to total hourly payroll costs, which is the proper comparative. Thus, fringes, including wage supplements, have been increasing more rapidly than have hourly earnings and hence the latter cannot be used to reflect wage trends. When hourly earnings are used, the result is an understatement in the relative rise in total labor costs. Because these factors are not compensating and cumulate in opposite directions, long-term comparisons must be made with great care. This is particularly important because long-term, rather than short-term, comparisons are the significant ones.

There are a number of combinations in which changes in productivity and labor costs may be compared. Four types of comparison can be made to answer significant questions: (1) real labor costs and national productivity, (2) money labor costs and national productivity, (3) money labor costs and productivity in an industry or company, and (4) money labor costs and value productivity in an industry or company. Two comparisons, sometimes used, are not too meaningful: real labor costs and productivity in an industry or a company, and money or real labor costs of a group of workers in an industry or a company and changes in their productivity.

While considerable research is still required to perfect productivity data at the industry and national level, it is also important to understand the proper uses of these data. This article has been concerned with the latter area. It is but an introduction to the subject. Much remains to be done.

Senator SPARKMAN. Mr. Hitchings wanted to say something.

Mr. HITCHINGS. I wanted to comment on the fact that, if profits have benefited to such a great extent, why is it that in the manufacturing area there has been since 1948, this 70-percent increase in the wages and salaries and supplement component, but virtually no in-

²⁶ It is recognized, of course, that the productivity of particular operations may be measured under some circumstances.

crease in profits after taxes? This has occurred despite a tremendous increase in capital investment which presumably should yield some return, and despite the fact that dollar sales have increased.

The test is what the relative shares in the income generated in manufacturing have been. That is the test over this period of the past 9 years.

Mr. WEINBERG. May I comment on that, Mr. Chairman? Perhaps one of the reasons is that profits in the base year used by Mr. Hitchings for the purpose of his comparison were already too high. I would like to call the committee's attention to some facts that seem to me to be deeply disturbing. I refer to the comparison of profits after taxes as a percent of net worth in 1929, the year that immediately preceded the crash in this economy of ours, and the year 1955, when, despite the profits I am going to mention, the corporations in these industries, or most of them, found it advisable to raise prices.

In total manufacturing, the average profit after taxes as a percent of net worth was 12.8 in 1929 and 15.0 in 1955. I call your attention to the fact that with corporate taxes so much lower in 1929 than they were in 1955, this means an enormously greater difference in the total profit taken out of the consumer's pocket.

In the iron and steel industry in 1929, the rate of profit on net worth was 11.2 and in 1955 when the industry raised prices it was 15.2. In autos and trucks in 1929 it was 23.5. In 1955 it was 29.1. The auto industry raised prices in 1955. These figures I am citing are the profit figures published by the National City Bank for leading corporations in these industries and I have taken the 1929 figures from the *Economic Almanac* published by the National Industrial Conference Board. The original source is the same, the National City Bank.

Senator SPARKMAN. Mr. Keyserling has been trying to get recognition for some time. By the way, I would like to bring this phase of the discussion to an end if possible. Senator Watkins, Dr. Talle, and Congressman Bolling are in here now, and I would like to get them into the discussion. Go ahead, Mr. Keyserling, and then I will call on one of them to direct questions.

Mr. KEYSERLING. Mr. Chairman and members of the committee, I would like to attempt to answer the question that Congressman Bolling raised before lunch, as to what is a standard against which to measure a desirable rate of return, because I think it gets to the heart of the problem we are dealing with.

If you ask—and this it seems to me is the trouble with most of the discussion relating to base years and absolute figures—is it possible to devise one uniform and definitive formula for profits or for wages or to relate them to a base or to relate them to each other, that is just as impossible a job as trying to define a perfect code of moral conduct. But you do not need a perfect code of moral conduct to say that generally speaking a man should not punch his wife in the nose. Similarly, there are certain general standards which are adequate to an evaluation now by this committee of the broad question of prices and wages.

The function of the economy is to get a balanced growth of production and consumption. Theoretically, if that balanced growth continued, the country would grow, and if the product were equitably and sensibly apportioned, theoretically it would not make any difference what happened to prices and wages and profits. The very reason why

prices and wages and profits are important is that they affect the basic relationships between production and consumption so as to cause the economy to flare at an inflationary rate or decline at a deflationary rate. If we look at the current picture, I think the statements made yesterday all bore out one central conclusion, that short of a total war or much bigger budget than the President is proposing, our total rate of economic growth over the next year will continue a decline in the rate of growth which has existed for several years. This trend is dangerous, measured by our own long-term experience, and measured by the Russian challenge. I think there would further be general agreement that the basic conditioning factor of this trend has been an inadequate expansion of buying by consumers. It all gets down to the ultimate point that the consumers are not buying enough to clear the markets of the production which our growing technology and our growing investment make attainable.

The central question about prices and wages is this: How does the wage side of the problem relate to the picture of consumption? How does the price side of the problem relate to the picture of investment? I think, although there will be disagreement on this, that the figures are clear, that the return of profit to industry at the current and recent level of prices, has not been a cramping factor holding investment down to excessively low levels. In fact, investment has gone on at excessive levels relative to consumption. Therefore, it would seem a conclusive general proposition that we did not need so much price increases in administered areas to give industry the funds it needs to perform its proper investment function in our economic system.

When we turn to the wage side of the picture, it is one of the very important factors bearing upon the inadequate expansion of consumption. If we develop criteria as to this ultimate needed balance between production and consumption, we will have something against which to test price and wage policy. I don't care primarily whether industry finances its growth out of the price system before it builds the plants or after it builds the plants. Industry can finance in the final analysis only out of the price structure, except the subsidies it gets from the Government. But I do care when the financing out of the price structure both before and after the plants are built abstracts from the stream of consumption too much to keep the economy in balance.

When there is financing out of price structure for expansion before the plants are built, and no reduction in prices when the new plants bring increased productivity, and when on top of this wage increases are inadequate, then industry is collecting too much for the good of the whole economy, or its own good in the long run.

This has a particular difficulty for small business, because small business cannot do it this way. Small business cannot finance out of the price structure before the plants are built, because it is largely supplying big business and big business will not let small business raise its prices so much, also, small business is more competitive.

Second, small business cannot finance out of the price structure because it does not have the quasi-monopolistic control of prices, and therefore small business is caught in a box, where it cannot expand and get competitive efficiency, and then because it cannot gain competitive efficiency it is forced out. This becomes a double disadvantage

when larger industry has this additional method of financing in advance out of the price structure.

Financing in advance out of the price structure also converges the financing for building the plants into too short a period of time. Normally, you would expect to finance out of the price structure during the life of the improvement that you were putting into effect. But the method used converges it not over the life of the project, but over a very small time. Therefore, it takes too much out of the stream of the relationship between production and consumption and affects the economy adversely at that point.

Senator SPARKMAN. Let me pass this over to some of the other members of the committee. They may want to continue that or they may want to get on to something else. Dr. Talle.

Representative TALLE. Thank you, Mr. Chairman. I will not ask any questions at this time.

Senator SPARKMAN. Senator Watkins?

Senator WATKINS. I will pass for the moment.

Senator SPARKMAN. Congressman Bolling?

Representative BOLLING. I am sorry to miss some of the discussion that took place before I could get here.

I gather from the answers that were made by some of the members of the panel to my question this morning that nobody cared to come up with what would be a reasonable profit for any particular industry. I assume, therefore, that those who answered at least feel that any profit is reasonable.

Mr. BRUBAKER. I dissented from that after you left this morning.

Representative BOLLING. Would you mind repeating what you said, as best you can? I would be interested to hear it.

Mr. BRUBAKER. The general tenor of my remarks, Mr. Bolling, was to the effect that where an industry has gotten to the stage where it can administer its prices enough or has become noncompetitive enough in the price area, as happens in steel and autos and a lot of other places in our economy, that we no longer have in those areas any real risk problem involved. It is therefore improper to talk in terms of letting those industries and those companies expect to make fabulous rates of return on their net worth in good times so that they can tide them over the bad times. I gave you some figures, then, from the steel industry. We took the rate of return on net worth of the industry over the entire period since 1939. In the majority of these years, the rate of return has actually exceeded 10 percent. This kind of a rate of return is enough to permit that industry to recover, or to permit the owners of that industry to recover their entire investment in the short period of 7, 8, or 9 years.

Very frankly, it is our considered judgment that it is entirely improper in industries which no longer really are competitive on price for them to make rates of return that are assumed to be proper because they are risking their capital and therefore are entitled to a higher rate of return.

I do not want to give you a precise figure on what is a proper rate of return. I would say very flatly that 10 percent in this kind of industry and this kind of price system is too high.

Mr. WEINBERG. May I add something to that? Mr. Rees spoke this morning of prices being based on demand and of the desirability of letting them rise as high as demand will push them. I think Mr.

Rees assumes in that statement the kind of economy we do not have, at least with respect to many industries, and that is the kind of economy in which rising prices, increasing in response to demand, and bringing huge profits to some of the firms in the industry, will lead to the entry of competing firms which will bring those prices and profits down. Under those circumstances I think it is possible to argue that any price and profit is reasonable as a means of allocating the product, at the moment, because ultimately the public and the consumer will be safeguarded since competition will right the situation and bring profits down to a more moderate level.

But the problem we are concerned with here is that in the auto industry and the steel industry and in many other industries we do not have that kind of safeguard. The auto industry can raise prices to any level it deems desirable and no new competitor will be able to enter successfully to bring those prices down. Witness the experience of Henry Kaiser in the postwar period.

So we come to the place in our economy today, it seems to me, where we have to find some kind of restraint to substitute for the restraints that the market place would normally apply in Mr. Rees' ideal economy. This is why we propose that we invoke public opinion, an effective public opinion which must be an informed public opinion, as a restraining influence. Where competition no longer controls prices, then let the public have the facts, price increase by price increase, for those industries in which a few corporations set the price tone and in which they are free to set prices, within very wide limits, to maximize their own profits.

We need a new kind of restraint and we think public opinion equipped with the facts can be that kind of restraint.

Mr. REES. Mr. Bolling, I would like to comment briefly on what Mr. Weinberg has just said, because I agree with it in part and I disagree with it in part.

The part I agree with, and I suspect most people here will agree with, is that competition is a desirable thing, and that we would all be better off in the long run if there were more competition in some of these industries that have been characterized as administered-price industries. I would be delighted to see—I do not know whether Mr. Hitchings would agree with me—several more good companies in the automobile industry. I think there is a little confusion on the point of just what administered prices have to do with price increases. It is not necessarily true in a period of inflation that the administered prices are the ones that are causing the trouble and are going up faster than the competitive prices. Just the reverse may be true.

I think it is the administered prices that are subject to the kind of pressure that Mr. Weinberg has been talking about that comes from the press, that comes from the Congress and from public opinion generally, so that in a period of inflation it is rather typical for administered prices to lag. In a mixed period, such as we are having at present, some administered prices may be on the high side—maybe automobiles are at the present time, because there does not seem to be any excess demand for automobiles at current prices—on the other hand, some administered prices may be too low. They may be lower than they would be in competitive economy.

I have been told at the moment there is a gray market for nickel. Nickel is a monopolistic industry. That price is almost completely controlled by the International Nickel Co. It is apparently being set way below the price that would prevail on a free competitive market, which means that some kind of nonprice rationing must be used. It is that kind of administered price that I was objecting to as being too low. The basic damage that is done in these industries by having too little competition, and too little production in the long run cannot be rectified by holding the price down. Holding the price down not only fails to correct the damage, but it adds to that damage by adding to the shortage of production, the misdirection of the production that does exist.

Mr. BRUBAKER. Could I ask you a question there, Mr. Rees? Do you think that holding the price down or raising the price up of nickel or steel, either one, is going to produce one more pound or one more ton of those products?

Mr. REES. It might be in the long run, but that is not my point.

Mr. BRUBAKER. That is a very important point, though.

Mr. BACKMAN. It does not have to.

Mr. BRUBAKER. Otherwise, the whole price system does not serve the function you ascribe to it. It does not get more production and relieve the overpricing.

Mr. REES. I think the difference of opinion that we are having comes from the fact that there are two quite separate functions of the price system. One of them is to increase supplies in the long run in areas where demand is increasing. This can only be done over time. There is a second function, which is the one I was talking about more specifically, which is helping to insure the wise use of those supplies that do exist.

Let me just come back to the notion that this thing that Mr. Weinberg says is desirable and should be done, of having these prices kept down by public opinion, has already been done and is just in effect what I am complaining about. It is quite true that the steel industry and some of the other administered price industries have made price increases only at the time of wage increases, and that these price increases have been very much larger than the wage increase to which their timing was related. I do not draw quite the same inference from that that has been drawn by some other people. It seems to me that in view of the state of public opinion and the state of opinion in the Congress that if I were running a steel company I would be forced to run it exactly that way. I would have to save up all my cost increases and accumulate them until the time of a wage increase, and then I would have to put them all on the price at once and hope that the union took the blame for it, because that is the only relationship that the public, and I might say the Congress, seems to understand.

I remember hearings before this committee in 1948 when Senator Taft was chairman, and Senator Martin was a member—I was not present at those hearings, but I read the transcripts—at that time the steel industry made a \$5-a-ton increase on semifinished steel which was not connected with a wage increase. They were called down here and they were given an awful dressing down for this price increase by Senator Martin and Senator Taft, two gentlemen that I would have suspected would have been friendly to the steel industry.

I think any steel executive at that time could have wisely concluded that if people as friendly to him as Senator Taft and Senator Martin are going to say that any price increase that is not connected with a wage increase is unjustified, then we had better not increase prices at any other time.

Representative BOLLING. Mr. Brubaker may have an opportunity, if he wants, to go on with his line of thought before we go on to something else.

Mr. BRUBAKER. I do not want to interfere with Professor Rees' running of a steel company, but I would like to correct a couple of his facts.

I pointed out this morning, and I appreciate the fact that probably he and many of the rest of you have not had a chance to look at the material which we gave you this morning, but you will find in the white books that we gave you a list of the price changes that have occurred in the steel industry over the period since the end of the World War II. You will find that the steel industry took not just one price increase each year, that is, after we got our wage increase. It is true, they always did that. It was always the biggest one they took. It is true that the union always was blamed for the price increase. The industry also took other price increases at other times and at lots of other times. In fact, the listing will show that there are almost 2 price increases on the average each year, whereas we have never had more than 1 wage increase in the year. That much just on keeping the facts straight.

We are also seeing this same thing at the moment. You will remember the industry took a big price increase last August right after our wage increase, \$8.50 a ton, according to their statements. We have had in the last 2 months a further price increase, not related to anything, that already averages \$2.25 a ton. It is true that is not quite \$8.50 yet, but it is growing. There is scarcely a week goes by that we do not see another announcement by another company of another item on which they have raised prices.

The thing that has been most disturbing to us as we have watched these price increases time after time is that they are excused as necessary in order to meet competition. On this score the steel industry is probably a little more frank than many of the others. They raise the prices—let us say Republic, for instance, leads out on raising the extras on sheet, for instance—the next week another company comes along and raises its prices on sheet, and it says it has done so to match Republic's prices, in order to be competitive. So we have now got this crude reversal of the whole idea of competition on price to where now, in the steel industry, every company has to raise its prices whenever one raises it in order somehow to be competitive on price.

Pretty obviously, if these people wanted to be competitive in the rest of the industry, and they did not have an administered price system, the rest of the companies would leave their price down when Republic raised its price and suddenly you would find that price increase falling away, and you would have prices back where they were before. But no, every time one raises its price, the rest go up with it.

Mr. BACKMAN. I would like to repeat first, if I may, Mr. Bolling, that price has two functions. If I may use a couple of simple words, I think these functions will be clear. One is the rationing function of price, which is the function that helps divide resources. The other

is the stimulating function. I would like to emphasize as strongly as I can that both are important. I do not want to hold any brief for or against any industry, but I think that Professor Rees could have mentioned that steel, selling in a gray market and steel involved in conversion pricing deals would be similar to the nickel situation in terms of a price that would seem relatively low in terms of what the market required regardless of whether this meant larger or smaller profits.

Mr. Weinberg tells us that the automobile industry can charge any price it wants, no limit at all.

Mr. WEINBERG. I said within wide limits.

Mr. BACKMAN. Within limits. What are these limits? I think we must distinguish what a Ford and General Motors charges and what the dealers in those cars charge. Any of us who have gone out to buy a car know that there is a very definite ceiling to the price of cars. You may sometimes find a squeezing of some dealers' margins. You may sometimes find restraints upon the companies. But the fact remains that you cannot raise prices without any consideration of the market and demand whether or not it is called an "administered price," which incidentally is merely a term describing a price-making process, and not a term describing a price-raising process. Over the years it is true that administered prices generally have risen less than other types of prices. The reason is the one Professor Rees mentioned. The people who can administer prices are those who are most sensitive to political forces. The fear that an investigation may take place or the anticipation that there will be the sort of observations that frequently are made in hearings such as those you have today acts as a restraining force. It would never act as a restraining force in a competitive market because it could not.

The fact remains that you do raise prices. Maybe the phrase that "prices are raised to be competitive" is an unfortunate one. I think a better one is that "prices are raised when you see what your competition does." There was testimony in those 1949 hearings, that some of you may recall, where I believe it was Jones & Laughlin executives who testified that they were very much opposed to the magnitude of the steel price increase. They wanted it much larger, but because of their competition they had to wait until 2 or 3 larger companies came along and raised the price before they could raise prices part of the amount they felt was necessary. The fact remains that prices in any sort of market whether you call it competitive or administrative must look to both what it does to supply and demand and both are very important.

Representative BOLLING. Before I go on to the other members of the panel, I want to make sure, Dr. Talle, that you may interject at any point. I do not want you to stay out because they are on my question.

Representative TALLE. Mr. Bolling, if I may at this point, there is something I would like to ask.

Perhaps I did not understand you, Dr. Keyserling, but I thought you said that the problem was one of inadequate consumer buying. Did I understand you correctly?

Mr. KEYSERLING. You understood me correctly, that I think the problem now and in the immediate foreseeable future is that the expansion of consumer buying is not keeping up with our rapidly advancing productive ability.

Representative TALLE. I was revolving in my mind two questions: One, I believe in 1955, 8 million cars were bought; in 1956, 5.8 million were bought. My question is: What would have happened to prices in 1956 if as many cars had been bought in 1956 as in 1955?

Mr. KEYSERLING. First, the basic point I am making is that, in an area such as automobiles, prices neither are nor should be responsive to the level of demand pressing upon supply. Let me illustrate by referring to a couple of points that have just been made. First, the point was made recently that administered prices have risen less than other prices. Even if that were true, it would not be terribly significant, because the administered prices are so much more important than other prices, because they include our basic industries. What happens to prices in the steel industry is much more important than what happens to some other prices, even if they had risen less.

The second point I want to make is that it is not true the administered prices have risen less. Take the steel industry. Comparing fourth-quarter 1956 with 1953 as a whole, the wholesale industrial price index has risen about 9 percent and steel prices have risen more than 22 percent, or more than twice as fast. Comparing the fourth quarter of 1956 with 1956 as a whole, the wholesale price index as a whole has risen about 6 percent and steel prices have risen 12 percent, or twice as fast.

In addition, the wholesale price index includes steel prices. So the disparity is even greater. We should look at some of these figures instead of these generalities in defense of administered prices.

We cannot let the price mechanism be the exclusive rationer of supplies for the very simple reason that we do not have the kind of world problems or national problems that we had years ago. We have a limited Federal budget of given size. Let us suppose that the rise in steel prices serves to ration supplies in the direction of the people who want and are able to buy more and more automobiles, and rations supplies away from a limited Federal budget that was trying to either build roads or schools or national defense. There you have rationing by the price system. But rationing exclusively by the price system—although I am for the price system in general—is utterly unconscionable in the kind of world we are living in. The economic philosophy of rationing exclusively by the price system was devised by people at a time when they did not care whether people bought apples, houses, or national defense, or what they bought. In the long run, everything would cure itself. If the people bought too many apples, they would get a stomach ache. But today we have considerable rationing of production and supply away from the things we need most for our national security and our domestic economic strength. If there had been more automobiles produced in 1956, I have no way of knowing what decisions the automobile industry would have made as to prices. I think they would have raised them a little bit, because they raise them a little bit most every year anyhow. They raise them even when the supply is high, they raise them when the supply is low, they raise them a little bit when the demand increases and a little bit when the demand decreases. So does steel, only more so. That is why this is not simply a problem of supply and demand. It is a problem of conscious business decisions in which I think the public has a great interest.

Mr. BACKMAN. I would like to address myself first to an observation now made twice by Mr. Keyserling, namely, the share of our national income going to labor and similar groups, and the question of whether or not buying power is available.

While he was talking, I made a couple of calculations and would be happy to submit an entire table if the committee wants it. I find that the share of compensation of employees to national income was 58 percent in 1929. It was 64 percent in 1950. It was 70 percent in 1956. There may be some who say this is not a fast enough rate of increase, and I suppose people are entitled to have any view they want. I think it is one thing to say that something did not increase as rapidly as you might like, and another thing to infer that in some way the relative share was going down.

I happened to have prepared a table on the relationship of corporate profits to national income which bears on the same problem from 1946 to date. I find, for example, in the first half of 1956, if we leave out the third quarter which was affected by the steel strike, the average profit was roughly 12.8 or 12.9 percent of the national income. I find that this is one of the lower ratios for the postwar years. In fact, in some of the postwar years the ratio was much higher.

If we are talking about the factors that affect prices now and have been affecting them in the past year, certainly with the same or lower ratio of profits under boomtime conditions it is difficult to understand how increases in profits have led to these increases in prices to which reference is made.

I would like to include that table in the record, if I may.

Representative TALLE. I ask unanimous consent, Mr. Chairman, that it be included.

Representative BOLLING. Without objection, it is so ordered.

(The table follows:)

Corporate profits before taxes and national income, 1946-56

[In billions]

Year	National income	Corporate profits and inventory valuation adjustment		Corporate profits before taxes	
		Amount	Percent of national income	Amount	Percent of national income
1946	\$179.6	\$17.3	9.6	\$22.6	12.6
1947	197.2	23.6	12.0	29.5	15.0
1948	221.6	30.6	13.8	32.8	14.8
1949	216.2	28.1	13.0	26.2	12.1
1950	240.0	35.1	14.6	40.0	16.7
1951	277.0	39.9	14.4	41.2	14.9
1952	290.2	36.9	12.7	35.9	12.4
1953	302.1	36.0	11.9	37.0	12.2
1954	298.3	32.9	11.0	33.2	11.1
1955	324.0	40.9	12.6	42.7	13.2
1956:					
January to March	311.3	38.5	12.4	39.7	12.8
April to June	321.9	40.2	12.5	41.1	12.8
July to September	328.3	41.6	12.7	43.5	13.3
October to December	334.4	43.4	13.0	46.4	13.9
1956:					
January to March	334.9	40.9	12.2	43.7	13.0
April to June	338.7	39.8	11.8	42.9	12.7
July to September	343.5	40.4	11.8	41.2	12.0

Source: U. S. Department of Commerce.

Mr. BACKMAN. Concerning Mr. Keyserling's comment that he does not like to have goods rationed through prices, the fact is that there are only three other ways they can be rationed. It can be first come first served, which means standing in line. It can be knowing the right people. It can be through Government rationing. There are no ways of dividing goods except those three, and the price system. If one thinks that standing in line and favoritism is an equitable way of dividing goods, I disagree with it. If one thinks that rationing of these goods by Government is what should be undertaken today, I completely disagree with it. If anyone thinks that automobiles can be rationed beyond the first 50,000 or 100,000 which would take care of the easily identifiable needs such as police department, and certain public-health services, I would say that this would be an illusion. The fact of the matter is that there is no way you can divide most of these goods except through the price system.

Mr. Keyserling may or may not like the fact that more steel goes to a racetrack than to a school, or more steel is used in making automobiles than in making highways or in building munitions. Mr. Keyserling is perfectly entitled to have his opinion. I may have a different opinion. But the fact of the matter is that it is not his opinion or mine which determines where these goods go. If people, generally, want an automobile with more horsepower than they want schools, they get it, and buy it. If they cannot buy it directly, they buy it in the gray market. We have seen that dozens of times in the postwar period. I would be very reluctant to see a situation develop where we are ready to wipe aside the price system which is one of the most ingenious systems of all time. Just consider the lunch we had today, consisting of products coming from all over the country and in some cases from all over the world, not because some economist or Government official said the products should be there, but because the price system in relationship to income caused the foods to be there.

I can make a much longer speech on this subject but I will not take the time.

Mr. WEINBERG. I want to introduce a clipping that I think is very pertinent to the subject of rationing via prices. This clipping, which I would like to submit for the record, is from the New York Times of January 10, 1957. Side by side we have two stories, one of which is headlined "United States Oil Output Sets a New High; Gasoline Inventories Increase," and the other reads, "Gasoline Prices Will Rise Today."

The first story talks in terms of gasoline stocks rising from 169,012,000 barrels a year ago to 186,808,000 barrels this year. Light fuel-oil supplies, 132,942,000 this year, 107,269,000 last year. Similarly with heavy fuel-oil stocks.

Is it because of a shortage of these products that the price rose in order to ration them among those who demanded them? Is it because we need to stimulate more production of gasoline that the price rose? The price rose because the corporations that dominate the price picture in the oil industry were able to raise the prices regardless of the relationship between supply and demand. It is true that the story about the price increase says something about costs, but how do we know that the cost compelled a price increase? Why is it not possible in this kind of situation, where the price increase serves no legitimate func-

tion that we can determine from the stories, to get at the facts on costs to find out whether there were cost changes that really necessitated these price increases? Knowing something about oil-industry profits and depletion allowances, I doubt that any legitimate case can be made out on the basis of cost.

(The clipping follows:)

UNITED STATES OIL OUTPUT SETS A NEW HIGH; GASOLINE INVENTORIES INCREASE

The United States last week produced more oil than ever before. An increase of 24,350 barrels a day in the Nation's crude-oil production was reported yesterday by the American Petroleum Institute. Production averaged 7,416,700 barrels a day, compared with 7,392,350 the week before and 7,026,450 a year earlier.

Imports of crude oil and products came to 1,515,100 barrels a day making the average 1,360,400 a day for the 4 weeks ended on January 4. In the 4 weeks ended on January 6, 1956, imports averaged 1,485,000 barrels a day.

Gasoline stocks last week increased 1,012,000 barrels. At the weekend, they amounted to 186,808,000 barrels, compared with 185,796,000 a week earlier and 169,012,000 a year ago.

Light fuel oil supplies were down 1,867,000 barrels to 132,942,000. They were 107,269,000 a year ago. Heavy fuel oil stocks gained 82,000 barrels to 42,731,000. A year ago, they amounted to 39,719,000 barrels.

Crude oil runs to stills average 8,290,000 barrels a day including 888,000 a day of foreign origin.

The daily average gross production of crude oil and condensate last week in the United States, by districts, the change from the preceding week and the output in the week ended on January 6, 1956, follow:

	Actual daily average production	Change from previous week	Week ended Dec. 30, 1955		Actual daily average production	Change from previous week	Week ended Dec. 30, 1955
New York-Pennsylvania.....	30, 100	+1, 100	29, 200	Texas.....	3, 070, 000	+12, 000	2, 938, 200
Florida.....	1, 250	+50	1, 400	Louisiana.....	975, 400	+3, 400	786, 900
West Virginia.....	4, 850	+100	6, 150	Arkansas.....	77, 700	-----	74, 200
Virginia.....	100	-----	100	Mississippi.....	114, 000	-900	111, 350
Ohio-southeast.....	2, 850	-----	3, 400	Alabama.....	11, 450	-50	4, 300
Ohio-other.....	8, 100	+750	9, 650	New Mexico-southeast.....	244, 400	+2, 900	227, 900
Indiana.....	33, 100	-150	31, 400	New Mexico-other.....	1, 900	-----	1, 600
Illinois.....	237, 250	-750	237, 300	Wyoming.....	297, 750	-3, 200	283, 000
Kentucky.....	48, 300	-350	44, 600	Montana.....	71, 600	+1, 450	47, 000
Michigan.....	27, 100	-----	29, 800	Colorado.....	157, 200	-2, 700	153, 200
Nebraska.....	37, 850	-1, 250	28, 200	Utah.....	9, 000	-----	5, 600
Kansas.....	339, 100	-4, 000	332, 400	Nevada.....	100	-----	300
Oklahoma.....	631, 600	+15, 200	617, 300	California.....	948, 100	+400	973, 300
North Dakota.....	36, 450	-150	42, 650	United States.....	7, 416, 700	+24, 350	7, 026, 450
South Dakota.....	100	-----	50				

GASOLINE PRICES WILL RISE TODAY—LEADING COMPANIES ALSO PLAN TO LIFT OTHER OIL PRODUCTS EAST OF THE ROCKIES

Prices of gasoline and most other oil products will be advanced 1 cent a gallon today by leading marketers in nearly all the United States east of the Rocky Mountains.

The Esso Standard Oil Co. domestic marketing and refining affiliate of the Standard Oil Co. (New Jersey), will increase prices of gasoline, kerosene, home-heating oil, and other distillates except bunker C and No. 6 fuel oils, by 1 cent a gallon for all methods of delivery. The increases will apply to 18 States on the east coast and in the South, and the District of Columbia.

The Standard Oil Co. (Indiana), will make a similar advance in all oil products throughout the 15 Midwestern States in which it markets. Indiana Standard said the price rise stemmed from the recent advance in crude oil prices that resulted from the crisis in the Middle East.

The Continental Oil Co., which recently advanced gasoline prices by 1 cent a gallon in Texas and New Mexico, announced a 1-cent increase in oil products in Montana, effective today.

COST RISE IS CITED

J. W. Liddell, vice president and general manager of Continental in the Rocky Mountain area, said the price rises were "a natural economic result of advances in everything we buy, including recent increases in crude oil prices."

Previously, the Sunray Mid-Continent Oil Co., of Tulsa, Okla., had advanced the prices of all oil products by 1 cent a gallon at the refinery level. The company said the increase was "economically vital to refiners who have had to meet the crude-oil price increases averaging 35 cents a barrel" in Texas, Oklahoma, and other Southwestern States.

With Esso Standard and Standard of Indiana the leading marketers in their respective territories, the price rise in oil products is expected to be met by other marketers in their areas and extended to all sections east of the Rocky Mountains.

Some difficulty may be experienced in making the rise in product prices stick. Stocks of gasoline and home-heating oils are sharply above the levels of a year ago. Gasoline stocks have been increasing at a rapid rate and now amount to 186,800,000 barrels, an increase of 17,800,000 over the 169 million of a year ago. Heating oil supplies are 27,650,000 barrels more than the 107,269,000 of a year ago.

Mr. WEINBERG. There was talk of price competition in the automobile industry among dealers. But the dealers obviously are limited in the prices they can offer the consumer by what they are charged by the manufacturer. The manufacturer, as Mr. Keyserling has indicated, raises prices in season and out, in depressed markets and in markets where demand is pressing on capacity. We have a situation in the auto industry similar to that recited in steel. Ford raised its prices twice this year. Why? It raised its prices first and GM came along and put in a higher price, so Ford raised its prices on the theory of higher prices "to meet competition" which, as Mr. Brubaker pointed out is completely nonsensical.

The theory that the administered price industries could charge even higher prices in response to demand—if this is the defense of the corporations and their price policies—is equivalent to the defense of the man charged with burglary who said there was \$100,000 in the till and he only took \$50,000. This is not exactly the kind of defense that I think we can accept.

The basic problem is that we are still living intellectually in a theoretical world where price is determined by competition and there is an absence of any power by any individual to affect the level of prices and thus to affect the allocation of resources in our economy. We still are living in that world theoretically, but in the practical world today prices are not determined by competition but by corporations whose price determinations determine the allocation of resources, including capital resources.

We have talked about the problem of small business in finding capital. Why does small business have difficulty finding capital? Because the capital is raised out of the consumer's pocket by the big corporations and locked up in their treasuries so there is no capital available for the small business. If capital was not raised by these means and was available in the competitive capital market, then small business would get a crack at it. Obviously no small business can get a crack at the capital General Motors has accumulated out of excessive prices, and kept locked up in its own treasury.

Representative TALLE. I should like to add this comment. The individual has need for two items that cost him much money. One is a car and the other is a house to live in. When I put my first question to Dr. Keyserling I had in mind not only the matter of the car but suppose the same thing had happened in the case of houses. I now add that as my second question.

Mr. HITCHINGS. I would like to comment on a few of these points that have been raised. One point was that we should stick to the facts, and I would certainly agree with that. So let us take a look at the facts of whether you can raise prices at will in the automobile industry. If that is the case then we must be very stupid people, because since 1950 our payroll costs have gone up 83 percent, our dollar sales volume has gone up 53 percent, our capital investment has doubled, and yet we do not show any higher dollar profits in total. In fact there is a decrease as compared with 1950.

If we can raise prices at will, there is something very peculiar about a situation where profits show no increase and yet payrolls go up 83 percent.

As far as the question of why car prices have been on a one-way street in recent years, I think the answer is to be found again in the payroll costs and in the materials processing. When those price costs and payroll costs go down, then you are in a position to reduce prices. When they are constantly rising, it is very difficult for one to reduce prices.

Mr. WEINBERG. When Mr. Hitchings took 1956 he was dealing with a depressed market. Let us take his 1950 comparison; 1950 was the highest year of profits that the corporation had enjoyed up to that time.

In 1950 the corporation earned \$541 million in profits before taxes. In 1955, it earned \$968 million in profits before taxes. In 1950, its profits before taxes in relation to net worth were 55.1 percent. In 1955, its profits before taxes in relation to net worth were the fantastic figure of 61.2 percent.

Let us trace the cost of payroll in relation to sales in the Ford Motor Co. In 1947, payroll, including salaried workers as well as hourly workers, came to 27.6 percent of sales. In 1955, payroll was 20 percent of sales. In 1947, profits before taxes in relation to sales were 7.2 percent; in 1955 profits before taxes in relation to sales were more than double that, 17.3 percent.

Do these figures suggest that the Ford Motor Co. raised its prices only in order to meet the additional payroll or materials cost it was confronted with? If so, how can it explain the fact that its profit margin more than doubled during that period?

Mr. HITCHINGS. May I comment on that?

Representative TALLE. Yes, sir.

Mr. HITCHINGS. Mr. Weinberg, as usual, selects noncomparable periods when he starts with a depressed period and ends with the most abnormal period. The year 1947 was hardly a proper base period for the auto industry. The auto industry was limited in its production in 1947 very severely. The result was that volume was unusually low.

In the year 1955 because of a combination of abnormal factors volume was unusually high.

If you are going to compare, you should compare two periods in which volume was the same, because—

Mr. WEINBERG. I have. I took two periods of high production and high sales, 1950 and 1955—1950 was the best year the auto industry had up to that time.

Mr. HITCHINGS. May I point out that we are comparing the figures of an individual company. For price-cost-profit relationships you should compare years in which the unit volume of that company is the same. Unit volume for our company in 1956 was about 2 million vehicles. It was about 2 million vehicles also in 1950. Volume was less than 1.1 million in 1947 and nearly 2.7 million in 1955. It is obvious which are the comparable years.

Mr. WEINBERG. Mr. Chairman, may I suggest since Mr. Hitchings wants to discuss Ford figures, that we have the full-blown hearing we are talking about so we go into them thoroughly and in detail.

Representative TALLE. Mr. Smith, were you asking for a chance to comment?

Mr. SMITH. Yes, Dr. Talle. Not to engage in controversy but to supplement the notion that facts speak for themselves, some time back Mr. Weinberg protested that the trend since 1929 to 1955 has been toward excessive profits. It so happens that the Department of Commerce has made a considerable study of that matter. In the November Survey of Current Business it published it. I would like to enter into the record the last sentence appearing on page 20. It is as follows:

An after tax distribution of labor and property shares in manufacturing cannot be calculated largely because of statistical difficulties, but it is apparent that such a distribution could indicate a shift in favor of the labor share over the period from 1929 to 1955.

Some time back, Mr. Keyserling, I am sure it was through a slip, got, I think, the wrong figures. He was referring to the increase in the price of steel. The Bureau of Labor computes an index on the basis of 1947-49=100 of finished steelmill product prices. For December of 1955, that index stood at 154.8; for December of 1956, 1 year later, that index stood at 168.8. That is an increase of 9.1 percent and not 12 percent in a year.

Mr. BRUBAKER. That was 1955 and 1956?

Mr. SMITH. December, yes.

Mr. BRUBAKER. I do not want to quarrel with the figures, but I also have the same figures that the Department of Labor furnished us and they showed for December 1955 the same index, 156.0, and for December 1956, the figure is 169.9. It is a preliminary figure. The difference is approximately what Mr. Keyserling has cited.

Mr. SMITH. I suggest that the staff ascertain from the Bureau of Labor what the figures are so that the correct figure may be instered in the record.

Against that I would like to, if I may, introduce a comparable figure. The total employment cost per man-hour in United States Steel in the fourth quarter of 1955 as against the fourth quarter just behind us, 1956—these figures just became available 2 days ago—the total cost per employee-hour was \$7.952 in the fourth quarter of 1956. In other words, for United States Steel to put a man to work for an hour and to equip him with the materials and tools and the management and the markets and the necessary capital costs and so forth, cost \$7.95. That was in 1956, the quarter just behind us.

In the fourth quarter of 1955 that was \$7.096.

Mr. BRUBAKER. How much wage increase did we get in between?

Mr. SMITH. The increase in the total cost per employee-hour from one quarter to the next was 12.1 percent. I thought that was probably what Mr. Keyserling had in mind when he cited the 12 percent. A question has just been asked me on the left—

Mr. BRUBAKER. I will be glad to stay on your left—way left.

Mr. SMITH. On my left.

Mr. BRUBAKER. I will be glad to stay on your left—way left.

Mr. SMITH. The same increase in total employment cost from one quarter to another quarter was 10.5 percent.

Representative TALLE. Mr. Chairman, we have a gentleman on the panel from Iowa State College, Mr. Fox. Should we not encourage him to enter into this discussion?

Senator SPARKMAN. He had a very fine statement. We have been more or less refereeing this discussion.

Representative TALLE. He may want to talk about how farmers in my State feel about the cost of tractors and some other costs.

Mr. FOX. Mr. Talle, I do not yet have as much direct contact with farmers there as I would like to. I would not say that I am here today as a representative of the farm interest, but simply as an economist. I know, of course, that with farm prices coming down the way they have during the past 4 or 5 years farmers are extremely impatient with the increases in prices of farm machinery that have taken place during the same period. Since there are forces that are tending to keep farm prices down—I would say forces of supply and demand as well as Government policy—the farmer's income is adversely affected when we have increases in the prices of farm machinery.

I cannot go on from that, however, to propose particular remedies or ways of preventing these increases in the prices of steel and machinery. I think the committee has wisely devoted attention and time today to these administered price industries.

Representative TALLE. Economic life must have been much simpler during the Middle Ages when the "just price" concept prevailed.

I did some searching several years ago to find out what kind of price that was, a "just price." I came to the conclusion that it was the customary price—what had been was "just."

Mr. WEINBERG. I can tell you, sir, how the workers in the agricultural implement industry feel about tractor prices. They feel that the agricultural implement industry in collaboration with Mr. Benson has priced them out of their jobs.

Representative TALLE. Does someone else wish to comment?

Mr. KEYSERLING. I would like to have a chance to comment upon these various brilliant but misguided forays that have been made against what I have said.

In the first place, very briefly as to what Mr. Smith said, the top of my statement on page 8 makes it very clear that I compared steel prices in the fourth quarter of 1956 with prices in 1955 as a whole, which is just as good a base as any other base. My figures are correct, and they are comparisons between the trends in steel prices and other prices. If I had taken the fourth quarter of 1955 as the base, the steel price increase by fourth quarter 1956 would have been lower; but if I had taken the first quarter of 1955, it would have been higher. So my figures are correct.

Second, as to the argument made by Dr. Backman, let us look at its full and, I think, devastating implications. What he says, and what Mr. Rees really says, is this: Prices cannot be wrong, because if they are too high they will come down, if anybody makes a price mistake his hands will be burned. For the same reason, they say, if we have more racetracks than research for atomic-energy development, that can't be wrong either, because the consumer has made that decision. We don't live today in the kind of world where these vast oversimplifications make sense. They negate the whole purpose of the Employment Act of 1946. The Employment Act of 1946 says that the President shall determine, and this committee shall evaluate, needed levels of employment, production, and purchasing power. If the price machinery and the wage machinery and choice of consumers decided all these questions, and maintained a stable economy, and gave us the national defense and other things we need, there would be no reason for this committee and there would be no reason for the President's functions under the Employment Act.

I believe in a free economy as much as anybody else. But I want it to stay free, and to stay free it must survive. I do believe it is an important national matter whether we have more racetracks or more national defense. I do believe it is an important national matter when farm income from all sources has gone down 8½ percent in the last 4 years while national income has gone up 11.5 percent. I do believe these are matters of national economic policy.

This talk about rationing exclusively through the price system would have some realism if we did not have even now a lot of national policies that intrude upon the price system. We have a national policy, the hard-money policy, which is interfering with the so-called free-price system. Through a Government-created monopoly, which claims that it is independent of the Government, the Federal Reserve Board, we have a combination of banks which would be illegal if we did not have the Federal Reserve Act, which is making nationwide decisions to push the rates of interest up. This is raising the price of money.

I say that this concerted policy is rationing goods and incomes in entirely the wrong direction from the viewpoint of our national interests. It is preventing people from buying some of the things they ought to buy, it is preventing the farmer from buying machinery, it is preventing localities from buying schools, and it is preventing us from buying national defense. This is not an example of a free-market economy.

As to the point Mr. Backman made about the figures on increases in wages, profits, and prices, I could take a different base year and get different figures. I could get a more recent base, and use more relevant figures, and show that the trend is the other way from what he states. But this would be playing with statistics and not the heart of the matter. It is inconclusive merely to show relative trends for wages, prices, and profits. Sometimes wages should increase faster than profits, and sometimes slower, and likewise as to investment and consumption.

But we have one criterion today which is relevant: Is our major central economic problem today an inadequate relative expansion of investment caused by an inadequacy of profits and incentives, or

is it an inadequate relative expansion of consumption based upon a shortage of wages, farm income, and supplementary payments to social-security recipients, and so forth?

I maintain it is clearly the latter. I maintain that this is the proper way to develop current criteria for the relative trends in profits, prices, and wages.

Mr. BACKMAN. Dr. Talle, I made a few fast calculations concerning the relative importance of employee compensation as a share of national income, and the figures I gave would still be the highest. It is easy to calculate because 70 percent is an easy target and in most of the years the compensation of labor has been in the 60's as the accompanying table shows:

Relationship of compensation of employees to total national income, 1929-56

[Billions of dollars]

	Total national income	Compensation of employees	Percent of compensation of employees to total national income		Total national income	Compensation of employees	Percent of compensation of employees to total national income
1929.....	87.8	51.1	58.2	1943.....	170.3	109.6	64.4
1930.....	75.7	46.8	61.8	1944.....	182.6	121.3	66.4
1931.....	59.7	39.7	66.5	1945.....	181.2	123.2	68.0
1932.....	42.5	31.1	73.2	1946.....	179.6	117.7	65.5
1933.....	40.2	29.5	73.4	1947.....	197.2	128.8	65.3
1934.....	49.0	34.3	70.0	1948.....	221.6	140.9	63.6
1935.....	57.1	37.3	65.3	1949.....	216.2	140.9	65.2
1936.....	64.9	42.9	66.1	1950.....	240.0	154.3	64.3
1937.....	73.6	47.9	65.1	1951.....	277.0	180.4	65.1
1938.....	67.6	45.0	66.6	1952.....	290.2	195.1	67.2
1939.....	72.8	48.1	66.1	1953.....	302.1	208.1	68.9
1940.....	81.6	52.1	63.8	1954.....	298.3	206.9	69.4
1941.....	104.7	64.8	61.9	1955.....	324.0	228.2	68.9
1942.....	137.7	85.3	61.9	1956.....	342.3	239.0	69.8

Source: Economic Report of the President, January 1957, p. 132.

With respect to the matter of the place of banks, I do not know what Mr. Keyserling means by the combination of banks, unless he means the Federal Reserve Board. If he means that, I think the record should show clearly that it is not the Federal Reserve Board that raised the price of money. It is the insatiable appetite of business, consumers, homeowners, and others to get more and more borrowings as compared with a relatively limited amount of savings. If you check the actions of the Federal Reserve you will find that they have followed the market up and they have not led it up. The fact is we have not experienced a shortage of credit in any absolute sense. The problem is not do we have more credit because we have more than we ever had in the history of this country. The problem is, Have we had more—more?

The restriction has been a question of cutting off of still further demands. In the past year when there was no mortgage credit available if we are to believe the builders, mortgage credit on 1- to 4-family houses increased by \$11 billion. In the past year when we could not have enough consumer credit, it increased over \$3 billion. In the past year bank loans increased by 8 or 10 billion dollars.

I would like to make one other point clear. Many of the banks in this country are in relatively modest sized communities, and by

law the amount they can lend to any particular borrower is limited. When there is a large increase in bank credit throughout the country it is not only big business which gets it. It must be small business, too, because the smaller banks very often will not make a loan of more than 10 percent of their capital, and if it is a bank with \$10 million or \$15 million or \$20 million or \$50 million in capital, the relative size of most of their loans is small, not big. Certainly, there are small borrowers who have been squeezed out of the market. But the fact remains that it is not that we have been lending less, it is because we have not been willing to lend enough more to meet all of the expanded demands.

What Mr. Keyserling is complaining about is not a reduction in the supply of credit but the fact that the Federal Reserve System has not continued to carry on an easy money policy which would involve the creation of additional reserves and would have made possible a still larger rise in credit.

The fact of the matter is that the Federal Reserve, as I said earlier, has leaned against the wind, but they have not leaned very far, because if they really wanted to tighten credit they would have increased reserve requirements and they would have sold Government bonds in the open market. Then they really could have forced a credit squeeze. What can the Federal Reserve do if the open market pushes up the price of short-term credit? Are they going to allow Treasury bills to go to 3 and $3\frac{1}{4}$ percent and keep a discount rate of $2\frac{1}{2}$ so the banks can make a profit by lending to the Government and borrowing from the Federal Reserve?

In Canada they recently changed it so that the Bank of Canada today automatically raises its discount rate to a level within a quarter percent of the short-term rate in the open market. This is not a question of any combination of banks to raise credit or to make more and more profits.

Let us face one very important fact. If the Federal Reserve System had attempted to ease credit in the past year instead of the price of interest going up, the prices of goods would have gone up still more.

With all due respect to Mr. Keyserling's complaints about the rate of increase in our economy, we are in the middle of a boom. In fact, it is a boom-boom, not a boom, it has been going along at such a terrific rate. If we produced more automobiles last year, we would have had to produce fewer bridges or fewer tanks or fewer something else, because with the amount of steel produced, except for the steel strike, pretty much at capacity, we couldn't use that same steel for two different things. We have had a shortage of skilled labor. We couldn't get away from that shortage merely because somebody would like to produce something else.

I am not saying that it would have been impossible to produce a little of this or a little of that, but whether Mr. Keyserling thinks that 4 or 5 percent is the right annual rate of increase or whether the proper rate is 2 or $2\frac{1}{2}$ percent, the fundamental facts that this economy has been going full blast and that is the main reason why prices have been going up. Much of these other arguments is irrelevant.

Representative TALLE. Your reply goes straight to my question. Thank you, sir.

Senator SPARKMAN. Have you any questions, Mr. Kilburn?

Representative KILBURN. I would like to give Dr. Rees an opportunity to comment.

Mr. REES. Thank you, sir. I wanted to comment on something Dr. Keyserling said about the Employment Act of 1946. I do this with considerable misgivings because I hate to dispute the meaning of that act with the former Chairman of the President's Council of Economic Advisers. But I understood him to interpret it as giving the President and the Congress some mandate not only to seek to keep aggregate production and employment high, but over and beyond that to say in what particular places or parts of the economy they ought to be high or low. If he meant the second, I would respectfully disagree. I don't think there was anything in that act that gave the Government any special responsibilities that it didn't already have for deciding in what industries production was going to take place.

I have defended the operation of the price mechanism here today, as have some others. I don't believe, and I have not said today, that the price system is going to give us an adequate level of aggregate demand and output and employment. We have learned in the past that it will not. It is for that reason that I am in favor of the responsibilities that the Federal Government has assumed under the Employment Act. So those of us who are defending the price system are not saying that this is a cure-all for all economic ills. We are saying that there are some particular things that it does well. It is important to provide substitutes for it where it doesn't function, and it is equally important to let it operate where it demonstrates that it can.

Just one more minute and I will be through.

That doesn't mean that even in the pricing of particular products everything should be done by a free market. I certainly agree that national defense, schools, and roads are a legitimate responsibility of government. The only plea I am making is that if you have decided that a certain area of the economy is to be run by free private enterprise—and I am not saying where the line should be drawn—then you have to recognize that there are certain perils and certain dangers in intervening and interfering in that area which you have decided is to be run by prices.

Representative KILBURN. I just want to say that the statement Dr. Backman made a few minutes ago made sense to me. That is all, Mr. Chairman.

Senator SPARKMAN. Mr. Bolling.

Representative BOLLING. Dr. Rees, would you tell me the extent to which you think there is price competition in three industries—oil, steel, and autos?

Mr. REES. I would have to agree with what I think is the intent or the implication of the question, that price competition in these industries is more limited than it is in many other industries. In particular in the automobile industry there has developed the tradition of nonprice competition, competition in terms of style and advertising and design. In the steel industry indeed there has not been a great deal of competition of any kind.

My difference with Mr. Weinberg and Mr. Brubaker is really about the appropriate methods for dealing with this. I think the antitrust laws are a very useful part of our economic system. I would not

want to be without them. I would like to see them strengthened and used to create real competition, not simply to create an artificial holding down of prices, which is not the same thing at all. It may appear to be the same thing, but it gives very different results and very much inferior results.

Representative BOLLING. Mr. Rees, have you any suggestion as to how competition might be increased in the industries I mentioned?

Mr. REES. Mr. Bolling, I have not made any detailed study of that. I would hesitate to make suggestions. There are people who have studied that and have made suggestions to the Congress. I believe Prof. George Stigler of Columbia University, has made certain suggestions for increasing competition in the steel industry. I would refer the committee to the testimony which he has given before some committee of the Congress—I am not sure at the moment just which one—in this direction.

Representative BOLLING. I gather that you think there is some price competition in the industries I mentioned. I hope at a later time to have an opportunity to go into what kind of price competition does exist. You mentioned, I think in your earlier statement in reply to another question, that you felt the force of public opinion had considerable control over possible administered price increases. Is there a difference in the profits of the administered price industries as compared to those of competitive price industries?

Mr. REES. I would say over the long run the profits of the administered price industries would be larger than those of competitive industries. In a period of rapid inflation, however, this situation may be reversed. In a highly inflationary period you may find that very competitive industries are making a higher rate of profit than the administered price industries.

Representative BOLLING. Could you be a little more specific? What is a very competitive industry?

Mr. REES. I would say food retailing, just to take one example.

Representative BOLLING. Can we find one in—

Mr. REES. In manufacturing?

Representative BOLLING. In the manufacturing field.

Mr. REES. Women's clothing.

Representative BOLLING. We are still in soft goods. Can we find one in the durable field?

Mr. REES. Some of these gentlemen know more about this than I do. I would suspect that certain lines of machinery are highly competitive.

Mr. BACKMAN. Many kinds of building materials would fall into that category.

Representative BOLLING. Highly competitive?

Mr. BACKMAN. Where you get a great deal of competition.

Representative BOLLING. What types?

Mr. BACKMAN. I think you can include bricks where you have a local rather than a national market. You can get into many of the clay products where the same thing would be true.

Senator SPARKMAN. Would you say that tractors and farm machinery would be competitive?

Mr. BACKMAN. Mr. Chairman, I think one of the phrases that bothers me a little bit about the questions that Mr. Bolling has been asking is the way "competition" and "price competition" have been used inter-

changeably. Actually you may not have complete price competition and may have very vigorous competition in other ways. I think many of these industries have very vigorous competition even though what we would call price competition in the classical sense does not exist. That term is a technical term which is almost impossible of realization when you have relatively few companies, because one of the underlying suppositions is that there is so large a number of producers that nobody can influence the price. This is always the supposition and an assumption under any sort of price competition when that term is used in its technical sense.

These companies may be very competitive in their pricing, but they may be even more competitive in their service or in the quality of the product that they offer. As Professor Rees mentioned, the automobile industry will insist that having better rubber tires or having a better type of driving apparatus or having more horsepower is an important competitive factor. We may not always agree with that.

The same thing is true in television and all of these hard goods to which you make reference. But there is also an awful lot of price competition at one stage or another in the distributive and manufacturing process.

Mr. BRUBAKER. How about steel?

Mr. BACKMAN. I think in steel you get your competition on the non-price front in spite of what Mr. Rees, said, because there are many areas where steel in terms of service, in terms of research, in terms of delivery, and other factors is extremely competitive. I would suspect that Mr. Smith, who can testify to this more effectively than I can, could assure this committee that if there was any way in which United States Steel could take a ton of steel away from Bethlehem Steel they would like to know quickly how it could be done and they are out trying to do it.

Representative BOLLING. Without any expert knowledge of the budgets various corporations apply to these uses, I wonder if in some fields competition is not advertising competition.

Mr. BACKMAN. This is one form in which competition takes place. But this is competition for the consumer's favor, and the advertising becomes a device to get that favor. I am not saying that every cent spent that way is necessarily the best way to spend the dollar, and we often distinguish between competing in that form and competing in other forms. But let me illustrate one of the problems.

The philosophy of the Fair Trade Acts implemented by the McGuire-Keogh Act is that if a retailer cuts price, in some way he is doing something antisocial and hence he is stopped from doing it if only one other retailer makes an agreement with the manufacturer. Take the Robinson-Patman Act. If a manufacturer charges a different price to one group of buyers than to another group of buyers which is a cut in price, immediately he is told that unless he can justify it—and nobody knows how you justify it under the standards we have—he is accused of price discrimination and must charge the same to everybody.

I recognize problems of discrimination, but I also call your attention to the fact that very often when you get what may be called price competition in some of these areas you also get governmental policies which say, "Price competition over here is something we don't want. We want it someplace else."

MR. WEINBERG. I would like to shed a little factual light on the question of profits in the administered price industries versus competitive industries. I have here the figures of the Federal Trade Commission and the Securities and Exchange Commission for manufacturing industry.

In 4 out of the 5 years 1951 through 1955, the motor vehicles industry was No. 1 in the rate of profit before taxes as a percentage of investment. In 1955 it almost exactly doubled the average rate of profit for all manufacturing, motor vehicles having 47.2 percent and all manufacturing having 23.8 percent.

Looking at the other end of the situation, the apparel industry which Mr. Rees mentioned as a competitive industry, it ranked No. 22 out of 23 industries for which figures are given, in terms of its rate of profit before taxes as a percentage of investment.

As you follow these figures through year by year for the individual industries you will find that the administered price industries tend to stay near the top of the range all the way through in terms of profits.

As far as the agricultural implement industry is concerned, Senator Sparkman, figures are not shown separately for that industry, and it is operating in a depressed market at the present time. I think it should be known, however, that this is not a competitive industry. Four companies—International Harvester, John Deere, Allis-Chalmers, and J. I. Case—dominate the market, with Harvester generally furnishing price leadership for the industry as a whole.

It may be recalled that the TNEC report, which set up criteria for price flexibility, showed that the agricultural implement industry was among the most inflexible of all in terms of changes in prices.

Representative BOLLING. Mr. Chairman, I am afraid I am taking too long.

Senator SPARKMAN. Let me say I shall have to leave very soon for an appointment which I must keep.

Mr. HITCHINGS, have you a comment to make?

Mr. HITCHINGS. In comparing the rate of return on investment for the so-called administered price area with the nonadministered price area, it should be pointed out that in the retail area there is a tremendous amount of competition and yet the rates of return on investment may be high. In food distribution, for example, which was mentioned as one of the most highly competitive areas, the rate of return on investment is relatively high. The rate of return, therefore, is no particular indication of whether or not there is price competition.

Representative BOLLING (presiding). What is an indication of price competition?

Mr. HITCHINGS. I think it is very difficult to set up standards. The fact that you have price uniformity is not necessarily an indication of lack of price competition, because in some of the areas of heaviest price competition there are fairly uniform prices at one moment of time. That is the indication of price competition. If you didn't have price competition, you would have a market in which there were different prices at the same time.

Representative BOLLING. I want to get this a little clearer. I don't understand how it can be decided that you can have competition and uniformity.

Mr. HITCHINGS. If there were no price competition in the auto industry, one company could charge one price and another company could charge a different price for a comparable product. The fact that you do have to meet your competition shows up in price uniformity. The meeting of competition at higher prices has been, as I mentioned earlier, because costs have been rising. If you were an employer faced with rising costs all the time, would you feel that you could cut the price?

Representative BOLLING. This brings me back to the point of most of the questions. I think there is unanimity in what the panel has already said, or an indication of unanimity. The President in his letter of transmittal of the economic report—I am sure you are all familiar with it—states:

Reliance for stability in economic growth cannot be placed exclusively on the fiscal and monetary policies of Government. Of particular importance in a prosperous economy is the responsibility of leaders of business and labor to reach agreements on wages and other labor benefits that are consistent with productivity prospects and with the maintenance of a stable dollar.

I got the impression that the panel generally agreed that this was probably if not impossible, highly improbable, and at least a few of the members of the panel felt that it was undesirable. Is there any very strong dissent to that view by the members of the panel? Mr. Backman.

Mr. BACKMAN. I think the objective is a good one. The dissent I expressed was in term of the feasibility of achieving it in 1957 when the key wage bargains have already been set. In other words, I agree with the objective. I just disagree with the possibility of achieving it at this time. I disagree generally with the whole problem or the whole approach of trying to control wages and prices by exhortation.

Representative BOLLING. Mr. Keyserling.

Mr. KEYSERLING. I very strongly favor the President's calling attention to the great problem of prices and wages. I think it is one of the most important things he has done. But I feel that his economic report has failed dismally to analyze this problem with any penetration, and it is dismally biased against wages. I do agree that we now live in an economy which cannot be preserved within the contours that we all want to keep if we rely exclusively upon the fiscal and monetary policies of Government, first because they cover too small a part of the economy, second because they have to concern themselves with problems besides stability. Sometimes we have to have more national defense, even if it is an unstabilizing factor, so we have to have counterstabilizing efforts elsewhere.

We have two choices. We have one choice of saying that the price and wage policies of our great organizations are so important to the public that they should be controlled by direct price and wage controls even in relative peacetime. I am against that. I think everybody else on the panel is against it. The other alternative is to bring to bear upon price and wage behavior the informed eye of a watchful Government and a watchful public. I don't think that is futile "jaw-bone control." If we didn't believe in that we would not believe in our free system. I think industry and labor have enormously improved their economic practices over the past 20 years just because we have believed in the value of facts and education and public opinion. I think we should do more of it. But I think we need a really thorough

investigation of this situation from top to bottom, so that we can get the facts and develop some realistic criteria.

This brings me to the President's economic report. The President's report completely neglects to set forth any objectives for employment, for production, or for purchasing power. Without that, you have nothing against which to measure prices and wages.

I want to say a word about what Mr. Rees said on the Employment Act. Mr. Rees said that so far as the overall levels of employment, production and purchasing power are high, there is no really vital matter of national concern or national policy with respect to the components. The answer to that is very simple. If that were true, the Government could act only after you got into a deflationary spiral, because the only things that could be wrong while you still have a high level of employment, production and purchasing power is that the components were getting all out of balance—farm income down, business income up, investment expanding 10 percent over the last year, consumption 2 percent over the last year, and so forth. Every Government policy does and must deal with these components. Whenever you pass a tax law, whenever you pass a farm bill, whenever the Federal Reserve Board does something, it attempts to change the relationships. Otherwise, the action taken would have no effect.

To say that the Employment Act has nothing to do with these components merely means that we should persist in the idea of viewing each item of national policy in an insulated compartment without any overall attempt to see how they relate to one another.

I think that this overall perspective is the job of the Employment Act. I think that one of the most vital problems now is the problem of the price-wage relationship and what is happening to it. Therefore, I strongly favor a basic top-to-bottom congressional investigation of this subject, which resorts to the practical weapon that a democracy can use, if it is not going to be somnolent on the one hand nor resort excessively to direct controls on the other. You have to steer a middle course somewhere in between the two.

We cannot afford, when the Russians are using their centralized direction to ration every grain and to ration every machine and to ration every worker, to say we are going to the opposite extreme of saying it doesn't really make any difference to us whether we have more racetracks or more national defense, more luxurious hotels or more schools.

This is a shocking thing to say in the middle of the 20th century. We are going the way of Carthage if we take that position. We have to find a middle ground.

Representative BOLLING. Mr. Weinberg had his hand up.

Mr. WEINBERG. I would not have wanted to interrupt what Mr. Keyserling was saying because I think what he was saying was very valuable and important, but I do want to get back for just a moment to the question of price competition in the auto industry and the question of the relationship between price increases and cost increases.

I have here the release of the Ford Motor Co. dated September 29, 1956, which says in part, quote :

Our prices are increasing no more than our actual costs for material, and services have gone up. Finished steel, for example, has gone up 6.25 percent, tooling costs are up 12 percent, and our base labor cost has increased 2 percent

without taking into consideration the annual improvement factor which is built into our agreement with the auto workers union.

This is in line with what Mr. Hitchings said about increasing prices in response to higher costs, assuming the facts are correct.

However, a few weeks later, General Motors increased its prices. General Motors happens to be confronted with the same kind of cost situation as Ford. Nevertheless, General Motors increased its prices by substantially more than Ford increased Ford prices. Whereupon, Ford immediately instituted a second round of price increases; and Ford approximately matched the General Motors price increases.

This, it seems to me, is as good testimony as you could have to the absence of price competition in the normal sense of meeting a competitor's lower price, because if that had been the case General Motors would not have dared to raise its prices more than Ford had previously raised them.

Mr. HITCHINGS. May I comment on that. The first price increase that we instituted did not cover all of our increased costs. It did not say so in the release. The price increase covered only certain increased costs. Even with the second price increase the full extent of our increased costs was not covered. In 1957, if we were to operate at the same volume at which we operated in 1956 with the same level of productive efficiency, we would not make as much profit as we made in 1956, despite the price increase.

Mr. BRUBAKER. I want to try to get back for just a moment to the question which you raised a moment ago as to whether we agreed or didn't agree with this statement in the President's report. I stated at the outset this morning that we were opposed to inflation, no matter where it sprang from. We still are. I honestly was a little bit appalled, though, at Mr. Backman's dissent from this in the terms of its being impossible to achieve because the key wage bargains for most of the economy for next year are already set. But set at what level? He ought to be happy that they are set, because he said in his own paper this morning that they are set at a level of 5 cents or 6 cents or thereabouts for this next year. That is a level which is at or below the long-range increase in productivity, which is exactly the criterion the President himself said should be used as a limiting force here. Actually, the rate of productivity in the economy as a whole in recent years has been generally well above a level which would support 5 or 6 cents. So to that extent, certainly, wages, in terms of this next year, don't have to be regulated or increases kept down or anything of the sort. They already are down by these key bargains, and he should be happy that they are if he doesn't want to see this so-called wage inflation which he keeps talking about somehow raise prices in the economy.

Mr. BACKMAN. I am glad that my happiness is a concern of Mr. Brubaker, but I think my testimony was that the average was 6 to 7 cents and that, in addition, I suggested there would be some 4 cents or more because of cost of living. That now takes us up to 10 or 11 cents. My testimony also was that the average increase in wage costs would be 4 or 5 percent at the minimum, and the long-term gain in productivity in this country even when you stretch it doesn't get above $2\frac{1}{2}$ percent, and more usually it comes closer to 2 percent.

I am not seriously suggesting that we undo the wage bargains of 1957. I said in my formal statement that this was an impossibility. But I do say that wage increases of 10, 11, 12 cents—and Mr. Brubaker could have added in some industries, including steel, there are also fringes which take it much beyond those figures—

Mr. BRUBAKER. No; you are wrong; this is not true for steel.

Mr. BACKMAN (continuing). Which take it much beyond those figures, do create the type of pressure against which the President was speaking. For steel, the increase in labor costs in 1957 will be close to 15 cents an hour, consisting of 7 cents an hour general wage increase plus an increase in increments of 0.2 of 1 cent (cost about three-quarters of 1 cent), an increase in week-end premiums to 20 percent from 10 percent, and a premium for holiday work of 110 percent instead of 100 percent. In addition, there will be a cost-of-living increase which already is 3 cents an hour.

I would like to refer to one other figure which has appeared in the record. Mr. Keyserling at least twice, maybe three times, has called our attention to the 11-percent increase in Russian production last year, which was announced in this morning's paper. As far as I can gather from him, there are many things which we ought to stop doing in our economy because they had an 11-percent increase. Eleven percent of what?

Let's take the steel industry. In the last 7 years the steel industry has increased its capacity in this country by 37 million tons (production by 39 million tons). The figures I have seen for Russia indicate they have increased their production by about 31 million tons, but since the base was so low that would be a sensational 133-percent figure as against the paltry 40 percent in this country.

I think we can get a little overwhelmed with percentages. I don't want to minimize and I am certainly the last one to minimize the whole war threat. I am a very enthusiastic supporter of our program to combat this very serious threat to our national security. But I think when we talk in terms of percentages, we forget that we have a pie that is so large in this country that if some people want to build race-tracks they can build racetracks, and if some people want to build automobiles they can build the automobiles and can build the roads and can build all the other things that are built, and we still have room to produce more in the way of armaments than Russia does. That is a wonderful thing. It is this tremendous leeway in our economy that makes it possible for us to use a price mechanism. You can't get away from what is a fundamental fact. If you want to throw the price mechanism out, whether it is called an administered price or a noncompetitive price or any other kind of price, you must find a substitute. That substitute can only be the three things I mentioned earlier. There is no other alternative. Those are the only ways to divide goods.

Representative BOLLING. Mr. Brubaker.

Mr. BRUBAKER. I have heard Mr. Backman about four times come back to this theme of his in which he refuses to compare "real" gains in productivity with "real" gains in wages. He somehow treats money gains in wages as being the equivalent of real gains in output.

This is a concept about which I am very sure he will find few members of the economic profession agreeing with him about, certainly none in the labor movement.

I would like to pose a simple question which may be even rhetorical. Let us just assume that for a year, next year, productivity rises 2 percent and wages go up 2 percent. This doesn't increase any costs, mind you, because wages are going up only as fast as costs are. In fact, wages are not all of costs. So actually you have even a discrepancy there.

But this does not raise "real" wages any more than the productivity gains. We have to raise wages a certain amount, and we are doing it here just as much as productivity.

Now comes along a 3-percent-cost-of-living increase. The cost of living goes up. We have an escalator clause in our contract which says when it goes up, after that, then wages are going to go up just as much percentage-wise.

Would he really seriously say and would anybody seriously propose that in that circumstance wages should stand still and not receive an offsetting cost of living increase and, as a result, that the "real" wage level should actually decline?

This is exactly what he has been saying in effect on about four different occasions today should actually happen. The comparison he is making is a completely wrong one, wrong I think in terms of economics and God knows it certainly is unfair in terms of people who are involved and their standards of living, because this would drive the standards of living of all working people down instead of up in our economy, and it would lead without any question to a situation that would make what we are talking about here look kind of silly.

Mr. BACKMAN. May I answer that?

Representative BOLLING. Certainly. Before you do, Mr. Backman, I am afraid at the conclusion of this answer the committee will have to recess until tomorrow.

Mr. BACKMAN. The question is, When the cost of living goes up, should workers get an increase? If you want to maintain the increase in real earnings, obviously they must get an increase in money wages. But the other question is really the important one. Labor movement or no labor movement—and I assume he would include economists in the labor movement as members of the economic profession, although he excluded them in the latter part of his statement—the fact is that when you increase your wage from \$1 to \$1.02 because workers turn out 102 units instead of 100 units—I am making it very simple—there is no change in unit labor costs. Then if you increase the wage further to \$1.05 to allow for a cost-of-living adjustment, wherever that cost-of-living pressure may have developed, you are now spending \$1.05 for labor for 102 units. This means that the average cost per unit is no longer 1 cent, but 1 cent plus this small fraction. That is exactly the nature of the inflationary implications of the cost-of-living escalator clause.

It is one thing to say that workers should be able to maintain their real living standards, which is what the cost-of-living clause does. It is another thing to say that such a measure doesn't feed the inflationary spiral, because the fact of the matter is that it does. It adds to unit costs just as truly as any other wage increase adds to unit costs when it goes beyond the increases in productivity. It creates what has been called a cost push on prices.

We may make all sorts of comparisons between wages and productivity. One of them is to see what happens to unit labor costs. When-

ever wages go up more than productivity, unit labor costs go up. This is a matter of simple arithmetic, not of theory or philosophy of labor-management relations.

Let me make the record clear. It doesn't mean that in every instance prices must go up. There will be circumstances where they do and others where they don't. But the fact is that unit labor costs go up under those circumstances, and no type of doubletalk can get away from the simple arithmetic of this problem. This is an A B C situation to which every economist would subscribe.

Representative BOLLING. Thank you, Mr. Backman.

Gentlemen, on behalf of the committee, I want to thank you all for helping us scratch the surface of the problem which we have before us. It is my own hope that the committee will decide—and I know that the committee has under consideration the possibility—to have a thorough, fair, and full examination into these controversial and difficult problems.

For tomorrow our business will be a little different. We will meet here in the same room at 10 o'clock to discuss fiscal and monetary policy for the coming year.

With that, the committee stands in recess until tomorrow at 10.

(Whereupon, at 4 p. m., the committee was recessed, to reconvene at 10 a. m., Friday, February 1, 1957.)

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 1, 1957

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

The committee met at 10 a. m., pursuant to recess, in room P-63 of the Capitol, Hon. Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Bolling, Mills, Talle, Curtis, Kilburn; and Senator O'Mahoney.

Present also: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Representative MILLS (presiding). The committee will come to order.

Chairman Patman has been delayed for a few minutes, and asked me to start this morning's hearings.

Today we have six expert witnesses in the area of monetary and fiscal policy. The Economic Report expresses concern about price increases. The President indicated limitations on Federal monetary and fiscal policy in maintaining economic stability under the present circumstances. Today we will explore these policies, their effectiveness and relationships, their impact on State and local governments, and what our fiscal and monetary policy should be for the coming year.

In order to expedite the discussion, the Chair will recognize each of the six panel members for the purpose of making an opening statement of 8 minutes, summarizing the views of the witness. We will proceed without interruption through the opening statements, following which there will be general discussion by members of the committee and panel. I understand this procedure is agreeable to the panel, and that they have requested that the committee staff notify each when his 8 minutes has expired.

The Chairman, Mr. Patman, has asked specifically that we reserve the testimony of Mr. Neal and Mr. Harris until his arrival. We will begin this morning's hearing, therefore, with a discussion of the impact of Federal fiscal and monetary policies on State and local governments.

Our first witness will be Prof. Walter Heller of the University of Minnesota. You are recognized for 8 minutes.

STATEMENT OF WALTER W. HELLER, PROFESSOR, SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF MINNESOTA

Mr. HELLER. Thank you, Mr. Chairman and members of the committee. Since my statement would run considerably more than 8

minutes, I am going to present a brief summary of the statement, rather than attempting to read it.

Representative MILLS. With the understanding that your entire statement will appear in the record.

Mr. HELLER. Thank you.

To gain a bit of perspective on the impact of Federal fiscal and monetary policies on State and local governments, it may be useful to consider very briefly the tremendous change which State and local government is undergoing today, a change of which people are not yet fully aware. This change has both qualitative and quantitative aspects.

Qualitatively, government is today confronted with a different complex of problems than during the 1930's and 1940's. From 1930 through 1945, we were preoccupied with problems first of economic survival, and then of military survival, problems that only the Federal Government could cope with. These problems are presumably now under control, or at least under consensus. We seem to have achieved a national, bipartisan understanding of the need of something like a \$40 billion a year Military Establishment in the present state of world affairs. We have also achieved a national 2-party consensus that it is the Federal Government's continuing responsibility to safeguard the economy from the ravages of unemployment and inflation and to join with the States in protecting the individual against the insecurity of unemployment, old age and physical disability.

We are turning now to the more abiding tasks of improving the quality and opportunity of life, of using our economic abundance to maintain and improve our educational effort, to improve our physical and mental health, to bring order out of chaos in metropolitan areas, and so forth. Here, as we become less preoccupied with survival and more concerned with higher levels of human well-being, State and local governments come back into their own. For here, though there is a national interest in each of these fields which the Federal Government should not shirk, the primary responsibility rests with the States.

This qualitative shift has its quantitative counterpart as is indicated in table 1 of my statement. In 1946, States reached the bottom of a long slide from their lofty perch of the late twenties, when they represented \$4 of every \$5 of Government spending. By 1946, they represented only \$1 out of every \$5 of Government spending. But since the close of World War II, there has been a striking rebound as the States and localities make up for time lost in depression and war, and as they respond to the terrific pressures of population and prosperity.

As we see in table 1, the revenues of State and local governments have risen in the last 10 years from \$13 billion to \$33 billion, a rise of 2½ times. Expenditures have more than tripled, from \$12 billion to over \$40 billion. Their gross debt has more than tripled, from \$16 billion to \$49 billion. These rates of growth are considerably faster than the Federal rate of increase in revenues, expenditures, and debt. This has meant that the States have risen from about 20 percent of total Government spending to about 35 percent in the past 10 years.

What about the future? Two years ago, the Tax Foundation estimated that State and local expenditures would rise from their \$30-billion level in 1953 to \$52 billion in 1965. Yet the striking fact is that in the first one-quarter of that 12-year period, the expenditures

rose by one-half of the estimated increase. So that \$52 billion estimate for 1965 is already obsolete. I think that we have to look forward at least to \$60 billion of State and local expenditures by 1965.

That puts us squarely before the question, do the States and localities have the financial resources to meet these responsibilities that are expanding by leaps and bounds? The answer, it seems to me, is that they do if four things happen: First, if we maintain a briskly expanding, fully employed, noninflationary economy; second, if the President and Congress exercise enough fiscal forbearance to set aside some of the revenue bounty of economic growth for tax reductions rather than expenditure increases; third, if the Federal Government will put its fiscal relationships with State and local governments on a sound basis of constructive cooperation; and fourth, if citizens at the State and local level rise to their responsibilities.

I want to address a few brief comments in my remaining time to these four points.

With respect first of all to growth and stability, by all odds the greatest single contribution that Federal fiscal and monetary policy can make to the financial stability of State and local governments is to promote full employment and vigorous economic growth. That enlarges State-local revenues directly and at the same time provides the slack by which Federal taxes can be reduced to make room for increased State and local taxation.

If we realize by 1965 a \$550 billion gross national product, total Government revenues at their present ratio of 28 percent of GNP, would approximate \$150 billion. The State and local share as I indicated earlier, would have to be about \$60 billion. That would leave about \$90 billion for the Federal Government. Or, in other words, if the Federal Government does not increase its cash expenditures by more than a billion and a half dollars a year for the next 7 or 8 years, the State and local governments would be able to pick up sufficient fiscal power from the taxes given up by the Federal Government. Not that they get a great deal of aid and comfort from last year's Federal budget or this year's budget on that score, but one would hope for a little better picture in the longer run.

When it comes to the form of these Federal tax reductions, it seems to me that the administration and Congress should add to the three traditional criteria of tax adjustment—equity, economic improvement, and ease of administration and compliance—a fourth one; namely, the maximum contribution to State and local fiscal capacity.

This point is far from academic. State Senator Mullin, of the Minnesota Legislature, stated just a few days ago that the failure of the Federal Government to reduce the corporate income tax was a distinct setback to the movement in Minneapolis toward a business and individual earnings tax. He has plans to introduce enabling legislation for certain excise taxes for Minnesota localities, but he has had to table these because the hoped-for reductions in Federal excises have not materialized.

The types of adjustments in Federal taxes which can most appropriately be made to aid State and local governments in solving their fiscal problems deserves careful study and analysis. Perhaps the Tax Subcommittee of the Joint Economic Committee could embrace a study of this type as part of such further plans as it may have to analyze the adjustment of the Federal tax system to the new condi-

tions of economic abundance and growth. In other words, in the process of what we would hope to be a winding down of the Federal tax system, this is one of the important aspects that should receive full consideration.

Another aspect of the impact of Federal financial policies on State and local governments concerns the impact of the rapidly rising cost of money. In the long run, this is bound to reflect itself in curtailed State and local construction capacity. A study of the school bonds issued in Minnesota during 1956 shows that the interest rate on those bonds rose from a median of 3 percent in January last year to 4 percent in December. Translated into the costs payable by a school district on a \$1 million bond issue repayable in equal installments over a 30-year period, a 1-percent interest differential amounts to more than \$200,000 of additional cost. Even when discounted to the present, this \$200,000 is equivalent to the loss of several classrooms per school. And this problem is far more than one of schools alone. Schools and other educational buildings represent only about \$42 billion out of \$200 billion of estimated State and local construction needs in the next 10 years.

It seems to me that serious consideration must be given to setting up some sort of a Federal agency which can make the superior borrowing power of the Federal Government available to State and local governments so that qualified projects of high priority which cannot compete on even terms in the private money markets will not therefore fall by the wayside.

Thank you.

(The full statement of Mr. Heller is as follows:)

IMPACT OF FEDERAL FISCAL AND MONETARY POLICIES ON STATE AND LOCAL GOVERNMENTS

THE CHANGED SETTING OF STATE-LOCAL FINANCE

Today's setting for a consideration of the interrelationships between Federal financial policies and State-local fiscal needs is vastly different from that of 25 years ago or even 10 years ago. In 1932 the setting was one of widespread unemployment, relief loads which State and local governments simply could not carry, widespread municipal bankruptcy, and enormous disparities in the fiscal capacities of various States (with per capita incomes ranging from \$124 in Mississippi to more than 5 times as much, \$658, in New York). Under those circumstances, the Federal-State-local interrelationship could only be a rescue, operation in which the National Government relieved State-local financial pressures by taking over functions and pouring out Federal aid on an unprecedented scale.

The great depression started State and local governments on the long slide that carried them from their lofty position of the late 1920's, when they accounted for nearly four-fifths of all government activity in the United States, to their lowly position just after World War II, when they accounted for only one-fifth. Under the impact of depression and war, public attention shifted from city halls and statehouses to the National Capitol, and public resources were directed into Federal rather than into State-local channels. As a result, both the fiscal problems and the physical facilities of the State and local governments were neglected.

Yet, 10 years ago, State and local governments were in a position of apparent financial ease. Lush revenues and limited expenditures during the war period left most State and local treasuries full to overflowing at the end of the war. A decade ago State-local demands on the Federal Government were at a minimum.

But today, in 1957, we realize that the feeling of financial ease was illusory, merely the calm before the storm. State-local government has been expanding aggressively, almost explosively, under the triple impact of (1) the pressure of postponement of public plant and equipment outlays during the thirties and

early forties, compounded by the vast demands for public construction created by the flight to the suburbs; (2) the pressures of population, of the multiplying numbers who require education, highways, welfare services, and the like; and (3) the pressures of prosperity, the demand that we use our economic abundance to generate higher levels of human well-being.

These pressures have moved to the top of our Government agenda such tasks as the maintenance and upgrading of our educational effort, the improvement of our physical and mental health, the clearance of city slums, the construction of better and safer highways, the equipping of our suburban areas with water systems, sewers, schools, roads, public buildings, and the like. And here, perforce, State and local governments come back into their own. For here, though there is a national interest in many of these fields which the Federal Government should not shirk, the primary responsibility rests with the States and localities. To determine the fiscal implications of this responsibility requires a quick review of the record of the past decade and projections for the decade ahead.

THE POSTWAR DECADE

The striking upsurge of State-local activity since World War II becomes readily apparent from an inspection of the figures in table 1. In contrast with 1946, when they accounted for only 1 out of every 5 dollars spent by government, State and local units are today spending 1 out of every 3 dollars and seem to be heading for a figure of 2 out of 5. In other words, their comeback has brought them close to double their relative position of 10 years ago.

The absolute increases are even more striking. In 1946, State and local governments were drawing \$13 billion of revenues from their own sources. For 1956, the figure is 2½ times as large, or \$33 billion. Expenditures, meanwhile, have more than tripled—from \$12 billion to \$40 billion. Gross State and local debt has also tripled since the war. As the table shows, these increases far outstrip the growth in Federal revenues, expenditures, and debt in the postwar decade.

Two of the most revealing figures in the tremendous expansion of State-local expenditures are those for capital outlays and for elementary and secondary education. State-local capital outlays increase from \$2 billion in 1946 to nearly \$12 billion in 1956, a sixfold increase. During the same period, total school expenditures (including construction outlays) increased from \$3 billion to \$11 billion, more than a threefold rise, while enrollment was increasing from 23.3 million to 32.7 million.

THE DECADE AHEAD

When we look ahead to the next 10 years, no abatement of this rapid upswing of State-local activity seems to be in sight. The capital-outlay item just cited is a case in point. Total expenditures on public works in the past decade have been estimated at \$70 billion. A recent survey by the United States Departments of Labor and Commerce estimates the overall need for State-local public works over the next decade at about \$200 billion, including \$92 billion for highways, \$42 billion for educational buildings, \$22 billion for hospitals and institutional buildings, \$25 billion for water and sewage works, and \$23 billion for other non-Federal public works. To meet these needs would require capital outlays of \$20 billion a year for the next 10 years as against the present rate of spending of perhaps \$12 billion.

Or, to turn from an estimate of needs to an actual forecast of expenditures, the Tax Foundation 2 years ago estimated that State-local expenditures, at stable prices, would rise from \$30 billion in 1953 to \$52 billion in 1965 (excluding outlays of Government-owned liquor stores and public utilities). Within the first 3 fiscal years, or one-quarter of that 12-year period, expenditures have risen by \$11 billion, or one-half of the total projected increase of \$22 billion. With the benefit of 2 years of hindsight on the Tax Foundation projections, it seems reasonable to predict that State-local spending will reach at least \$60 billion by 1965. That this may also be an underestimate is suggested by the fact that the \$60 billion figure represents an increase of only 50 percent in the 1956-65 decade as against a 200 percent increase in the 1946-55 decade.

How large a gap would this leave between revenues and expenditures in 1965? If we assume a growth of gross national product from the year-end level of \$424 billion to a 1965 level of \$550 billion—Dr. Arthur Burns, former chairman of President Eisenhower's Council of Economic Advisers, recently held out the prospect of \$600 billion by 1966—one may assume that present State and local taxes and related receipts would yield about \$45 billion in 1965. If Federal aids

double by 1965, as assumed by the Tax Foundation, they would add \$5 billion to \$6 billion to this total. This leaves a \$9 billion to \$10 billion gap to be filled, or the equivalent of a State-local tax increase averaging \$1 billion per year. While the crossover point from net borrowing to net repayment may not yet be reached by 1965, thus causing part of the gap to be filled by borrowing, two sobering reflections are in order here: (1) The day of reckoning on State-local debt may be delayed but it cannot be avoided; (2) an estimate of \$60 billion of spending in 1965 may be as obsolete 2 years from now as the earlier estimate of \$52 billion is today.

THE FINANCIAL RESOURCES OF STATE-LOCAL GOVERNMENTS

These projections bring us face to face with this basic question: Do State and local governments have the financial resources needed to meet their responsibilities? This is in part a question of underlying economic potential and in part a question of whether local, State, and Federal tax systems can be adjusted to convert this potential into adequate State and local revenues.

Underlying economic capacity depends, first, on the size and growth of our national economy and, second, on the size of the Federal Government's slice of the economic pie. Here, the perspective for the years ahead is decidedly reassuring. Today's \$33-\$35 billion of State and local revenues represents roughly 8 percent of our \$424 billion gross national product as against the prewar level of about 9 percent (in 1940, when GNP was \$100 billion). Adding in \$82 billion of Federal cash receipts brings total Government receipts to nearly 28 percent of GNP today. One way of looking at the State-local tax potential is to apply this same percentage to the projected GNP of \$550 billion in 1965 and then subtract the likely claim of the Federal Government against the resulting \$150 billion of potential Government revenue. (Actually, existing taxes would yield more than 28 percent of the enlarged GNP because of heavy reliance on income taxes.)

What does this computation suggest? Simply this: That if Federal cash spending increases by \$1.5 billion or less each year between now and 1965 (bringing us from the current level of \$77 billion to a 1965 level of \$90 billion or less), we can afford reductions in Federal tax rates equal to or greater than the required increases in State-local tax rates. Out of the total revenues of \$150 billion (nearly 28 percent of the 1965 GNP), State and local units would be getting about \$60 billion while the National Government would be getting about \$90 billion.

But simple arithmetic is not synonymous with simple solutions. Note what this "60-90 solution" requires:

1. That we maintain a briskly expanding, fully employed, noninflationary economy.
2. That the President and Congress exercise enough fiscal forbearance to devote part of the revenue bounty of economic growth to tax reductions rather than expenditure increases.
3. That the Federal Government put its fiscal relationships with State and local governments on a sound basis of constructive cooperation, i. e., (a) that it structure its tax reductions so as to facilitate the expansion of State and local revenues; (b) that it adjust its monetary and debt policies to relieve the States and localities of undue economic pressures and restrictions both in booms and in slumps; (c) that it strengthen administrative ties between Federal and State-local tax enforcement agencies.
4. That citizens will rise to the occasion by accepting responsibility, i. e., taxing themselves more heavily and intelligently, at the State and local level rather than running hat in hand to the Federal Government.

Let me comment briefly on each of these points.

FULL EMPLOYMENT AND ECONOMIC GROWTH

By all odds, the greatest single contribution Federal fiscal and monetary policy can make to the financial stability of State-local governments is to promote full employment and vigorous economic growth. State and local governments have a direct stake in the revenue flows generated from their own sources by a healthy, growing economy and an important indirect stake in the Federal tax reductions made possible by sustained growth. The second point has already been illustrated, but an example or two from recent Minnesota experience may be illuminating on the first point. Between the fiscal years 1951 and 1956, a period of remarkable price stability, normal individual income tax revenues grew from \$35 million to \$50 million, or 42 percent, without any change in rates or exemptions. Or, take another example: normal income tax collections in Minnesota

(individual and corporate combined) for the fiscal year 1957, which were tentatively estimated at \$60 million late in 1954 on the assumption of a no-growth GNP of \$361 billion, have now been reestimated at \$72 million on the basis of the actual 1956 GNP of \$412 billion, an increase of 20 percent in revenue in response to a 15 percent growth in GNP. The fact that Minnesota's Legislature can enact both expenditure increases and tax decreases during its 1957 legislative session traces in considerable part to economic expansion, coupled with Minnesota's reliance on relatively responsive sources of revenue.

State and local governments have an equally vital stake in the avoidance of inflation. Their budgets are far more vulnerable to increases in the price level than the Federal budget. On one hand, their reliance on generally more regressive revenue sources such as property and consumption taxes means that their revenues do not respond as readily to the upthrust of inflation as the Federal corporate and individual income taxes. On the other hand, they spend a much higher proportion of their total budget in purchases of goods and services and much less on interest and transfer payments than the Federal Government. For example, for the calendar year 1956, the Economic Report (pp. 42 and 165) indicates that State-local purchases total \$33 billion in comparison with total cash payments of 30.4 billion (excluding Federal aids), while the corresponding Federal figures are \$47 billion in comparison with \$75 billion (including Federal aids). On balance, then, inflation reflects itself much more quickly and forcefully in State-local expenditures than in State-local receipts.

As State-local debt skyrockets past the \$50 billion mark, inflation may seem more attractive to such governments as a means of shifting burdens to their creditors. But appearances are deceiving. For their creditors, the financial community, will readily perceive the danger of inflation and require still higher interest rates to offset the threatened erosion of principal.

In terms of State-local concern over possible unemployment and inflation, there is considerable uneasiness at present. On the one hand, while Federal tax and credit policies are being utilized to curb inflation, considerable adverse impacts on the costs of local borrowing and the development of State-local tax systems are being felt. On the other hand, statements from prominent administration sources that suggest unwillingness to use tax reduction as a means of combating future recessions are alarming. For these reductions not only help restore the economy to its path of full employment and growth (as the 1954-55 experience so dramatically demonstrated), but also make room for strengthening the taxes of State and local governments, which must live by the balanced budget rule both in prosperity and depression.

FEDERAL TAX REDUCTION

Given a healthy and growing economy, Federal revenues are likely to increase faster than Federal expenditure programs. If this assumption proves valid—though it gains little comfort from this year's or next year's Federal budget—the Federal Government can make a constructive contribution to State and local fiscal capacity by reducing its taxes. In fact, assuming that tax reduction will be possible, one may earnestly suggest that the administration and Congress add to the three traditional criteria of tax adjustment—equity, economic improvement, and ease of administration and compliance—a fourth criteria; namely, the maximum contribution to State and local fiscal capacity.

This contribution will appear in different forms to different groups of States. For example, a reduction in Federal individual and corporate income taxes automatically expands the tax base and revenues of the roughly 20 States whose income taxes allow deduction of Federal income taxes in computing the State tax base. Or the contribution may take the form of making room for imposition of new or increased State and local taxes. This point is occasionally belittled on grounds that the State and local units did not step in to make use of the leeway afforded by the reduction of Federal amusement taxes in 1954. But this ignores the fact that the Federal tax reduction was widely understood to have been granted because the movie industry was ailing. State and local governments may have thought it unseemly to step in with their own taxes under such circumstances. If the Federal Government were to reduce its cigarette taxes, for example, there is every indication that the States would not be slow to take advantage of the leeway thus created.

That the point made here is far from academic is demonstrated by the statement made just a week ago by Senator Gerald Mullin, of the Minnesota Legislature, to the effect that the failure of the Federal Government to reduce the

corporate-income tax was a distinct setback to the movement in Minneapolis to impose a business and individual earnings tax. Moreover, his plans for introducing enabling legislation with respect to certain excise taxes for Minnesota municipalities, predicated on reductions in the relevant Federal excise taxes, have had to be held in abeyance since the Federal tax reductions are not yet in sight.

In advocating the use of Federal budget surpluses for tax reductions that will make room for State-local tax increases, rather than using the surplus to enlarge Federal aids, one frequently encounters the objection that the net effect will be a shift from progressive Federal taxes to regressive State-local taxes. The fear is that the overall Federal-State-local tax systems will become less equitable, that built-in flexibility will be weakened, and that tax administration will, on balance, be less efficient. To some extent, no doubt, this charge is true.

But on the other hand, the force of this argument is blunted by several considerations. First, in winding down the Federal tax system, care can be exercised to cut out those pieces which are most regressive or repressive in their impact. Second, if the economy continues to grow rapidly and operate at substantially full employment, it may well be that the fear of interstate competition and loss of industry will become less and less of a factor pushing States toward regressive consumption taxes. An economy of abundance is the best path to the loosening of restrictive practices of all kinds, including State and local tax concessions to lure industry away from its natural habitats.

Third, a growing and prospering economy also increases the attractiveness of income-based taxes which respond readily to an expanding GNP and helps create an environment in which equity considerations get a fuller hearing. For example, Governor Freeman has endorsed and the Minnesota Legislature is now actively considering a tax program developed by a balanced industry-labor-agriculture group which would increase the State's relative reliance on corporate and individual income taxes and decrease the relative reliance on regressive personal property taxes.

The types of adjustments in Federal taxes which can most appropriately be made to aid State and local governments in solving their fiscal problems deserve careful study and analysis. Perhaps the tax subcommittee of the Joint Economic Committee could embrace such a study as part of such further plans as it may have to analyze the adjustment of the Federal tax system to the new conditions of economic abundance and growth.

CONSTRUCTIVE COOPERATION IN FISCAL AND MONETARY POLICY

One aspect of constructive cooperation has already been discussed; namely, the structuring of tax reductions to facilitate the expansion of State and local fiscal capacity and revenues. But another aspect is even more pressing at the moment; namely, the impact of Federal tight-money policies on vital State and local construction projects. In brief, does Federal credit policy discourage State-local projects of high social priority, while private projects of lower priority are permitted to continue?

The President's recent recommendation for school-construction aid and loans suggests that his answer is in the affirmative with respect to the field of education. It may well be that many of the other projects in the \$200 billion of State and local construction summarized earlier in this statement are of equally high priority. Schools, for example, cannot function on buildings and teachers alone, as we found in a suburb of the Twin Cities a few months ago; our new junior high school building was completed but could not be opened because the construction of the necessary sewer system had not been completed.

Pressures on State and local borrowing are also reflected in the report earlier this week by the Investment Bankers' Association: High borrowing costs caused postponement of 87 scheduled tax-exempt bond issues, totaling \$191 million during the last 3 months of 1956. As reported in the Wall Street Journal, its study noted that bonds authorized during the final 6 months last year, but unsold on January 1, 1957, totaled nearly \$3 billion. Together with the heavy volume of issues postponed in 1956, the IBA said, these authorized bonds will create an exceptionally high demand from State and local governments for long term funds during 1957.

Postponement of certain projects does not mean that the overall volume of public construction at the State-local level is declining. Even when ground down by the upper millstone of high interest rates, the projects forced into being by

the nether millstone of irresistible need represent a continually rising volume. In Minnesota, for example, the F. W. Dodge reports indicate that educational construction rose from \$54 million in 1954 to \$63 million in 1955, and to \$73 million in 1956, while other public works and utility construction rose from \$100 million to \$117 million in the same period.

Undoubtedly this volume is lower than it would have been with lower interest rates. The rapidly rising cost of money is bound to reflect itself in curtailed State-local "construction capacity" in the longer run. For example, a study of the school bonds issued in Minnesota during 1956 shows that the interest rates on those bonds rose from a median of 3 percent in January to 4 percent in December. Translated into the costs payable by a school district on a \$1 million bond issue repayable in equal installments over a 30-year period, the 1 percent interest differential amounts to more than \$200,000 additional cost. Even when its cost is discounted to the present, this amount is equivalent to the loss of several classrooms per school.

Evidence of this kind suggests that under present monetary policies, unless alleviated by measures on even a broader scale than the President's proposal for a \$750 million loan fund for school construction, State-local governments will have to take a back seat in the process of sharing in our economic abundance. The tax-exemption privilege enjoyed under the Federal income tax by State and local bonds is no longer enough. In fact, with the tripling of such debt in 10 years, the point of saturation of the upper income brackets which benefit from this tax privilege is rapidly being approached. So the interest rates on such securities are subject to the dual upward impact of tight money and lessened tax attraction.

What the situation calls for is the establishment—as Dr. Gerhard Colm, several Governors, and others have recently suggested—of a "national fund" which would issue its securities with a Federal guaranty and use the resulting funds to purchase bonds at reasonable interest rates from State and local governments and agencies. In booms, such an agency would relieve State-local government of the tight-money pressure which might otherwise cut off many projects of high social priority—higher than others which would get the available loan funds under existing institutional arrangements. In recession, the funds would give the States and localities readier access to loanable funds and thereby help avoid the restrictive practices which forced them into bankruptcy and net debt repayment during the depths of the great depression.

STATE-LOCAL RESPONSE

Even when the Federal Government has done its part, there remains the question of the response of State and local governments. No one can yet speak with assurance on this point, since the full implications of the new role of State-local government under the triple pressure of postponement, population, and prosperity are not yet widely perceived. But there is heartening evidence not only of a resurgence of responsible interest in State-local finance, but of an improvement in the basic economic capacity of these units to do a larger share of the overall job of Federal-State-local taxation.

Apart from the growth in overall capacity, reflected in the growth of per capita real income from \$773 (in 1956 prices) 25 years ago and \$1,051 in 1940 to over \$1,700 today, there has been a marked improvement in the distribution of that income among the several States. The ratio of the highest to the lowest State per capita income has been cut in half; the high of \$2,513 per capita in Delaware in 1955 is just over 2½ times the low of \$946 in Mississippi, in contrast with a ratio of 5 to 1 in 1933. This gap is still much too large to allow any complacency. It makes clear that there is still a strong case for increases in Federal aids. But it also suggests that ability to meet financial problems at the State-local level is increasing and will continue to increase as differentials narrow under the impact of economic prosperity and growth.

As to attitude, there is also hopeful evidence that citizens are becoming steadily more willing to incur the pain of increased taxes in their home city or State rather than seeking the pleasure of increased Federal support. Two-thirds of the States have had study groups examining their fiscal problems in the past year or two. Many of them—like our unique self-financed and balanced labor-agriculture-business committee of 20 which recently issued a unanimous report in Minnesota—are showing their willingness to modernize and invigorate State-local fiscal institutions and to accept the higher tax burdens that are bound to accompany this process in the longer run.

Representative MILLS. Our next panelist is Prof. Benjamin U. Ratchford, department of economics, Duke University. You are recognized for 8 minutes.

STATEMENT OF BENJAMIN U. RATCHFORD, PROFESSOR, DEPARTMENT OF ECONOMICS, DUKE UNIVERSITY

Mr. RATCHFORD. Thank you. I am speaking in my capacity as an individual and not for the university. I will attempt to answer in some form the three questions which were posed to us by the staff, however, I will concentrate most of my attention on the second one.

I am glad that Professor Heller devoted as much time as he did to the last one, because I thoroughly agree with what he says on that score. Like him, I will try to summarize my points rather than reading my paper with the understanding that the full paper will be printed in the hearings.

Representative MILLS. The full paper will appear in the hearings.

Mr. RATCHFORD. First I would like to call attention to the most spectacular impact of recent monetary and fiscal policies, that is, the sharp rise in the interest rate paid by State and local governments, and the failure in a considerable number of cases of those governments to sell bonds which they offered. The rise, as Professor Heller has mentioned, has been very sharp. Over the past year, the increase in the average yield of municipal bonds has increased by some 38 percent compared with only 28 percent for United States Government obligations and about 24 percent for corporate bonds. Going back to 1951, the yield on municipal bonds has risen by over 70 percent compared with approximately 30 percent on United States Government and corporate bonds.

It is my belief that while fiscal and monetary policies have obviously been in part responsible for this, they have not been entirely responsible. State and local governments, as the statistics show, have been borrowing very heavily and, further, borrowing at an increasing rate. In the early part of this decade, they were borrowing less than \$3 billion per year on the average, whereas in the last 4 years they have been borrowing approximately \$6 billion per year. Furthermore, they have been borrowing a considerable portion of this from commercial banks. For a period of about 9 years, commercial banks bought on the average nearly a billion dollars a year of State and local bonds. When the credit got tight, commercial banks stopped or reduced very heavily their purchases and the sharp rise in the last year has been very closely tied in with this sharp reduction in the purchases of State and local bonds.

Now as to the first question, the effect of this upon the volume of construction, frankly I do not have the data necessary to give an informed opinion on it. However, it would be my guess that it has not as yet had any significant effect because the credit squeeze has been so recent that it has not had time to affect plans for construction. However, the recent increases in construction costs would suggest to me that the large new highway program, superimposed upon normal construction, is already taxing our construction industry to the limit, and there is not a great deal of room, without increasing cost considerably, for further construction activity.

I think it is probably true that the sharp rise in interest rates will have considerable effect upon projects in the planning stage, and to the extent that this could be done without serious inconvenience I think it would be desirable.

Now, as for suggestions for improving the financial position of State and local governments in periods of financial strain, of course, so long as they are borrowing heavily and so long as they are depending heavily on commercial banks, it is inevitable that in periods of credit strain they will be subject to sharp rises in the rate of interest. So to the extent that it would be possible they should reduce their dependence on borrowing. I recognize, of course, that is a very difficult problem, and one which is not possible in the immediate future.

I might say that the fact that they have borrowed heavily from commercial banks has meant that in periods of easy money they have enjoyed very low yields on their bonds. That suggests that in part the present credit strain is temporary, if we assume that our tight money situation is temporary. When it passes, the yield on State and local bonds will fall more rapidly than the yield on Government and corporate bonds. That has been true over the past 10 years.

Now, as for some other suggestions, I throw these out very briefly because I have not thought them through or worked them out in detail. For one thing, I think the State and local governments might give more attention to economies in construction, to see if it would be possible to develop more standardization and more mechanization in their construction. That has been accomplished in the highway building field to a considerable extent, with the result that highway costs have gone up only 40 percent since 1946, whereas building costs have gone up some 88 percent.

Another possibility would be for State and local governments to mobilize the cash balances which they now have and to use them more efficiently. These governments, all of them together, are holding from 12 to 13 billion dollars of cash balances. The Federal Government spends almost twice as much as these governments do with a cash balance considerably less than half of this.

In the field of private business in recent months, high interest rates have forced them to do a larger volume of business on lower cash balances. I am convinced that much could be done here if they would use their cash balances more efficiently.

Another suggestion would be for them to sell some part of the 15 or 16 billion dollars' worth of United States Government bonds which they now hold, and to reinvest the proceeds in State and local bonds. These bonds were bought originally because the yields on United States governments were considerably higher than the yields on State and local bonds. Now that differential has narrowed a great deal and this would be a good time for them to shift some of those investments.

Next, States might do a great deal more in supervising and aiding their local governments in their borrowing in the same way that is being done in North Carolina by the North Carolina Local Government Commission. That, I believe, is the only State which has a commission of this type. They have done a great deal to raise the standards of borrowing and to enable their local governments to borrow at lower rates of interest. Eventually it might be possible if this

were done for State and local governments to develop a mutual system of guaranty or insurance of their bonds, somewhat after the fashion of the FDIC.

Another suggestion would be that in periods of high interest rates more of the bonds should be made callable. At present a small portion of the general obligation bonds are callable. All of these things I have mentioned thus far can be done by the State and local governments by themselves.

One suggestion which would require Federal action would be to consider the possibility of investing some portion of the unemployment trust fund in State and local bonds. Obviously that would have to be done carefully and only bonds with large amounts outstanding and that were quite safe could be bought for reasons of marketability and security.

Finally, to come to the last question, as I said, I agree with Professor Heller in what he has said on that and I think I will close my brief remarks, if I may, by endorsing what he had to say on that point.

(The full statement of Mr. Ratchford follows:)

THE IMPACT OF FEDERAL FISCAL AND MONETARY POLICIES ON STATE AND LOCAL GOVERNMENTS

Two developments of the past 6 months have highlighted the impact of current fiscal and monetary policies on State and local governments. The first is a sharp increase in interest rates and the second is the failure, in a significant number of cases, of governmental units to sell the bonds they offered.

The rise in interest rates on State and municipal obligations has been greater than increases in comparable fields, and for the first time in many years the yield on high-grade, tax-exempt municipals is about the same as the yield on taxable United States obligations. From June 1954 to December 15, 1956, the yield on high-grade municipals, as measured by Standard & Poor's index, rose by 38 percent compared with an increase of 24 percent on United States Government bonds and 28 percent on AAA corporate bonds. Measured from the average for 1951 to December 15, 1956, the increase on municipals was 71 percent as against 30 percent each for United States bonds and AAA corporates.

Many complex factors account for this sharp rise in the interest rate on State and local obligations. Federal fiscal and monetary policies constitute only a part of the story. In part, State and local governments themselves are responsible. During the past 10 years State and local governments have sold a total of more than \$43 billion of long-term obligations. Further, these sales have been rising at an increasing rate, although there has been some leveling off in the past 2 years. During the years 1947-49 the annual average was \$2.8 billion; during the next 3 years it was \$3.8 billion, while in the past 4 years it has been \$6 billion. These are gross figures, it is true, and there have been large offsets in the form of debt redemption and payments to sinking funds, pension funds, and the like. But after allowing for these it is still true that State and local governments have had a large net demand for investment funds. During most of this period inflationary forces were strong. This means, then, that State and local governments have been practicing deficit financing on a fairly large scale during an inflationary period.

Further, a fairly large proportion of their bonds have been sold to commercial banks, thus tending to increase the money supply. From June 1947 through June 1955 insured commercial banks increased their holdings of State and local obligations by \$7.8 billion—a rate of almost a billion dollars per year. From June 1955 to June 1956 the increase was only \$148 million and in the last half of 1956 it was apparently very small. Commercial banks now hold over one-fourth of all State and local bonds. This heavy dependence on commercial banks as purchasers of their bonds gave State and local governments very low interest rates when money was easy but it inevitably makes them vulnerable to high interest rates in periods of tight credit.

During 1952-53 insured commercial banks cut their acquisitions of State and local bonds by one-half compared with the previous year and the yield on

municipals rose by 42 percent while the yields on United States bonds and AAA corporates were rising 18 and 15 percent, respectively.

In the following year bank acquisitions of State and local bonds went back to the 1951-52 level and within 15 months the yield on municipals was back to approximately the level of June 1952.

EFFECTS ON VOLUME OF CONSTRUCTION

With respect to the effect of current policies on the volume of State and local construction, I do not have sufficient information to support any firm opinion. It is not likely that they have had any significant effect as yet because the stringency has developed quite recently—largely in the past 6 months. The recent increases in construction costs would suggest that the new Federal highway program, superimposed upon the heavy construction program previously existing, is straining the construction industry to the limit of its capacity. In fact, it is possible that this highway program, by raising prices and creating shortages, may do more to limit other forms of construction activity than monetary and fiscal policies.

It is probable that the high interest rates and the difficulties in obtaining funds are having their effects upon projects in the planning stage, either by reducing their scope or postponing them. To the extent that this can be done without serious inconvenience, it is to be hoped that such is the case, for that would help to bring the supply of and the demand for investment funds back into equilibrium without further large increases in the interest rate.

We are not justified in assuming that State and local governments, as borrowers, should be exempted from the operation of market forces and that every one of their projects is indispensable and should have absolute priority over the demands of private business.

Further, to the extent that these projects can be postponed they may help to sustain the demand for investment funds at a later time when we may have trouble finding uses for all of our savings.

SUGGESTIONS FOR IMPROVING FINANCIAL POSITION

It is not easy to suggest means for improving the financial position of State and local governments during periods of inflationary strain. As long as they continue to borrow heavily and as long as commercial banks are major holders of their bonds, it is inevitable that they will be squeezed when it becomes necessary to use monetary policy to restrain inflation. Certainly it is not desirable that general monetary policy should be determined with the sole view of accommodating the credit demands of State and local governments.

Therefore, the first and most basic change, and undoubtedly the most difficult one, is to reduce their dependence on borrowing. For 10 years they have been borrowing heavily and during that time they have tripled their debts. Each year they have increased their revenues, in part because of inexorable demands to service a growing debt. They are in much the same position as a householder who is unable to save to buy his durable consumer goods but who loads himself up with installment payments and then has to save to meet the payments. State and local governments are about 2 years behind in their revenue programs; if they could bridge that gap they would reduce their dependence on borrowing, greatly increase their freedom to maneuver, and at the same time make a substantial contribution to reducing inflationary pressure.

Below I list, in barest outline, several suggestions which might be helpful in improving the financial position of State and local governments in periods like the present. I have not developed them in detail and am not prepared to defend them. Undoubtedly they require much thought and investigation. They are possible lines of approach to the problem.

1. Give more attention to economies in construction. This would include attempts to develop the use of more economical materials and methods and more standardization. In particular, attention should be given to the possibility of achieving mass and mechanized production.

Apparently this has been done in the building of highways and as a result construction costs of highways have risen only 40 percent since 1946 in contrast with an increase of 88 percent in the cost of constructing buildings. At a time when we are building thousands of school buildings we might see if it is possible to develop 5 or 6 standardized structures and have the plans and specifications available from a State agency at a nominal cost.

2. Mobilize the cash balances of all governmental units and manage them more efficiently. In recent years State and local governments have been carrying cash balances in the range of \$12 billion or \$13 billion. The Federal Government spends almost twice as much as these units with a cash balance less than half as large. Under the pressure of high interest rates, private business units have in recent months found ways to finance a larger volume of business with smaller cash balances. It is true that the problem is complicated by the thousands of spending units, but still much could be done toward using these balances more efficiently. Each of the States and larger cities could appoint a finance or investment officer who would take over and manage the cash of all agencies of that unit. He would estimate consolidated cash requirements and would dispose of the total funds so that those requirements could be met. He would do for all the agencies of the unit what the commercial banker does for the community and in the same way as the commercial banker would cut down drastically on total balances required.

3. Sell a part of the United States obligations they hold and buy State and local securities. Over and above reserves in the unemployment trust fund, State and local governments are now holding some \$15 billion or \$16 billion of United States obligations. These represent the investment of unneeded cash balances, sinking funds, retirement funds, and so on. They have been made over the past 15 years or so largely because Federal obligations were more liquid and carried a higher yield than State and local bonds. That differential has now narrowed considerably or disappeared.

A minor part of these holdings might be shifted to State and local obligations. Such a shift would have to be carried out slowly and gradually over a long period of time to avoid disrupting both the Federal and the municipal bond markets. The effect of this operation would be to throw more of the burden of financing on the Federal Government, but that would only be reversing the effects that have prevailed over the past 10 years or more.

4. States could do more to supervise and control local borrowing and to aid local units in selling their bonds after the fashion of the North Carolina Local Government Commission. In addition to enacting statutory controls, North Carolina has established a commission which has some discretionary power to approve or disapprove local borrowing. The commission advises local units and helps them plan their borrowing, sees that legal requirements are met, offers the bonds for sale, sells the bonds, supervises the printing and delivery of the bonds, and turns the proceeds over to the local units only after it is satisfied that the funds are properly protected. It also supervises the levy of taxes necessary for debt service. It has been successful in raising standards of borrowing and has helped the local units to get better prices for their bonds. The work of this commission merits considerations by other States.

5. Eventually State and local governments might develop a system for the mutual insurance or guaranty of their bonds. If the States generally adopted systems of effective State supervision of local borrowing, it might then be possible for them to set up a mutual organization similar to the FDIC, which would insure or guarantee any bonds approved by supervising commissions. This would take time to develop, and it is not a possibility for the immediate future.

6. More State and local bonds might be made callable. Despite the painful experience of the thirties, when they had to forego hundreds of millions of dollars in potential savings, because their bonds were not callable, many States and local governments are still not making their general obligation bonds callable. This feature is almost universal in private finance and even in household mortgages. It is generally used in public-revenue bonds. The present high level of interest rates suggests that this feature might now be used advantageously.

7. Consideration might be given to allowing the unemployment trust fund to buy limited amounts of State and local securities. Since the reserves in this fund technically belong to the States, there would seem to be no valid reason why some part of them might not be invested in State and local bonds.

Unemployment insurance is a joint endeavor, yet the Federal Government has completely controlled the investment of the reserve and has put all of them into Federal obligations. For a long time this was justified in part by the fact that Federal bonds provided a higher yield than was available on the best State and local bonds.

As already noted, that differential has greatly declined, and the present might be a good time to allow States and local governments to share some of the benefits of this market. Admittedly, considerations of marketability and safety would limit the purchases to the issues of the larger and stronger units and would limit

the total of State and local obligations to a minor part of the total—say 25 to 30 percent.

On more detailed study, some of the suggestions may well prove to be impractical, and certainly no one of them alone will solve the problem. But a combination of the more feasible ones may well make a substantial contribution toward a solution.

ADEQUACY OF STATE AND LOCAL RESOURCES

Are State and local financial resources adequate to meet their long-range responsibilities? In general, with the present scale of Federal aid, I believe they are if the State and local units will make a determined effort to develop those resources. The major proviso is that the Federal Government will not preempt too large a portion of those resources before the State and local units have a chance to get at them.

Today State and local taxes are taking about the same proportion of national income as in 1929—about 7.5 percent—and considerably less than in the thirties. The great difference is that in 1929 Federal taxes were taking about 4 percent of national income while today they are taking about 20 percent.

The new Federal highway program will give the State and local governments very substantial aid with one of their major expenditures for the next 15 years. With that help the State and local units, if they will make a strong and intelligent effort both to raise more revenues and to use them more economically, can measure up to their responsibilities.

(The table of sales of long-term State and local government bonds, holdings by insured banks, and certain bond yields appears at p. 788.)

Representative MILLS. Our next panelist is Prof. Louis Shere of the department of economics, University of Indiana. You are recognized for 8 minutes.

STATEMENT OF LOUIS SHERE, PROFESSOR, DEPARTMENT OF ECONOMICS, UNIVERSITY OF INDIANA

Mr. SHERE. Mr. Chairman, I have a brief statement that I would like to read for the record.

The fiscal and monetary policies which are being pursued currently are sound. To reverse these policies now would inflate the economy without expanding it appreciably.

But as soon as there is no longer any threat of inflation, credit restraints should be relaxed. This should be given top priority. Taxes should be reduced. The state of the economy, rather than the size of the budget surplus, should determine the appropriate fiscal and monetary policies.

General credit controls do not have a uniformly effective and salutary impact upon all segments of the economy. There has been proper concern about the excessive potency of credit restraints as they apply to small business, housing, the financial requirements of State and local governments, and technological change; and, perhaps also, about their relative impotency in the consumer and speculative markets. General credit policy has been implemented and its scope shrunk by the adoption of a variety of devices which supply credit on especially favorable terms in various directions through the huge Federal credit programs.

I doubt the need for new devices to reduce further the scope and perhaps the potency of general credit policy. While the control of credit must always be qualitative as well as quantitative the better to give effect to social goals and priorities, there is great danger that excessive encroachment upon general credit policy would enfeeble it unduly as a stabilization measure.

I strongly endorse the President's recommendation for a broad national inquiry into our financial system, covering public as well as private agencies.

There should be included in this inquiry the important questions whether there is need for a more formal arrangement to coordinate the monetary policies of the Federal Reserve Board with the economic recommendations of the Council of Economic Advisers and whether steps should be taken by private enterprise, with or without the assistance of the Government, to pool the risks of making credit and capital more adequately available to small business, at reasonable rates.

I turn next to tax policy. Under the stimulation of the work of this committee, I have prepared a paper on Federal tax revision to promote economic growth and stability. It contains some 40 specific recommendations. If the committee approves, I would like to offer this study for the record and in these remarks focus on the nature of the tax legislation and investigations that I recommend for 1957. The recommendations are based on different assumptions about economic conditions that may prevail over the coming year.

(The document referred to follows:)

FEDERAL TAX REVISION TO PROMOTE ECONOMIC GROWTH AND STABILITY

By Louis Shere, professor of economics and director of tax research, Indiana University, November 1956

I. INTRODUCTION

The Federal tax system is a powerful revenue producer and one that is substantially responsive to changing levels of economic activity. However, each major source—the individual income tax, the corporation income tax, the excises, and the estate and gift taxes—can be improved, better to serve the objectives of economic growth and stability. The purpose of this paper is to provide a catalog of proposed changes which, separately and particularly in combination, would accomplish this result. It is believed that all the proposals should be enacted within the not too distant future, as economic conditions permit. They would on the whole reduce the revenue potential of the Federal tax system, but, properly spaced over time, they would not reduce the revenues below economic requirements.

The present tax system would almost certainly prove to be too high if it were maintained intact for many years. With the increase in population and the absorption of technological advances that persistently augment the productivity of the labor force the revenues from the present level of taxation, barring emergencies, would continue to outrun the public expenditures. The mounting surpluses would reduce the public debt more rapidly than is compatible with the objectives of the Employment Act. The feasible rate of tax reduction will depend in an important way upon the level of expenditures necessary for defense and the speed with which the public elects to wipe out the residual backlog of urgently needed public facilities.

Tax reduction may become necessary as the result of either a reduction in expenditures, growth, or a recession. It may be useful to set forth some broad guidelines for action on the issue of which taxes to reduce in these different situations. For present purposes the problem is essentially the same if the need for tax reduction results from lower expenditures as from rising receipts due to the growth of the economy.

Tax reduction must always be harmonized with the requirements of economic stability. The size of the surplus is not by itself a sufficient guide to the timing of tax reduction made feasible as the result of reduced expenditures or economic growth. If investment is already proceeding at a sufficient rate and tax reduction would risk inflation, then tax reductions should be postponed until it would better harmonize with stability requirements. In such circumstances it is appropriate to reduce the public debt. But if the economic situation on the

whole is such as to make possible the absorption of the tax reduction without inflation, and without resorting to drastic monetary restrictions, then to the fullest extent feasible tax reductions made possible as the result of economy or growth should be invested in promoting growth by reducing mostly the taxes that weigh against savings and investment. This means the corporation income tax and the middle- and upper-bracket incomes of their individual income tax. The political pressures are always on the side of raising the current standard of living and tend to play up the equity considerations. These pressures cannot be fully resisted. It means that some tax reduction must be of the type that primarily affects consumption and secondarily investment. Some reductions of excises and also of the lower-bracket individual income taxes fulfill this requirement.

Tax reduction may become necessary for stability reasons if there is a drop in the level of economic activity. Under these conditions the weighting of the taxes in the tax-reduction package should be the reverse of that indicated as appropriate for tax reduction which has its origin in economy or growth. Taxes that impinge primarily upon consumption and only secondarily upon investment can be manipulated cyclically with less risk of breeding uncertainty that would prejudice investment than if cyclical tax policy were reversed and the changes made in taxes that impinge primarily upon investment. Tax relief directed at consumption has a more immediate and certain impact in recession than tax reduction directed at savings and investment. Despite these considerations, tax reduction initiated for stability reasons should be a mixture of both types, with the weighing substantially heavier for the consumption taxes. The reason for including some taxes weighted against investment in the mix of tax reduction to alleviate a recession is that the resistance to the restoration of taxes to the desired level, following a tax reduction undertaken for stability reasons, will be much greater if the increase applies only to taxes weighted against consumption and not at all to taxes weighted against investment. If secular inflation is to be avoided, taxes must move both up and down in response to changes in economic activity, not merely down. They move up with much greater resistance than down, and with greater resistance for some types of taxes than others.

The best that can be expected is to have the weights in the packages of tax reduction stemming from economy or growth and from stability requirements substantially different for the different types of taxes. It should be recognized too that these weights may need secular adjustment to maintain balance between consumption and investment and possibly the better to accord with the public's changing preferences between higher living now and the good life of the future.

If tax policy were required to bear the full load of stabilization, the outlook would be for secular inflation, because the frictions to tax changes in the upward and downward direction are not symmetrical. In terms of stability requirements taxes generally would be too low, except for conditions of recession. But tax policy is required to carry only part of the stabilization load. Monetary policy, and various specific economic policies do the rest. This greatly reduces the required swings in taxation and this makes discretionary fiscal policy practicable. If upward tax adjustments lag or are lacking, there is monetary policy to take up the burden of restraining the expansion and the downward tax adjustments appropriately can be substantially less when teamed up with expansionary monetary policy.

As previously indicated, the cyclical swings in taxation should for the most part be in types of taxes that primarily affect consumption decisions—the first bracket individual income tax and, if we had one, the rate of a general sales tax. If, however, there is to be a secular change in the taxation mix to attain some desired shift as between consumption and investment, this should be reflected in the weights assigned to the different types of taxes in both types of tax reduction—those that have their origin in stability requirements and those that stem from economy (and efficiency) or growth. Both types of tax reduction must, however, be articulated with stability requirements, and while monetary policy can be adjusted to ease a tax reduction stemming from secular growth into the framework of stabilization policy, it is at least not clear that such use of monetary policy provides an adequate practical alternative to arranging weights in the cyclical type of tax reduction with some glance at secular requirements and in the secular type of tax reduction with an eye on the cyclical problem.

II. REVISION OF THE INDIVIDUAL INCOME TAX

1. The role of the individual income tax in the tax system

The individual income tax plays the dominant role in the Federal tax system. Net of refunds, it accounts for almost one-half of Federal net budget receipts, which excludes contributions for social security. It yields over three times the revenues from excises and over 50 percent more than the corporation income tax. The Federal receipts, by major source, are given in table 1.

TABLE 1.—Federal receipts for fiscal year 1956, by major sources

[In millions of dollars]

Type of receipt	Actual receipts fiscal year 1956			
	Amount	Allocation of refunds	Amount	Net percent of refunds
Individual income taxes.....	35,337	-3,152	32,185	47.2
Corporation income taxes.....	21,297	-416	20,881	30.7
Excise taxes.....	10,004	-70	9,934	14.6
Estate and gift taxes.....	1,171	-13	1,158	1.7
All other.....	4,016	-34	3,982	5.8
Subtotal.....	71,825	-3,684	68,141	100.0
Deduct refunds of receipts.....	3,684	-3,684		
Net budget receipts.....	68,141		68,141	100.0

Despite the important place of the individual income tax in the Federal tax system it should not be deemphasized. There are two principal reasons for this conclusion:

First, while there is still some fringe opposition, the case for progression has been made with the American public and this is the most important progressive tax in the system. Yet the rates above the first bracket are applicable to only about 30 percent of taxable income and account for only about one-fifth of the revenue from the individual income tax. Progression in the lower brackets of taxable income stems largely from the personal exemptions. Also, the tax is based on net income, rather than gross income. The expenses incident to earning the income are taken into account in determining the measure of taxable capacity. These features—the netness of the tax and its progression—appeal to the American public as fair. Second, these same features both contribute to increase the responsiveness of the revenue yield to changing economic conditions in a manner which makes for stability. There is, to be sure, some basis for concern lest a graduated net income tax with relatively high marginal rates affect adversely the incentives to work and to venture. But the impact on incentives is unlikely to become an important mark against the income tax so long as it is accepted by the public as the most desirable way of distributing the tax burden. Once the public loses faith in the fairness of a tax system, all taxes have unfavorable incentive effects and effective government becomes difficult as the taxpayers war among themselves and with their Government to escape from taxation.

2. The individual income-tax base

The individual income tax base is a relatively narrow one. Taxable income in 1955 was estimated at only a little over 41 percent of personal income. Some items included in personal income are not required to be reported for tax purposes. Chief among these are: social-insurance payments, imputed incomes, and nontaxable pay and allowances of the armed services. Some items required to be reported are not reported as the result of error or evasion. Some of the income is reported on nontaxable returns. Then huge blocks of reported income are whittled out by the deductions and exemptions allowable under the law. In scale the stepdown from personal income to taxable income is as follows:

Adjustments from personal income to taxable income, estimated for 1955

	Percent
Personal income -----	100.0
Items excluded for tax purposes -----	11.2
Nonreported income -----	7.9
Reported on nontaxable returns -----	5.9
Deductions of taxable returns -----	9.9
Exemptions of taxable returns -----	24.0
Taxable income of individuals -----	41.0
Taxable income of fiduciaries -----	.2
Total taxable income -----	41.3

The narrower the tax base the higher the tax rates required to yield a given amount of revenue. The distorting incentive effects of high marginal rates could be reduced if the tax base could be broadened. It is important, therefore, for the Congress to reexamine carefully the exclusions, deductions, exemptions, and credits that eat into the yield of the individual income tax to be sure that desirable objectives in each case are being attained, and, if attained, to be sure that the economic and social benefits match those that would flow from reduced rates made possible by a broader tax base.

Some items affecting the base and the yield of the individual income tax, including the dividend exclusion and credit, tax-exempt interest, capital gains, percentage depletion, averaging, and enforcement, will be discussed in sections III and IV.

No suggestions are made on the deductions for contributions and medical expenses. They are probably on the generous side, but in matters of this kind it may not be very helpful to offer advice.

The home-produced food consumed on farms is income and should be included in the tax base, but so should the tomatoes from my garden. The importance of this item shades from the negligible to the significant. For administrative reasons unimportant amounts of such income would need to be excluded. At best the item could be included only on an arbitrary basis, as for example, \$100 per capita. This would introduce a new element of discrimination, but one which is not as important as the existing one which results from complete exclusion. Strong resistance would need to be overcome before this item of income could be taxed. This is part of a larger problem, the general undertaxation of farm income on which a recommendation is made in section IV.

There are, however, a number of ways to broaden the tax base and to strengthen the yield of the individual income tax that are both practicable and desirable. These involve: (a) A better alinement of the tax as between renters and homeowners; (b) the elimination of the deductions for interest and taxes generally; (c) the elimination of duplication in the system of exemptions; and (d) a better alinement of the tax as between low-income recipients that derive their income from wages and other taxable sources, and low-income recipients that receive income as transfer payments and wage supplements.

A. Renters v. homeowners.—To put the homeowner on the same basis for income-tax purposes as the renter, it would be necessary to include in his tax base an amount equivalent to the net return on his equity in the house. The renter's income from an equivalent amount of investment that he may have elected to put into, say, bonds or securities, instead of housing is taxed. The owner's income in the form of housing services is not taxed. The renter buys the housing services as he needs them and pays for various costs of managing the rental properties (including depreciation, interest, and taxes) and a margin of profit. The owner's net income from his home is the gross rental value of equivalent property less the cost of maintenance and management (again including depreciation, interest on the mortgage, and property taxes). A short-cut way of arriving at this figure, to avoid records, might be to impute a 3 or 4 percent return on the equity, rebuttable by actual records for those that relish files and arithmetic.

In present law the weights are tipped in favor of the homeowner, not merely by the failure to include some return on the equity in his tax base, but in addition by the allowance of a deduction for interest on the mortgage and for property taxes, which are significant components of rent that cannot be deducted, even in part, by the renter.

The problem of aligning the renter and the homeowner is reflected in the standard deduction. The standard deduction is in lieu of itemized nonbusiness deductions—contributions, interest, taxes, casualty losses, medical and dental expenses and miscellaneous others. For the homeowner interest on the mortgage and property taxes together constitute the most important item of nonbusiness deductions. For him there is often little or no margin left for other items within the standard deduction of 10 percent of adjusted gross income, not in excess of \$1,000. Many elect to itemize their deductions. For the renter, on the other hand, some substantial part of the standard deduction may be viewed as being in lieu of the deduction items associated with homeownership. The standard deduction brings the renter and owner closer together, but not sufficiently close, and it does so in a very crude way, considering the great dispersion in the ratios between itemized deductions and adjusted gross income that obtains in the absence of the standard deduction. Initially the standard deduction was 6 percent; except for this indirect approach to equalization between the renter and the owner, a ratio as high as 10 percent probably never would have been enacted.

The standard deduction has mitigated but has not eliminated the bias in favor of homeownership. The persistence of some such bias should perhaps be taken as reflecting the public's attitude to the problem. In view of the difficulties of getting agreement on the policy issues involved and on the feasibility of taxing imputed rent of owner-occupied homes, the situation appears to call for some compromise solution.

The recommendation is that imputed rent of owner-occupied homes be allowed to remain nontaxable, but that the deduction for personal, nonbusiness interest and taxes generally, including the deductions for interest on mortgages and for property taxes be eliminated. Thus, the subsidy to homeowners would be reduced substantially. Simultaneously, the standard deduction should be reduced by 50 percent—from 10 percent to 5 percent of adjusted gross income, with a limit of \$500 instead of \$1,000.

The elimination of the deductions for personal, nonbusiness interest and taxes generally, including those relating to housing, would increase the yield of the individual income tax by approximately \$2 billion. Homeowners would still continue to get an income-tax advantage from the exclusion of imputed income worth over \$1 billion annually in tax savings. The 50-percent cut in the standard deduction would increase the yield of the individual income tax by roughly $1\frac{1}{4}$ billion.

B. The elimination of the deductions for interest and taxes.—The case for eliminating the deductions for interest and taxes relating to housing has been indicated. The other items now deductible that should be disallowed include interest on personal loans and State and local income, sales, and excise taxes. It is not clear why in principle interest on personal loans should be deductible. Moreover, on practical grounds the deduction is difficult to police and, as litigated cases have shown, it affords the unscrupulous taxpayer a temptation to evade taxes. Similarly, the deductions for State and local sales and excise taxes appear to be without foundation in principle and objectionable in practice. It is difficult to audit the taxpayers' claims. These deductions increase the regressivity of the sales and excise taxes and make a mockery of the excises founded upon the benefit principle. The net sales and excise taxes, after taking into account the effects of deductibility under the progressive Federal income-tax rates, are inversely related to the size of the taxpayer's income.

The case for deductibility of the State and local income taxes—the avoidance of the possibility of confiscatory taxes—is only persuasive so long as the Federal income tax rates are maintained at their present excessively high levels toward the top of the scale. Since, as indicated below, these rates should be reduced even if the base is not broadened, but particularly if it is, it will be practicable to eliminate deductibility for income taxes without risking confiscation. The States that allow deductibility of Federal income taxes—about two-thirds of all the States that levy State income taxes—might well retaliate by simultaneously eliminating this deduction. While the larger incomes are gathered beyond any one State's boundaries, it is not clear why it is nonetheless appropriate for some States like New York and California to tax their wealthier residents on the whole of their incomes while other States tax theirs only on the part, sometimes the lesser part, remaining after Federal tax. Most States could well use the little extra revenue that the elimination of deductibility would bring them. The pressure for State revenues and advances in interstate cooperation can be relied upon to prevent competitive tax cutting to attract wealthy taxpayers, and the

fear of migration can at the same time be expected to so discipline the States as to avoid raising their taxes to the point where they would impinge unduly upon the Federal revenues from the income tax.

C. *The elimination of special exemptions.*—Under present law the aged and the blind get an additional exemption. This means that if the taxpayer is 65 or over he is allowed 2 exemptions of \$600 or \$1,200 altogether, and if he is also blind, 3 exemptions or \$1,800. The same treatment is accorded his spouse but not other dependents. These special exemptions introduce a substantial element of discrimination. Unfortunately the blind are only one of many disability groups that suffer from handicaps in life. Chronological age is not a satisfactory measure of fitness, and fitness is not an acceptable measure of taxable capacity under the income tax. The social security system, which now approaches universal coverage, is an elaborate institution especially designed to provide benefits for those 65 and over, and now also for the disabled. The benefits under this system can be better adjusted to meet some rational standard than can the hidden benefits under the graduated income tax which are progressively scaled to income. The public would be in better position to evaluate the sum total of benefits that are desirable for older and disabled persons if they were kept together in one place under the social security system, and if they were brought into the open instead of being in effect concealed among the income tax deductions.

It is recommended that benefits for the aged, the blind, or any other handicapped group be handled under social security, not in the form of special exemptions under the individual income tax.

If special exemptions for the aged and the blind were eliminated from the individual income tax and benefits for them were adjusted upward under OASI, then these extra OASI costs would need to be financed, under current policy, with higher payroll taxes. Any reduction in income tax rates made possible by such a shift would require an increase in payroll rates to finance the higher OASI costs.

Under present law the earnings of dependents are not taxed to anyone if earnings do not exceed \$600. The excess over \$600 is taxed to the child as a taxpayer, but the parent may also claim the child as a dependent (if the child is under 19 years or over 19 years and still attending school and the parent provides more than one-half the support). In effect, then, for children that are earners there are two exemptions, and for those that are not only one exemption. Clearly this is illogical. The rule prior to 1954 was that once the child became a taxpayer it ceased to be a dependent. This rule was unsatisfactory because it inhibited the children from crossing the \$600 earnings line for fear of doing financial injury to their parents. The \$600 exemption is worth more in tax saving to the higher bracket parent than to the child. Under the old rule, the family would lose if the child broke through the \$600 earnings barrier. This too did not make sense.

It is recommended that the taxpayer be required to include in his return the amount of income (in excess of \$100 or so, for administrative reasons) received by any person whom he claims as a dependent.

The effect of this would be to sweep into the tax base the small amounts of income of dependents between the administrative minimum and \$600 that now escapes tax, and to deny dependent status to those who earn over \$600 because there would be a tax saving if such earners were dropped as dependents and became independent taxpayers. The elimination of the special exemption for dependents with earnings would increase the yield of the individual income tax by roughly \$0.1 billion.

D. *Transfer payments and wage supplements.*—The basic protection from the impact of income taxes should be provided by the personal exemptions. Otherwise the income tax should be comprehensive in its coverage. If benefits of one kind or another are excluded some of the recipients of the excluded income, especially if the flow is from more than one source, are likely to do better than some of the taxable low-income recipients. Such discrimination would be obviated if all sources of income above the personal exemptions passed through the tax mill.

It is recommended that exclusions for: (1) Old age and survivors and railroad retirement insurance benefits; (2) unemployment compensation; (3) temporary disability benefits under workmen's compensation, and sick pay; (4) nontaxable military pay and allowances; (5) mustering-out payments to members of the Armed Forces; (6) veterans' pensions; and (7) readjustment and subsistence allowances to veterans be eliminated and with them the credit for retirement

income which is designed to equalize the tax treatment of private pensions and social-security benefits. Since the OASI and railroad retirement benefits are supported in part by the contributions of the beneficiaries, they should be taxable under the annuity rule which permits the recovery of the investment tax free during the average life expectancy of the beneficiary.

Social-security payments are large and will continue to grow as the system and the population matures. The exclusion of these very large amounts from the tax base will become progressively less defensible as the tax burden of carrying the benefits increases. If all these exclusions and the credit for retirement income were eliminated, the yield of the individual income tax would be increased by about \$2 billion.

In summary, the revisions of the individual income-tax base recommended here would add \$5.8 billion to its yield as follows:

<i>Item</i>	<i>Effect on yield</i>	<i>Billions of dollars</i>
Elimination of the deductions for interest and taxes-----		2.0
Reduce standard deduction by 50 percent-----		1.3
Eliminate special exemptions for aged, blind, and earnings of dependents--		1.5
Eliminate exclusions for social security, veterans, etc., and credit for retirement income-----		2.0
		5.8
Total increase in yield-----		5.8

¹ \$0.4 billion of this relates to special exemptions for the aged and the blind.

There is no disposition to take issue with a humane approach to the handicapped. If the increase in income-tax revenues of about \$0.4 billion from the elimination of the special exemptions for the aged and the blind were to be offset by an increase in social-security expenditures for additional benefits of like amount, there would be no net increase in Federal receipts over expenditures, on a cash basis. Some adjustments may also need to be made in the social-security benefits, and in the other benefits now excluded from the income-tax base.

(c) The starting rate is also too high and is applicable to too wide a bracket of income, the first \$2,000 above exemptions of single persons, and the first \$4,000 of exemptions of married couples. While the exemptions provide a substantial amount of progression for the lower income taxpayer, considering the impact of the overall Federal tax system, and particularly the United States system as a whole, there would seem to be need for much more progression in the lower regions of the income tax base. There is merit to rate progression beyond equity considerations--it increases the automatic responsiveness of the yield to changing economic conditions and helps to maintain stability.

(d) The rates applicable to single persons and married couples filing separate returns, those applicable to heads of households, and those applicable to married couples filing joint returns are substantially different, decreasing in severity without apparent rationale for the large differences (tables 2 and 3).

The distribution of the number of taxpayers, the tax base, and the tax, as estimated for calendar year 1956, by taxable income brackets is shown in table 4.

3. The individual income tax rates

The individual income tax rates are obsolete. They are a legacy from the great depression and war. The top rates were moved up sharply in depression in quest of the redistributive potentialities of the graduated income tax, and they were maintained in the periods of war and inflation to support or to help win support for the increases in the starting and other rates at the bottom of the scale that were needed to meet the large revenue requirements. With the long period of postwar prosperity there has come a more widespread distribution of income and with the growth of the economy the pressures for revenue have lessened, despite continuing high levels of security expenditures. It is now feasible to revise rates so that the individual income tax may better conform to the requirements of economic growth and stability.

The rates are defective in four respects:

(a) The top rates reaching at the extreme to 91 percent are too high and so tend to prejudice work and investment incentives.

(b) The high top rates are mitigated by many special provisions with the result that these rates apply in a discriminatory way among the upper income groups.

TABLE 3.—*Marginal individual income tax rates*

Taxable income (in thousands)	Marginal rates			Taxable income (in thousands)	Marginal rates		
	Single persons and married persons filing separate returns	Heads of house- holds	Married couples filing joint returns		Single persons and married persons filing separate returns	Heads of house- holds	Married couples filing joint returns
0 to \$2.....	20	20	20	\$44 to \$50.....	72	66	59
\$2 to \$4.....	22	21	20	\$50 to \$52.....	75	68	59
\$4 to \$6.....	26	24	22	\$52 to \$60.....	75	68	62
\$6 to \$8.....	30	26	22	\$60 to \$64.....	78	71	62
\$8 to \$10.....	34	30	26	\$64 to \$70.....	78	71	65
\$10 to \$12.....	38	32	26	\$70 to \$76.....	81	74	65
\$12 to \$14.....	43	36	30	\$76 to \$80.....	81	74	63
\$14 to \$16.....	47	39	30	\$80 to \$88.....	84	76	69
\$16 to \$18.....	50	42	34	\$88 to \$90.....	84	76	72
\$18 to \$20.....	53	43	34	\$90 to \$100.....	87	80	72
\$20 to \$22.....	56	47	38	\$100 to \$120.....	89	83	75
\$22 to \$24.....	59	49	38	\$120 to \$140.....	89	83	78
\$24 to \$26.....	59	52	43	\$140 to \$150.....	89	83	81
\$26 to \$28.....	59	52	43	\$150 to \$160.....	90	87	81
\$28 to \$32.....	62	54	47	\$160 to \$180.....	90	87	84
\$32 to \$36.....	62	58	50	\$180 to \$200.....	90	87	87
\$36 to \$38.....	65	58	53	\$200 to \$300.....	91	90	89
\$38 to \$40.....	65	62	53	\$300 to \$400.....	91	91	90
\$40 to \$44.....	69	62	56	\$400 and over.....	91	91	91

TABLE 4.—*Estimated cumulative number of taxpayers, their taxable income, and tax distributed by taxable income brackets for calendar year 1956*

Taxable income bracket (\$000)	Total other than heads of households		
	Cumulative number of taxpayers ¹	Taxable income ²	Tax ³
	<i>Thousands</i>	<i>Millions</i>	<i>Millions</i>
Not over \$2.....	77,871	\$90,649	\$18,130
\$2 to \$4.....	17,787	18,241	4,013
\$4 to \$6.....	4,821	6,222	1,618
\$6 to \$8.....	2,124	3,584	1,075
\$8 to \$10.....	1,491	2,537	863
\$10 to \$12.....	1,102	1,840	699
\$12 to \$14.....	777	1,381	594
\$14 to \$16.....	603	1,063	500
\$16 to \$18.....	476	820	410
\$18 to \$20.....	392	633	336
\$20 to \$22.....	281	505	283
\$22 to \$26.....	227	751	443
\$26 to \$32.....	153	719	446
\$32 to \$38.....	89	457	297
\$38 to \$44.....	67	308	212
\$44 to \$50.....	45	227	164
\$50 to \$60.....	31	265	199
\$60 to \$70.....	24	180	140
\$70 to \$80.....	12	101	82
\$80 to \$90.....	9	74	62
\$90 to \$100.....	6	51	44
\$100 to \$150.....	5	151	135
\$150 to \$200.....	2	68	61
Over \$200.....	1	133	121
Total.....		130,962	30,926

Taxable income bracket (\$000)	Heads of households		
	Cumulative number of taxpayers	Taxable income ²	Tax ³
	<i>Thousands</i>	<i>Millions</i>	<i>Millions</i>
Not over \$2.....	700	\$1,174	\$235
\$2 to \$4.....	437	497	104
\$4 to \$6.....	113	158	38
\$6 to \$8.....	56	96	25
\$8 to \$10.....	38	68	20
\$10 to \$12.....	28	51	16
\$12 to \$14.....	22	40	14
\$14 to \$16.....	18	32	12
\$16 to \$18.....	15	27	11
\$18 to \$20.....	13	23	10
\$20 to \$22.....	10	20	9
\$22 to \$24.....	9	16	8
\$24 to \$28.....	7	24	13
\$28 to \$32.....	5	18	10
\$32 to \$38.....	4	21	12
\$38 to \$44.....	3	16	10
\$44 to \$50.....	2	12	8
\$50 to \$60.....	2	13	9
\$60 to \$70.....	1	8	6
\$70 to \$80.....	1	6	5
\$80 to \$90.....	(4)	4	3
\$90 to \$100.....	(4)	3	3
\$100 to \$150.....	(4)	9	7
\$150 to \$200.....	(4)	2	2
\$200 to \$300.....	(4)	1	1
Over \$300.....	(4)	1	1
Total.....		2,341	592

¹ Married couples filing joint returns are counted as 2 taxpayers, each with one-half of the combined income.

² Does not include long-term capital gains subject to the alternative rate.

³ Does not include the alternative tax and is before the 87 percent limitation, the retirement income credit, and the dividend received credit.

⁴ Less than 500.

These tables reveal some important characteristics of the present individual income tax:

(a) The marginal rates are high at the top. They rise rapidly, but at markedly different rates depending upon the marital status of the taxpayer. Thus, the 50-percent rate is reached at \$18,000 for a single person, \$24,000 for a head of household, and \$36,000 for a married couple; the 75-percent rate is reached at \$60,000 for a single person, \$80,000 or a head of household, and \$120,000 for a married couple; and the 91 percent rate is reached at \$200,000 for a single person, \$300,000 for a head of household, and \$400,000 for a married couple.

(b) A change in marital status can result in very large differences in tax. The tax on a single person with taxable income of \$20,000 is \$7,260; a head of household with the same taxable income pays \$6,260; and a married couple, \$5,280. Marriage may not seem to be such an unreasonable tax bargain at this level. But at \$100,000 the corresponding figures are \$67,320, \$60,480 and \$53,640; and at \$200,000 the figures are \$156,820, \$145,480 and \$134,640.

In general the personal exemptions are supposed to carry the burden of allowing for differences in taxpaying capacity arising from differences in marital status and size of family. Beyond these allowances which are most significant for low incomes, there was no deliberate attempt to adjust the tax burden to differences in taxpaying capacity of taxpayers with different family responsibilities. Existing differences were not planned that way. They arose from income splitting enacted in 1948 which leveled on entirely different problems—first, the problem of achieving geographic uniformity in tax as between community property and the other States and secondarily, the problem of aligning the treatment of earned and unearned income. Splitting was established in the community-property States and was spreading to other States. It was also spreading all over the Nation with respect to property income. The higher earned income recipients were at a tax disadvantage. By 1951 the Congress could no longer overlook the incidental but important tax consequences of income splitting as it prejudicially affected single taxpayers. Thus, it extended to heads of households, single persons with substantial family responsibilities, roughly one-half the benefits of income splitting. In 1954 the Treasury recommended that full income splitting be extended to single persons who support parents, children, grandchildren, brothers, and sisters. Instead, the Congress decided only to ease the transition in marital and tax status by allowing full income splitting for those whose spouse had died during either of the 2 preceding years; thereafter only about half the benefit on income splitting would become applicable.

There is at present no satisfactory basis for differentiating the rates of the income tax according to marital status.

It is recommended that the existing differentiation in rates by marital status be eliminated by extending full income splitting to all single taxpayers and to heads of household.

This would cost roughly \$0.5 billion in revenue. This estimate includes the cost of going the rest of the way with respect to heads of households and covering the relatively few footloose single persons that are now entirely outside the umbrella of income splitting. This proposal would not undo what income splitting has done to solve the community property problem and to equalize the treatment between earned and unearned income. It would merely eliminate the unplanned rate differentiation which accidentally became, perhaps, the most significant feature of income splitting.

(c) As estimated for calendar year 1956, about 77 percent of the taxpayers do not have taxable income in excess of the first bracket. They are subject only to the starting rate. They account for 69 percent of the tax base and 58 percent of the tax.

It is recommended that the first bracket be split and a lower rate be made applicable to the first block of income within the present first bracket.

This would step up progression, improve the fairness of the tax and make its yield more responsive to changing economic conditions. The administrative and compliance problems growing out of a split first bracket have been greatly mitigated by the experience gained in recent years with the use of tax tables to determine income-tax withholdings and tax liabilities for the great majority of income-tax payers.

The individual income-tax rate schedule needs to be revised throughout, not merely at the bottom of the scale.

If the base is broadened, and international emergencies subside so as not to require an expansion of defense expenditures beyond those recently planned for the future, then, there will be room for tax reduction without unbalancing the budget. But whether and when there actually should be tax reduction will

depend on economic conditions. If full income splitting were made general and all the base-broadening items were adopted, the yield of the individual income tax would be increased by \$5.3 billion; \$5.8 billion gained from the revisions of the tax base less \$0.5 billion lost from the additional income splitting.

For illustrative purposes, rate schedules to reduce the individual income-tax yield by \$5.3 billion and \$2.6 billion are provided. In matters of this kind, it is well to count only every other chicken. Even if the most optimistic assumptions were to become reality, it would be desirable to use some of the revenue gained from broadening the individual income-tax base to finance some of the more desirable revisions which are recommended in later sections of this paper. The more the base is broadened, however, the more is it possible to make significant tax reductions in the middle brackets. If the first bracket is to be split, a tax rate reduction schedule of \$2.5 billion necessitates that the reductions be confined largely to the lower brackets (table 5).

TABLE 5.—*Revised individual income tax rate schedules to reduce revenues by \$5.3 billion and by \$2.6 billion*

Taxable income bracket	Present law	Schedule to lose about \$5.3 billion ¹	Schedule to lose about \$2.6 billion ²
	Percent	Percent	Percent
Not over \$750.....	20	15	17
\$750 to \$1,000.....	20	15	19
\$1,000 to \$2,000.....	20	17	19
\$2,000 to \$4,000.....	22	21	21
\$4,000 to \$6,000.....	26	25	25
\$6,000 to \$8,000.....	30	27	29
\$8,000 to \$10,000.....	34	29	33
\$10,000 to \$12,000.....	38	31	37
\$12,000 to \$14,000.....	43	33	42
\$14,000 to \$16,000.....	47	35	46
\$16,000 to \$18,000.....	50	37	49
\$18,000 to \$20,000.....	53	39	52
\$20,000 to \$22,000.....	56	41	55
\$22,000 to \$26,000.....	59	43	58
\$26,000 to \$32,000.....	62	45	61
\$32,000 to \$38,000.....	65	47	64
\$38,000 to \$44,000.....	69	49	65
\$44,000 to \$50,000.....	72	51	66
\$50,000 to \$60,000.....	75	53	67
\$60,000 to \$70,000.....	78	55	67
\$70,000 to \$80,000.....	81	57	68
\$80,000 to \$90,000.....	84	59	68
\$90,000 to \$100,000.....	87	63	69
\$100,000 to \$150,000.....	89	66	69
\$150,000 to \$200,000.....	90	68	70
Over \$200,000.....	91	70	70

¹ In this schedule the rate on the first \$1,000 of taxable income is reduced 5 points. Significant additional reductions are made in the middle and upper brackets to scale to a top 70 percent at \$200,000.

² In this schedule the rate on the first \$750 is reduced 3 points, the remaining rates, in general, 1 point, with minor additional adjustments to scale to a top 70 percent at \$150,000.

III. THE CORPORATION INCOME TAX

1. *The role of the corporation income tax in the tax system*

The Federal revenue from the corporation income tax is about two-thirds the amount received from the individual income tax. If this tax were completely eliminated the whole of the revenue now derived from it would not be lost, because some substantial portion of the tax saved by corporations would be distributed in dividends, thus increasing the individual income-tax base. Even the retained part of the tax saved would to some extent swell the individual income-tax base. The higher retained profits would be reflected at least partly in higher prices of the corporate securities. As these were traded in the security markets the stockholders would realize taxable capital gains. Elimination of the corporation income tax would also increase the yield of the estate tax to some extent since the value of corporate securities would rise. It would be optimistic, however, to expect that as much as \$3 billion of the \$21 billion revenue lost from the repeal of the corporation income tax would be recaptured under the other Federal taxes. Net of all offsets, the corporation income tax now contributes about \$18 billion of revenue.

The high revenue potential of the corporation income tax and the fact that it is administratively relatively simple to collect are its chief attractions. It has others. Profits are highly responsive to changing economic conditions. The corporation income tax powerfully reinforces the individual income tax as a built-in stabilizer. It is an essential integral part of any income-tax system because, without a corporation income tax and with no penalty for the unreasonable accumulation of corporate profits, a substantial part of the individual income-tax base could hide away in the form of retained corporate profits. This problem was recognized at the outset and in one form or another the corporation income tax was reinforced with special penalty taxes for the unreasonable accumulation of profits to avoid individual surtax. If retained profits were adequately reflected in security prices and if capital gains were taxed at the same, or approximately the same rates as other income, the individual income tax would need to rely less upon the special penalty tax on accumulations, and upon the corporate income tax itself to reach effectively corporate retained profits, but without some low annual tax on retained profits, tantamount to an interest charge, the difference in the timing of the individual income tax as it applied to retained profits as against distributed profits would still constitute a substantial problem of tax avoidance. Actually studies have shown that retained corporate profits are only partially and imperfectly reflected in security prices, and the capital-gains rates are only half the regular rates for the taxpayers in the lower brackets and substantially less than that for upper bracket taxpayers.

A multiplicity of principles, including privilege, faculty and all that, have been advanced to support the corporation income tax, but the case for maintaining the tax at about its present strength in current circumstances boils down to the fact that we do not know where to go for superior replacement revenue. It has its faults: it shrinks the funds and incentives to invest; it encourages debt financing as against equity financing; it overtaxes the stockholders with law incomes; illogically, it adds less and less net burden over and above the individual income tax, as the size of the stockholder's income increases; it fits awkwardly and differently on such institutions as cooperatives, insurance companies of various types, investment companies, mutual savings banks, building and loan association, Western Hemisphere corporations, and utilities; and in many situations, even when the profits are retained it overtaxes small corporate business by comparison with unincorporated business. Some indeterminate part of this tax is shifted and has the attributes of a sales tax. It also affects consumption through its impact on dividends. But, as the catalogue of complaints suggests, the bulk of this tax is probably borne by the stockholder and impinges primarily on corporate savings and investment.

2. The corporation income-tax rates

The corporation income-tax rates until April 1, 1957, are 30 percent normal tax plus 22 percent surtax on the bracket of income in excess of \$25,000. Thus, amounts of corporate income up to \$25,000 are taxed at 30 percent, and amounts above that figure are taxed at a combined rate of 52 percent. On April 1, 1957, the normal tax rate of 30 percent reverts to 25 percent, so the combined rate becomes 47 percent. This change would cost over \$2 billion of revenue.

Senator Fulbright has introduced a bill to favor small business which would reverse the normal and surtax rates: the normal tax would become 22 percent and the surtax 30 percent on amounts of income in excess of \$25,000. Such a change would cost roughly \$400 million.

If in addition to reversing the rates the exemption for surtax were raised from \$25,000 to \$100,000, the combined revenue cost would be roughly \$1.4 billion.

In addition the normal tax rate were reduced from 22 to 20 percent the combined revenue cost would be roughly \$2.2 billion, whereof \$0.8 billion would go to relieve corporations with net incomes of less than \$100,000.

The recommendation is that the corporate normal and surtax rates be reversed effective for 1957 and that further reduction in the corporate normal tax rate to 20 percent and an increase in the corporate surtax exemption from \$25,000 to \$100,000 be postponed. These items should, however, be given a priority next to reductions in the individual income tax rates.

To secure the benefit of multiple use of the surtax exemption, there is a tendency, even under present law, to create a parent with several subsidiaries or to create several corporations owned by one family. Under the recommendation this form of tax avoidance would be aggravated unless it were provided that, entirely without regard to the motive for the multiple corporations, whether it

be tax avoidance or business reason, a group of related corporations should have only one surtax exemption—this to extend to parent-subsidiary relationships and to corporations owned substantially by the same shareholders.

3. Integration with individual income tax

The great majority of corporations are small (table 6).

TABLE 6.—Estimated distribution of corporation returns with taxable net income, by taxable income classes (excluding life-insurance companies) for the calendar year 1956

Taxable net income class	Number of returns	Taxable net income	Tax liability
		<i>Millions</i>	<i>Millions</i>
Under 25.....	337,000	\$1,980	\$594
25 to 50.....	35,000	1,220	442
50 to 75.....	15,000	920	306
75 to 100.....	7,500	650	297
100 and over.....	30,500	36,030	18,567
Total.....	425,000	40,800	20,296

It does not seem reasonable to many that small corporations should be taxed differently than are proprietorships or partnerships. In his budget message for 1955 the President stated: "Small businesses should be able to operate under whatever form of organization is desirable for their particular circumstances, without incurring unnecessary tax penalties. To secure this result, I recommend that corporations with a small number of active stockholders be given the option to be taxed as partnerships and that certain partnerships be given the option to be taxed as corporation."

The Congress acted favorably on part of this recommendation. It extended to some types of partnerships the option to be taxed as corporations, but it did not extend to small corporations the option to be taxed as partnerships. Under the existing structure of rates this recommendation would merit further exploration and adoption, unless such exploration uncovers serious practical obstacles. In this connection it should be noted that there is substantial uncertainty whether the complicated partnership rules are appropriate for partnerships. It would seem desirable to dissipate this uncertainty before seriously considering the extension of the partnership treatment to small corporations. It should be recognized further that (1) many small corporations pay little corporate tax because of the salary deduction, (2) a practical option exists now for many small corporations, since the barriers to operating like partnerships are not too difficult to surmount, and (3) if the exemption for surtax were raised to \$100,000 and the normal tax dropped to 20 percent, there would be less need for the adoption of the partnership option for small corporation, than under present law. Still, while a substantial measure of equality of tax treatment between the incorporated and unincorporated forms of business organization would have been achieved, the stockholders of small corporations still would not be able to offset the corporate losses against their income from other sources, as can the owners of unincorporated business.

Assuming the adoption of the recommendations on corporate rates and surtax exemption, the integration problem, better known as the double taxation problem, falls essentially outside the small business area. It results from the extra burden which the corporation income-tax imposes on the stockholders, an extra burden which under a progressive individual income tax diminishes with the size of the stockholder's income. There is double taxation with respect to the dividends, because they are not allowed as a deduction in arriving at the taxable corporate income. Even the retained profits are reached for extra tax under the individual income tax, but they are reached only when reflected in a capital gain. Not all retained profits are so reflected and the capital gains tax rate is low. While there is an integration problem both with respect to undistributed and distributed profits, it is much more important, and fortunately it is also easier to provide a solution, for that part of the problem which relates to distributed profits.

The recommendation on integration of the corporate and individual income tax is that corporations be allowed a deduction initially to the extent of 10 percent of dividend payments. Simultaneously, the present dividend exclusion and credit

under the individual income tax should be repealed. As circumstances permit the deduction for dividends should be increased. It would serve little purpose, however, to speculate now about a desirable "destination" percentage for the dividend deduction.

The net revenue cost of these proposals in combination would be \$0.2 billion. The deduction of 10 percent of dividend payments would cost about \$0.6 billion, but this would be offset to the extent of about \$0.4 billion by the repeal of the dividend exclusion and credit.

The present dividend exclusion and credit are too small to be very significant as incentives to invest in equities, but if they can be justified it is only on these grounds. As a method of integrating the corporation and individual income taxes they are technically defective. For present purposes the dividend exclusion which is tied to equity or administrative considerations may be disregarded. The relief from double taxation afforded by the credit is 4 percent of dividends received. Since the burden of double taxation decreases with the size of the stockholder's income, the proportional credit as a percentage of the burden increases. To illustrate, the burden of double taxation on \$100 of corporate income taxed to the corporation at 50 percent and distributed to a stockholder in the 80 percent bracket is \$10 [(\$50+80% of \$50)—\$30] as against \$40 [(\$50+20% of \$50)—\$20] for a stockholder in the 20 percent bracket. The credit for dividends received is \$2 in both cases. Thus, the credit relieves 20 percent of the double taxation burden for the stockholder in the 80 percent bracket, as against 5 percent for the stockholder in the 20 percent bracket.

The proposed 10 percent deduction for dividend payments would by contrast make a proportional reduction in the burden from double taxation. This may be illustrated as follows: let dividends paid out equal \$100 and assume that this represents total profits after tax at the rate of 50 percent. Then corporate profits before tax would be \$190 [$x - (.5(x-10)) = \100]. The corporate tax is 50 percent of [\$190—\$10] or \$90. By assumption the remainder is distributed: if to a stockholder in the 80 percent bracket, the combined tax is \$170; and if to a stockholder in the 20 percent bracket, the combined tax is \$110. Without the 10 percent deduction the corresponding figures would have been \$171 [50% of \$190+80% of \$95] and \$114, [50% of \$190+20% of \$95]. With complete elimination of the corporation tax, the figures would have been \$152 (80% of \$190) and \$38 (20% of 190). The excess burden on account of the corporate tax is therefore \$19 for the 80 percent stockholder and \$76 for the 20 percent stockholder. The 10 percent deduction for dividends eliminates \$1 of this for the 80 percent stockholder (\$171—\$170) and \$4 for the 20 percent stockholder (\$114—\$110). In both cases one-nineteenth of the excess burden is eliminated.

IV. SPECIAL PROBLEMS IN INCOME TAXATION

A number of difficult problems, affecting both the individual income tax and the corporation income tax, have long awaited satisfactory solution. Among the more important are: averaging; capital gains and losses; tax-exempt securities; depreciation; depletion; and enforcement.

1. *Averaging*

The Federal income tax, from its inception, has been without a general averaging system. This defect has become increasingly serious as the coverage and the rates have increased and the tax has become more progressive. Even if in the future tax rates are reduced substantially the institution of a general averaging system will continue to have a high priority among the desirable Federal tax revisions.

Averaging tends to relieve the depressing effects of high marginal rates on risk assumption and fluctuating incomes. It would greatly improve the fairness of the income tax and the public's disposition toward it. Even if the tax were proportional there would be need for an averaging system to handle the problem of unused personal exemptions which is important for many small taxpayers. Except for this problem, a long carryover period for net losses would be adequate if the tax were proportional. It would average the positive and negative incomes. But with progression the need for averaging arises even if the law were to contain carryover provisions adequate to take care of unused exemptions and the loss situations. With the institution of averaging, however, there would be no need for a carryover of unused exemptions and it would not be necessary to continue the net loss provisions.

In addition to the net loss offsets, the present law contains other limited averaging provisions.¹

(a) Where an individual receives (or accrues) in a single year 80 percent of the total compensation for a job in which he was engaged for more than 36 months, he can spread the compensation over the period of employment. If the compensation is from a partnership and if the individual was a member of the partnership for at least 36 months before, it may be spread in the same manner, except that the spreading period is limited to the period during which the individual was continuously a member or an employee of the partnership earning the compensation, if this period is shorter than the period the partnership was employed on the job.

(b) A similar provision applies with respect to income from an invention or artistic work. If the work covered a period of 24 months or more and such income for the taxable year is not less than 80 percent of the total income for the invention or artistic work, including the 12 months following the close of the taxable year, then, to the extent that such income is not long-term capital gain, it may be spread back over the period of work but not in excess of 60 months in the case of a patent covering an invention, or 36 months in the case of literary, musical, or artistic composition and copyrights covering the same.

(c) Where an individual receives in a lump sum the proceeds of an annuity or endowment contract in 1 year, the tax cannot exceed the tax determined by spreading the proceeds in equal installments over the taxable year and the 2 preceding years.

In the absence of general averaging, it has become the practice for the Congress to alleviate various types of lumpy or irregular incomes from the impact of the regular income tax rates by making applicable the capital gains rate of 25 percent. Among the situations covered in this manner are: Lump-sum distributions from qualified pension plans on account of death, retirement, or other separations; shares acquired in stock options, livestock, unharvested crops, and five or fewer lots from real estate acquired for investment.

The taxpayers persistently keep pushing the Congress in the direction of extending similar treatment to other situations and the courts find it increasingly difficult to draw the line differentiating justly between situations. Thus the Mayer provision² may be the hole in the dike through which eventually will pass lump-sum distributions from unqualified pension plans. Congress has already had to face the question: If capital gains treatment is appropriate for livestock then why not for turkeys and chickens? Court cases have extended capital gains treatment to sales of oil and gas rights and sulfur royalties and, without the Treasury's acquiescence, to in-oil or in-minerals payments for oil or mineral property. These are symptoms of the pressures to which the Congress is being subjected and the difficulties it will continue to encounter with the present trend of substituting capital gains treatment for averaging. In some cases, as for example, coal, timber, and sulfur royalties, the application of the capital gains rate is an outright tax preference unrelated to the averaging problem, for no lumpy income source is involved. But such brazen preferences are easier to press upon the Congress and the courts because of the road that the Congress elected to follow in handling the averaging problem in its manifold manifestations.

So long as the capital gains rate is substantially below the income-tax rates some of these pressures will persist even after averaging is adopted. Congress will need to continue to defend the tax base from such inroads as are attempted through the collapsible corporation and the various schemes for bailing out dividends in the form of capital gains. The lure of a low capital gains rate will still result in extinguishing, through sale or liquidations, many family and closely held businesses. Averaging would ease problems of tax avoidance generally, but it would be particularly helpful with respect to the many lesser ones. In most cases, where the averaging element is clearly discernible, the Congress has found it impracticable to deny the claimant. Of the two available routes—capital gains or the spread-back (secs. 1301–1302 style), the first is both simpler and more generous. There has been little disposition to use the second.

¹The most important of these are in secs. 1301–1304 of the 1954 Internal Revenue Code which superseded sec. 107 of the 1939 Internal Revenue Code.

²Sec. 1240 of IRC of 1954.

Despite the growing list of capital gains beneficiaries many income-tax problems with an averaging component remain unrelieved. Among the unrelieved taxpayers are: the professions, athletes, entertainers, most artists, the farmers, and fishermen and other primary producers, small businesses and the developer of new products, the recipients of accumulated dividends on preferred stock and delinquent or accumulated interest, and the many small taxpayers with low incomes that lost the tax benefit from unused personal exemptions. The high-paid executives are only partly relieved to the extent that they are covered under qualified pension plans. The list is by no means complete but perhaps it is sufficient to indicate that averaging problems will continue to press for solution. Those who are beneficiaries neither from capital gains nor from the rudimentary averaging provisions of the present law feel and emit a sense of unfairness. They, in combination with those now unjustly relieved, tend to undermine the solidarity of the American taxpayers. For this reason early action on the averaging problem is becoming imperative.

In the individual income tax it is perhaps not desirable to strive for an averaging period longer than 5 years. This is not a long enough period to solve the averaging problems of all taxpayers. To solve the averaging problems for the professions and the executives, for example, would require lifetime averaging. But apart from administrative considerations, the case for lifetime or long-period averaging is weak. If the averaging period is long, at the extreme a life span, gross injustices would result from an averaging formula that yielded the same lifetime taxes for the same aggregates of income if the constituent annual amounts were distributed on a substantially different time pattern. It offends against a proper cross sectional distribution of the tax load. It is the living that judge whether the cross sectional alinement of taxes comports with their political tastes. It is not sufficient that the right tax answer turn up at death. The living are likely to think of a few things: even if interest is taken into account, a dollar in year 1 is not the same as a dollar in year N; it is not the same because the economic environment from which the dollars flow may have had entirely different characteristics and potentialities for the reaping of incomes. This is particularly so if prices have changed appreciably over the averaging period. In emergencies like war this point is recognized and tax systems are adjusted to take it into account, but in a lesser way the same considerations apply in peacetime. The dollars in the troughs and peaks of business cycles are not treated as identical dollars by those responsible for tax and fiscal policy. The quest for stability alone requires differentiation in the tax treatment of these dollars.

Several important experiments with short period averaging have failed. Great Britain, Australia, and Wisconsin tried a moving averaging system which failed primarily because taxpayers were confronted with impossible taxpayments when tax liabilities, determined partly on the higher incomes of prosperity years, fell due and had to be met out of declining incomes in recession. Such an averaging system had perverse economic effects; it increased the difficulties of stabilization. The British surrendered their 3-year averaging plan in 1926. Wisconsin, after a trial of 7 years, gave up its 3-year averaging plan completely by 1934. Australia gave up in 1938 when it limited its 5-year averaging plan to primary producers.

In 1949 Canada adopted an averaging plan for farmers and fishermen. The incomes of primary producers characteristically have a high degree of instability. The Canadian plan is of interest because it is modeled on a general averaging plan long advocated by the late Henry Simons and others. It has the merit of relative simplicity. As originally proposed, the taxpayer would be able to elect to recompute his tax for a 5-year period, including the current year, as if the income had been earned ratably over the period. If the taxes paid were, say, 5 or 10 percent higher than the recomputed taxes, he would be allowed a refund. As regards fiscal policy, it would be unfortunate if such refunds were to fall into periods of boom instead recession. This defect can be mitigated by requiring that the refunds be spread forward for a given number of years to offset the future liabilities. A superior way of handling this problem, perhaps, is suggested as the result of the Canadian experience. It is to replace the block system (that is the one which requires that no year may be repeated in any 5-year averaging period) with one that would allow the averaging period to end in each successive year, provided the years that had previously been included in an averaging period were raised (but not reduced) to the average income assigned to them in such averaging period. This modification of the plan would not only reduce the hardship of waiting for the mitigation of the severity

of the tax to the close of the block of years included in the averaging period, but it would also reduce the chances that the refunds would be destabilizing. There would be less concentration of refunds than under the block system. The Canadian averaging system, so revised, would come close to the spread-back system, section 1301-1302 style.

The spread-back system of the present law can be increased in scope to embrace some of the situations now relieved through capital-gains treatment and still others that are not relieved at all. The basic questions are whether a limited extension of these provisions would, in fact, solve the averaging problems under the income tax and whether it is practical to extend this system without quickly encountering formidable administrative difficulties. These are matters that may need further exploration, but ultimately both are likely to be answered in the negative. The objectives of averaging are to improve investment and work incentives and also to eliminate discriminatory taxation over the whole range of incomes. All taxpayers must have confidence in the fairness of the tax. Small steps to improve the fairness of the tax for the few will yield worthwhile but relatively small results.

The need is for a general averaging plan. It will cost a substantial amount of revenue and requires a major change in administrative procedures. The real obstacle to averaging is the truly monumental administrative task which it would involve, particularly during the initial years. It would be a mistake to institute general averaging before IRS is organizationally prepared for it. Specifically, this means that IRS should first establish an individual account system for each of the many millions of taxpayers. The Government can keep taxpayers' records more effectively than the taxpayers can themselves. With mechanical aids it can also compute the taxes and the refunds under an averaging system with less social cost. In proper administration of a tax system the salient facts about all the economic operations of each taxpayer should be collated and kept as a matter of record and ready reference for several years. In the long run, the cost of a general averaging system will pay for itself many times over in more effective tax administration.

The recommendation on averaging is that the President request the Treasury to prepare a practical averaging plan for the individual income tax by June 30, 1957, with a view to establishing it fully within the next 2 or 3 years, as soon as practical obstacles can be surmounted. When this is done the net-loss provisions should be eliminated for proprietorships and partnerships.

This is a major undertaking of vast importance which should not be prejudiced by hasty preparation after all these years of inexcusable delay.

The recommendations on averaging for corporations are:

(a) The net loss provisions should be continued and liberalized by extending the carryback from the present 2 to 5 years.

(b) Unused surtax exemptions of corporations should be carried back and forward against corporate income subject to the surtax rate for a period of 5 years each way.

These two measures in combination would provide an effective averaging system for corporations.

Since the carryforward period is 5 years, a similar carryback period would give 11 years for the averaging of losses and profits of corporations. Such an extension of the carryback would increase the administrative burden on IRS but is nonetheless desirable for several reasons. It would: (1) Reduce the chance that the tax might impinge upon capital rather than income, with resulting overpayment of taxes; (2) improve incentives to undertake risky ventures and to enter types of business that characteristically have fluctuating profits; (3) increase the built-in flexibility of the tax; and (4) lessen the problem of policing the transferability of losses from corporation to corporation for the purpose of preventing tax avoidance and uneconomic mergers.

The carryover of unused surtax exemptions would tend to equalize the taxes on small business with irregular and stable incomes and to mitigate the severity of the tax on small business generally because it characteristically has irregular income.

2. *Capital gains and losses*

One of the least settled problems in Federal income taxation is the treatment of capital gains and losses. The law has been changed frequently, but it is still unsatisfactory.

In the case of both corporations and individuals, capital gains and losses are for the most part segregated from other income. A distinction is made between

short-term and long-term capital gains and losses. Long-term relates to capital assets held longer than 6 months. In the case of corporation, net long-term capital gains (the excess of long-term capital gains over long-term capital losses) in excess of net short-term capital losses (the excess of short-term capital losses over short-term capital gains) may be taxed at an alternative rate of 25 percent, if segregation results in less tax than subjecting the excess to the regular rates. In the case of individuals, the excess of net long-term capital gains over net short-term capital losses may likewise be taxed at an alternative rate of 25 percent, if segregation results in less tax than subjecting 50 percent of the excess to the regular rates. In the case of corporations, with an exception to be noted later, capital losses are allowed in the current year only to the extent of capital gains, where as capital losses of individuals are in addition allowed to offset other income up to a limit of \$1,000 a year. Both corporations and individuals are allowed a 5-year carryover of net capital losses, treated as short-term capital losses.

It is not difficult to understand how the case for segregation of capital gains and losses developed. The niggardly treatment of capital losses in the past has resulted from a desire to protect the revenue, particularly in depressions. It developed before it was as well understood as it is now that fluctuating revenues are compatible with a stabilized economy. Even now it is not feasible to permit the offset of capital losses against other income without limit. The volume of loss-laden assets is always substantial. If capital losses were permitted to offset other income without limit the taxpayers could embarrass the Government's fiscal policy by an unfortunate timing of sales in periods of expansion to wipe out substantial amounts of the tax liabilities. Moreover, some feel that these accumulated losses are for the most part bygones that should not be liquidated belatedly at public expense. As for capital gains, the higher the income-tax rates rose the less reasonable did it become to subject amounts accrued over substantial periods to the full tax rates in the year of realization. In the absence of averaging a lower rate was made applicable to capital gains early in the history of the income tax. Averaging would have mitigated the extremes in the favorable treatment of capital gains and the discriminatory treatment of capital losses, but it would not have prevented some differentiation.

It should be recognized that the case for favorable treatment of capital gains rests in part on a disposition to stimulate economic incentives and to eliminate tax interference with normal business processes. Even in the absence of a general averaging system several improvements can be made in the treatment of capital gains and losses, but, of course, it would be possible to go much further in liberalizing the treatment of capital losses and in taxing capital gains if an averaging system were adopted.

A. *Capital loss offset against ordinary income.*—Capital losses of corporations and individuals are now allowed to offset only capital gains, with two exceptions: First, net losses on property used in a taxpayer's trade or business if held over 6 months are treated as ordinary losses (but net gains are treated as capital gains) and second, in the case of individuals, as previously mentioned, capital losses are allowed against other income up to \$1,000 each year.

No change is recommended with respect to the treatment of losses on property used in trade or business but it is recommended that the net gains on such property, except in the case of compulsory or involuntary conversions (complete or partial destruction, theft, or seizure or an exercise of the power of requisition or condemnation) be taxed as ordinary income. The exception should be eliminated with the adoption of general averaging. This would treat the gains and losses symmetrically.

It would also be desirable to liberalize the capital loss offset against other income of individuals. A net capital loss up to \$6,000 realized in one year can now be offset against ordinary income over a 6-year period.

It is recommended that the annual limit of \$1,000 be raised to \$5,000, so that capital losses of \$30,000 could be offset against ordinary income over a 6-year period. With the adoption of averaging and an upward adjustment of the capital-gains tax to approximate the tax on other sources of income, it is recommended that the annual limit be further increased to \$10,000; and that capital losses be permitted to be carried back for 5 years as well as forward for 5 years as in present law.

These revisions would increase the responsiveness of the income-tax yield to changing economic conditions. It would also improve the climate for risk assumption. The direct investor in small business would benefit and so would

the dabblers in the security markets. It would tend to broaden the participation of the public in the capital markets.

Under conditions of high employment this proposal to raise the annual limit from \$1,000 to \$5,000 would lose about \$100 million annually. Under less favorable conditions, the loss would be higher.

B. The holding period.—The present distinction between short- and long-term capital gains and losses, which divides on capital assets held for 6 months is arbitrary. It would remain so for any other single dividing line. Either the distinction should be eliminated completely or the principle of allowing for the period of accrual should be followed consistently. For some the primary function of the dividing line is to distinguish between speculation and investment, so that gains from speculation can be dealt with more harshly. Even if this were a worthy objective, it is not a type of distinction that is easy to implement. It is true, however, that gains accumulated over long periods would not be taxed fairly if they were taxed the same as gains of like amount realized in a quick turnover of capital. It is as if interest on an investment were accumulated for many years and paid out in lump sum to be taxed at high marginal rates in the year received. If the gain accrues uniformly over the holding period it should be prorated over the holding period. A gain realized on an asset held 25 years should be treated differently than a gain from an asset held 5 years; the first should be prorated over 25 years, the second over 5 years. But the pattern of accrual is not easy to reconstruct. Even if the problem of record-keeping and computation were shifted to the tax administrators, as a practical matter, it would, in all probability, still be necessary to assume uniform accrual and to limit the spread-back period to 5 years. This has the advantage of simplicity and would yield most of the benefits of a more refined system of proration. A spread-back system is an averaging system. The prorated capital gain would fit onto the taxpayer's incomes standing at different levels in each of the years included in the spread-back period, and be taxed at whatever tax rates were in effect for those years. The spread-back system allows for statutory changes in the rates.

The recommendation is that averaging for capital gains should be postponed until a general averaging system is adopted. In the meanwhile, in the absence of an averaging system, a multiple-holding period is recommended, with the percentages of gain taken into account falling by very fine steps as the period held increases.

Such a system would minimize tax interference with the fluidity of the capital markets; it would recognize differences in the period of accrual of the gains; but it would not take into account the changing income status of the taxpayer, nor changes in statutory rates.

C. Capital-gains rates.—If the spread-back period were not limited and the pattern of accrual could be approximated with reasonable accuracy there would be no case on equity grounds for a special capital-gains rate. Since, as a practical matter, the period must be limited and it is necessary to assume uniform accrual, there is a case for a special rate even if averaging is adopted, but averaging greatly weakens the case for it. A 5-year spreadback would not do full justice in the case of any accrual period substantially longer than 5 years, but it would go a long way. The case for a special rate may be a little stronger if, in the absence of averaging, a multiple-holding period is adopted. The exclusions of capital gains under this system are designed to approximate averaging, there is no other valid reason for them, but they can do so very crudely, if at all. It would depend on the schedule of these exclusions whether they are more or less generous than averaging and consequently whether there is any need for further concessions through a special rate.

The recommendations on the holding period and the capital gains rate are as follows:

(1) For corporations, no distinction should be made between short- and long-term capital gains and losses. Both should be taxed as ordinary gains and losses.

This recommendation has already been made above, in effect, with respect to property used in trade or business. It is now extended to other types of property, including securities.

(2) For individuals: (a) When a general averaging system is adopted the capital gains should be prorated over the period the assets were held, but not in excess of 5 years, and taxed as any other income under the general averaging system. If for some reason, for example, the effect on investment, it is desired to make further concessions to capital gains, some part could be excluded and

the proration be made for a given percentage, say, 90 percent, of the total gain realized. (b) In the transition period, before a general averaging system is instituted, a multiple capital gains holding period should be adopted, with percentages of exclusion set sufficiently generous to preclude the need of a special rate.

An example of such a schedule is the following :

Assets held	Percent of capital gain		Assets held	Percent of capital gain	
	Included	Excluded		Included	Excluded
1 year or less.....	100	-----	6 to 7.....	70	30
1 to 2.....	95	5	7 to 8.....	65	35
2 to 3.....	90	10	8 to 9.....	60	40
3 to 4.....	85	15	9 to 10.....	55	45
4 to 5.....	80	20	Over 10.....	50	50
5 to 6.....	75	25			

Since the taxes on capital gains under this schedule would be much more severe than under present law, this illustrative schedule is unlikely to qualify with the Congress as generous, in which case the percentages could be stepped down to fit prevailing concepts.

The salient features of these recommendations are: first, that progression would be applicable to capital gains as for other income with such concessions in the severity of the tax, relative to other income, as are desired; and second, the taxes on capital gains would be raised by comparison with present law. This is recommended because it is believed that it is the sharp differences between the rates on capital gains and other income, rather than the level of the capital gains rate itself which raises the problems of capital market fluidity, tax avoidance and enforcement. The various schemes to take down dividends in the form of capital gains or otherwise to convert ordinary income into capital gains whether through the legislative process or by tricky business organization, reorganization and practices would seem less worth while if the stakes were smaller. There is no proof that the level of investment and risk assumption would be lowered if the capital gains gate through the income rate structure were closed, wholly or partly. So long as the gate is open some will walk through it, but if it is closed they may walk elsewhere rather than not at all. If simultaneously other opportunities for tax avoidance (some of which are discussed later in this section) were closed, the tax on capital gains could be increased without prejudice to the growth of the economy. Indeed, by making the tax system fairer, improving tax morale, and contributing to the revenue required to finance other essential tax reforms, an upward adjustment of the taxes on capital gains is more likely than not to contribute to the growth and stability of the American economy. Finally, it is at least not clear that small, new and growing business would fare worse under higher capital gains taxation. The birth rate might be lower, but so would the death rate. Some capital is now lured into small business by the favorable capital gains tax rate, but some small businesses are being extinguished as original investors are tempted to cash in their profits under the low capital gains rate. It is difficult to know whether on balance a high differential and favorable capital gains rate contributes to the virility of small business or is a socially wasteful way of trying to promote the free enterprise system.

D. Tax postponement and the special capital gains rate.—In the absence of averaging, there has been a tendency to put lumpy incomes accumulated over a period of several years under the special capital gains rate. Thus tax relief from postponement has been piled upon tax relief from the special capital gains tax rate. Tax is now postponed, for example, on income from stock options, lump sum settlements of qualified pension plans, reorganizations, switching of residences, and it is being urged for others. It should be clear that tax postponement itself involves an implied special rate or more accurately an implied schedule of exclusions of income, in that no account is taken of the interest factor. A tax of \$100 paid in year N is not the same as \$100 paid in year N + 10. To ignore the interest factor and to superimpose a special low capital gains tax rate on the income which is ultimately taken into account constitutes a measure of tax relief which should be carefully scrutinized for social results. Tax favors should not be disbursed lightly on the mere chance that they may do

some good, because they may also do some harm. The harm comes when others take up the extra burden. They can be expected to do so without a sense of injustice only if the incentive effects and the impact on economic organization from tax concessions are demonstrably favorable to economic development.

E. *Basis problems of assets transferred inter vivos and at death.*—Present law tends to freeze assets that have appreciated in value because the gains can be avoided if the assets are held until death. The basis for assets transferred at death, for both gains and losses, is the market value at time of death. When the heir sells he pays a capital gains tax only on the appreciation of the asset during the period held by him, the appreciation during the life of the decedent escapes tax.

If the assets are transferred as charitable contributions similar tax avoidance results. For such purposes the assets receive the full market value basis and the deduction for charitable contributions is figured on this full market basis, not the cost to the donor. Thus, it may be cheaper to give away an asset (because of the deduction at a high marginal rate) than to sell it and keep the proceeds after tax, even at the low capital gains rate.

If the assets are transferred inter vivos by gift, substantial tax postponements may result. The basis of such property for gains is the donor's base and for loss is the lower of donor's basis or market value at time of gift. Thus, the gains accrued to the donor, together with those accrued to the donee, get taxed at the time of sale by the donee, if in the meanwhile the assets have not depreciated in value.

The recommendation is that the basic rules for gifts, both for gains and losses, be made applicable to the transfer of assets at death, with an appropriate adjustment to reflect the estate tax.

The transferee can scarcely claim hardship since the tax on the appreciation in the hands of the deceased is postponed until the transferee actually sells the property. Since the logical basis for the property to the transferee is zero, donor's basis for gains and the lower of donor's basis or market for losses would still be exceedingly generous. There is substantial merit in the suggestion that property transferred at death or inter vivos should be subjected to both the capital gains tax and the transfer tax, the first tax being credited against the base of the second. This would tend to unfreeze property held for tax benefits to be realized upon transfer under present law.

3. Depreciation

The tax regulations on depreciation have been a perpetual source of irritation to business. Business wants "latitude," that is, freedom to take depreciation when it believes it to be to its greatest advantage to do so. In the extreme this means the privilege to expense capital outlays. A less extreme proposal, which has been in circulation for some time, would permit the depreciation rates to depart for some time, would permit the depreciation rates to depart 25 to 50 percent from the "average" rates promulgated by IRS to guide it broadly in the administration of depreciation. The denial of all-out or restricted "latitude" may prejudice investment in longer lived assets and otherwise distort the use of optimum production methods. There are, however, important obstacles to latitude. First, the large revenue losses over a substantial period of transition to the new depreciation system, necessitating higher tax rates or new taxes to replace the revenue. Second, the pattern of tax reduction implied in latitude is destabilizing, because capital outlays expand in prosperity and shrink in recession.

Fortunately, the liberalization of depreciation in the 1954 code appears to have taken most of the steam out of the movement for latitude. In plans for further tax reduction it is important to note, however, that the system of depreciation adopted in 1954 has resulted in a substantial reduction of business taxes. It is true that the distribution of tax reduction through liberalized depreciation is very different from the one that would have resulted had rates been reduced. Liberalized depreciation relieved the taxpayers with depreciable capital assets. The relief ranged from substantial for taxpayers that relied heavily upon such assets to little or nothing for those with few or no depreciable assets. When liberalization was enacted, it was estimated by the staff of the Joint Committee on Internal Revenue Taxation that, if capital replacement and additions and tax rates continued at present levels, it would reduce taxes for 1956 by over \$1 billion and for 1960, the maximum year, by about \$2¼ billion, with lesser amounts each year until 1968. The aggregate tax reduction for the transition period 1955-68 was estimated at \$19 billion. Subsequently much higher unofficial

estimates have been made. Thus, in testimony before the Joint Committee on the Economic Report, Robert Eisner of Northwestern University estimated, that if taxpayers took full advantage of the law, and assuming 4 percent annual growth in the rate of gross additions to depreciable property, the 1954 liberalization would cost over \$1½ billion in 1956 and over \$6 billion in 1971. By the end of 1957 the tax losses would cumulate to over \$5 billion and by the end of 1960 to over \$14 billion.

All these figures are controversial. In the first place, they are tied to specific assumptions as regards participation, the rate of capital formation and tax rates, none of which are regarded as realistic, even by the estimators themselves. In the second place, the allowances for the impact of liberalized depreciation on levels of investment range all the way from zero to substantial. Eisner, for example, holds that replacement taxes would offset the lifting effect of liberalization. The Treasury and Terborgh, on the contrary, hold that the favorable impact of liberalization on investment levels and the economy in general would about offset the direct revenue losses. In all probability, the truth, as usual, lies somewhere between the extremes.

Disagreement on the merits of liberalization is understandable because there is no measurable standard for correct depreciation either for accounting or for economic purposes. It is not easy to determine whether the optimum and most harmonious adjustment of America's capacity to produce to America's capacity to consume would be better served by the selective tax reduction which is implicit in liberalized depreciation or by a more uniform reduction in the tax rate applicable either to corporate income or more generally to all income. In all probability, however, the 1954 code struck an important blow for economic development by reducing the risk of investment and particularly by reducing or eliminating the discrimination against long-lived assets. Also it should be remembered that in a world of price instability, and this world still exists despite the record of the past few years, there is a case for a quick rather than slow writeoff. The slower the writeoff period the greater the chance that nominal depreciation will fail to match real depreciation. The depreciation problems which arise from fluctuating prices cannot be blinked even by those who would oppose the LIFO type treatment for depreciable assets as discriminatory by comparison with the treatment of financial and other nondepreciable assets.

The 1954 liberalization was not extended to old assets. It applied only to new property acquired or constructed after December 31, 1953. Liberalization was not extended to old assets because it was felt that the additional revenue loss would not be warranted and because there was fear of subterfuge. There is some danger that if old assets were included, tax considerations might induce a substantial volume of asset swapping. This would permit the depreciation of assets that had already been fully or substantially depreciated and, under present law, it would also permit the conversion of ordinary income into capital gains. The swapping of assets to gain a tax advantage can, however, be easily exaggerated, because most businesses would be too seriously disrupted by the pursuit of such tactics to make them worth while. In any case, the subterfuge problem would disappear if, as recommended above, gains and losses on depreciable assets were treated, symmetrically, as ordinary income and losses. Depreciation policy should not be complicated by the consideration that a dual advantage may accrue to the owner of depreciable property if he depreciates it in whole or part at an excessive rate and then sells it for more than the adjusted basis.

In the case of most facilities certified in connection with the Korean conflict, unlike those certified in World War II, there is a recapture clause which treats the excess of amortization over regular depreciation as ordinary income. But if overdepreciation results without certification, in the general application of the depreciation rules, then there is available an avenue of tax avoidance from the conversion of ordinary income into capital gains. The remedy is to modify the capital gains provisions rather than to restrict the application of liberalized depreciation to new assets.

Small business is put at a disadvantage by the failure of liberalization to apply to new acquisitions of secondhand assets. Some have advocated the restriction of liberalized depreciation to new assets because they believe that investment would not be stimulated at all by the extension of liberalization to used assets. But liberalized depreciation would improve the market for used assets and shift them into hands that could not afford them on any less favorable basis. This would create a market for new assets as well as improve the market for old assets. While the primary stimulus to investment is derived from the application of liberalization to new assets significant secondary effects can be expected from

its extension to old assets. Such an extension, it is true, would increase the revenue costs. In the initial year these costs would amount to about one-third the cost of liberalization for new assets and thereafter the costs would taper off rapidly to a near vanishing amount in 5 or 6 years. Like any other desirable structural change in the tax system which would reduce the revenue, this calls for a realignment of the taxes rather than the discard of a meritorious proposal.

In the case of rental property, it is customary for the original builder to hold the property for a number of years, and then to turn it over to an ultimate investor. Only the original owners can now benefit from liberalization. The purchasers who invest in residential rental buildings to hold and manage them over most of their useful lives are denied the benefits of liberalized depreciation.

It is recommended that liberalized depreciation be extended to old assets, including machinery and equipment, plants and buildings and residential rental buildings.

Before liberalization, the case for allowing quick writeoff for a limited amount of assets to help small business was a strong one. It would help reduce risks and to finance small business. Since the enactment of the 1954 Code, the case for further liberalization of depreciation to provide tax relief to small business is less clear. A proposal to permit individual and corporate taxpayers to write off annually over a period of 5 years \$100,000 of depreciable assets was considered at the end of 1954 but was not recommended by the President. It was estimated to cost \$10 billion over the first 10 years or an average of \$1 billion a year. This proposal would have provided relief to unincorporated enterprises as well as small corporations. The great majority of small businesses do not have large amounts of depreciable assets. The firms which would have benefited most from the proposal would have been neither the very small nor the very large ones.

It was recommended above that the carryback of net losses should be extended from 2 to 5 years. The link between this recommendation and liberalized depreciation is clear and important especially as it affects small business. With the extension of the carryback more businesses would be able to avail themselves more fully of the benefits of liberalized depreciation.

4. Depletion

It is not generally recognized that nearly all extractive industries are now being subsidized by the Federal Government. The subsidy is an indirect one, resulting from two tax favors conferred exclusively on these industries: First, exploration and development expenditures are, in general, permitted to be expensed instead of capitalized and amortized over the life of the property.¹ The present worth of the tax benefits are therefore substantially higher than they would be under accounting rules applicable to other taxpayers. Second, the present depletion provisions not merely permit the remaining cost of the property, exclusive of intangible drilling and development costs, to be recovered, as in the case of other taxpayers, but to be recovered several times over, without limit, through the operation of percentage depletion. Cost is only one of the bases for depletion. Alternatively, taxpayers with interests in different extractive industries are allowed to deduct from gross income specified percentages of gross income, but not in excess of 50 percent of the taxable income from the property (computed without allowance for depletion).

The percentages specified in the Internal Revenue Code are as follows:

"(1) 27½ percent—oil and gas wells.

"(2) 23 percent—

"(A) sulfur and uranium; and

"(B) if from deposits in the United States—anorthosite (to the extent that alumina and aluminum compounds are extracted therefrom), asbestos, bauxite, beryl, celestite, chromite, corundum, fluor spar, graphite, ilmenite, kyanite, mica, olivine, quartz crystals (radio grades), rutile, block steatite talc, and zircon, and ores of the following metals: antimony, bismuth, cadmium, cobalt, columbium, lead, lithium, manganese, mercury, nickel, platinum and platinum group metals, tantalum, thorium, tin, titanium, tungsten, vanadium, and zinc.

"(3) 15 percent—ball clay, bentonite, china clay, sagger clay, metal mines (if paragraph (2) (B) does not apply), rock asphalt, and vermiculite.

¹ In the case of mines, the amount of exploration costs that may be expended is limited to \$100,000 annually, and in the case of gas and oil certain development costs not specifically associated with the wells may not be expended.

"(4) 10 percent—asbestos (if paragraph (2) (B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

"(5) 5 percent—

"(A) brick and tile clay, gravel, mollusk shells (including clam shells and oyster shells), peat pumice, sand, scoria, shale, and stone, except stone described in paragraph (6); and

"(B) if from brine wells—bromine, calcium chloride, and magnesium chloride.

"(6) 15 percent—all other minerals (including, but not limited to, apelite, barite, borax, calcium carbonates, refractory and fire clay, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (2) (B) does not apply) bauxite, beryl, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc, including pyrophyllite), except that, unless sold on bid in paragraph (3), the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as riprap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term 'all other minerals' does not include—

"(A) soil, sod, dirt, turf, water, or mosses; or

"(B) minerals from sea water, the air, or similar inexhaustible sources."

The departure from cost depletion had its origin in connection with World War I, for incentive reasons, to assure supplies of a few critical items essential for national development and security. Initially it took the form of discovery-value depletion which was later replaced by percentage depletion. As the foregoing long list indicates, percentage depletion has spread to items which, for the foreseeable future, at least, are not in short supply—to items where subsidy, if it can be justified at all, cannot be justified on the grounds initially advanced.

The excess of percentage depletion over cost depletion involves a revenue loss of about \$1¼ billion. In addition, the expensing of exploration and development costs, instead of capitalizing them, involves, as minimum, the interest cost on substantial amounts of revenue postponed for several years. The dimension of the depletion subsidy is such that it should not be continued any longer without careful reexamination and revision. Tax avoidance tends to feed upon itself, as other taxpayers become dissatisfied and press for similar tax benefits. For example, the Congress has been asked to consider percentage depletion for patents. Spectacular instances of tax avoidance also tend to breed tax evasion and to multiply the problems of enforcement. The revenues saved from tightening the depletion provisions could go a long way to finance other essential changes in the Federal tax system.

The recommendations on depletion and exploration and development expenditures are as follows:

(a) Exploration and development expenditures should be capitalized, not expensed.

(b) Depletion should be allowed for the cost of the property, including the capitalized intangible exploration and development expenditures, in a way that bears some reasonable relation to the need for incentives. Incentives could be provided in two ways:

(1) The depletion rates should vary so as to permit earlier recovery of the investment in the higher risk and more critical items, but in general should not be set so high as to recover the investment quicker than in one-half the life of the property.

(2) The rates should be made applicable to varying percentages of total cost, again in accordance with the need for incentives. Thus, for item A, the percent of cost to be recovered might be set at 110; for B, at 125, but in no case should the taxpayer be permitted to recover more than 150 percent of the full cost of the property (including exploration and development expenditures).

The President should request the Treasury, working with the extractive industries, to ready a proposal for submission at the next session of the Congress.

In this connection, as alternative to (b) above, careful consideration should be given to the following specific proposal:

(1) The only basis for depletion would be cost, including exploration and development expenditures.

(2) Incentives would be provided more selectively than now and also more selectively than under recommendation (b) above, as follows:

For the items certified by the Department of the Interior, the Department of Defense, or some other designated agency or agencies, that the normal operation of the market would not make them available in adequate supply for the purposes of national welfare, development, and security, the Federal Government would provide an immediate tax-free payment of 50 percent of net losses from all the properties of the taxpayer falling into the designated area. Taxpayers that could benefit from a net loss carryover would not receive such payments.

These payments would be integrated with the net loss carryover provisions, for with rates of 50 percent or more taxpayers now receive the equivalent of a Government guaranty to stand behind the net losses to the extent of 50 percent or more. Taxpayers (individuals and corporations) subject to rates under 50 percent, would, of course, elect to receive the cash payment in lieu of the net loss carryback. All taxpayers (or nearly all) irrespective of rate classification, with no record of profits and tax payments and hence with no carryback potentialities, would elect the cash payment in lieu of the carryforward. A few individual taxpayers in the very high brackets might prefer the carryforward of net losses to a cash payment of 50 percent.

The advantages of this approach are clear. The subsidy is likely to be very much more efficient than under recommendation (b) above and still more so than under the present depletion provisions. Established taxpayers would get little or nothing beyond the important incentives now provided by the net loss offsets. The smaller and financially less well-established would get the lion's share of the total subsidy. At present the bulk of the subsidy flows to the big, well-established taxpayers that already have ample incentives to go all out in the search for supplies of critically essential products from the excess of depletion over cost and from the expensing of exploration and development costs.

(c) The distinction in the present law between "deposits in the United States" and deposits outside the United States should be eliminated with the adoption of the recommended revisions of the basic depletion provisions. The only justification for the illogical limitation as it applies to deposits outside the United States is that it limits an unwarranted privilege.

The basis for this distinction is understandable. Presumably, for security reasons, it aims at self-sufficiency. If, however, under modern conditions, national security would be as well served, or better served, by supplies scattered widely over the world as by sources of supply located exclusively in the United States, there is no reason why an American taxpayer exploiting a source of supply abroad should not receive as favorable tax treatment as one doing the same thing domestically. Of course, on this recommendation, the voice of the experts who know our security requirements best must rule. In the absence of such expert opinion to the contrary the present discrimination is not warranted.

(d) Except as otherwise provided in the code the depletion provisions apply for American operations abroad so long as the operation is by a United States citizen or a branch or division of an American corporation. If, however, the foreign country requires or the United States corporation elects to organize a foreign subsidiary, the American investors lose the benefit of the United States depletion provisions. The dividends received from operations in the extractive field are treated like other dividends. The arguments in (c) above, against discrimination for United States investment in the extractive industries abroad appear to apply, again, assuming that the recommended revisions of the basic depletion provisions are adopted.

It is recommended that percentage depletion be made applicable to income received by United States investors from foreign subsidiaries operating in the extractive industries.

5. Tax exemption of interest on State and local securities

The interest on State and local securities is wholly exempt from Federal income tax. The ownership of the securities as of June 30, 1955, is estimated as follows:

	<i>In billions of dollars</i>
Commercial banks.....	12.8
U. S. Government investment accounts.....	.3
Individuals (including partnership and personal trust accounts).....	16.6
Insurance companies.....	5.8
Mutual savings banks.....	.7
Corporations (excluding banks and insurance companies).....	.9
State, local, and Territorial governments.....	4.9
Miscellaneous (including savings and loan associations, nonprofit associations, corporate pension trust funds, dealers and brokers, and investments of foreign balances and international accounts).....	.8
Total outstanding.....	42.7

Some of the securities are held by those who are actually not taxable as in the case of Government accounts or by those who, while technically taxable, in fact, do not pay much tax, as in the case of insurance companies and mutual savings banks. Commercial banks, individuals, and corporations that are fully taxable hold about three-fourths of the State and local securities, involving perhaps as much as \$900 million of interest. It is not easy to gage the revenue loss from exemption because if this interest were taxable, the distribution of the holdings would be different. If it is assumed that the pattern of ownership is not affected by the tax status of the securities, then the exemption results in a revenue loss of about \$300 million annually.

The existence of tax exemption has 1 advantage and 2 overriding disadvantages. The advantage is that it facilitates the financing of State and local governments. Exemption gives them better access to the capital markets. They can also borrow cheaper. The disadvantages are: First, the high income investors particularly are tempted away from risk assumption to reap higher net yields from the relatively safe tax-exempt securities; and second, the distribution of the tax benefits from exemption is such as to favor the higher income taxpayers. The lowest income taxpayers do not find tax exemption attractive. Like other taxpayers they surrender something in gross yield from the tax benefit, but unlike the higher income taxpayers what they surrender in gross yield does not match the tax benefits. There is then an economic and equity argument against tax exemption.

The Federal Government loses more revenue from tax exemption than the State and local governments gain in savings on interest. If exemption were eliminated for future issues, the Federal Government would gain, after a transition period, even if a generous settlement were made with the State and local governments fully compensating them for the interest cost that would be added by the conversion of their securities to taxable status. Since the payments would be geared to the interest cost, the smaller and weaker jurisdictions would automatically receive favorable consideration.

A payment of one-quarter to one-third of the interest on taxable securities issued by State and local governments is recommended as reasonable compensation for the surrender of tax exemption. In the case of refunding of old securities the issuing government should be permitted to elect whether to continue the exemption and receive no compensation with respect to the interest charge or to surrender the exemption and to participate in the Federal grants. The technical details for such grants should be worked out by the Federal Treasury and the Bureau of the Budget in collaboration with representatives from the State and local governments. Among the questions to be settled is whether such grants should be made to the States on behalf of themselves and their localities or directly to each security-issuing jurisdiction.

The recommendation seems, in effect, to commit the Federal Government to a substantial and perpetual fixed charge. Actually, the subsidy is already there in the form of tax exemption. The grants would bring the subsidy out into the open. It may be that grants constitute a more irrevocable commitment than tax exemption, but the exemption is so well established that nobody can be certain about it.

In a sense the recommendation is tantamount to a general purpose, rather than a specific grant. Thus considered it would have merit and it is probably well within the limits of the assistance to State and local governments which the Federal Government will need to provide in the future. But it should not be considered in the context of the Federal grant system; rather it should be appraised in relation to the important problems which emerge from tax exemption.

During the transition period the Federal Government might collect less from taxpayers holding State and local government securities than it would pay out to the State and local governments. The reason is that as the volume of tax exemptions is reduced, the reduction would be first from the holders that are wholly or partially exempt from Federal income tax. The exempt securities would command an increasing premium in the market as high-income individuals, commercial banks, and corporations bid up the prices. The shift in ownership would retard the revenue flow to the Federal Treasury from these securities. The drain on the Federal budget would in no year be likely to amount to very much and, after the transition period, the deficits would be restored and converted into an annual net surplus, that is, the revenues from the interest on State and local government securities would exceed the Federal grants to help the State and local governments meet their additional interest costs.

6. Taxation of income from investments in foreign countries

Billions of dollars, both private and public, have been invested in strengthening remote underdeveloped countries, as well as in the more highly industrialized nations of the world. As a good neighbor and to serve our own interest best, it is important for the United States to stimulate a larger flow of private investment abroad. Some encouragement to American investment abroad can be provided by changing United States tax law. In making these changes it is essential to guard against discrimination between investment in the less developed domestic regions and investment abroad, and to provide a reasonable basis for the hope that they will produce the pattern of foreign investment most congenial to our interests, instead of developing into avenues of tax avoidance. Tax exemption of income from foreign sources or even a rate differential in favor of such income cannot be justified, because both would discriminate against domestic investment and both fail to differentiate selectively for variations in risk. Within the United States risks in investment vary by geographical regions and industry. The only technique used for allowing for these variations, apart from the automatic correction implied by the use of net income as the measure of taxable capacity, is the loss offset.

The United States, like the United Kingdom and some other important capital-exporting countries, taxes income from foreign sources.¹ As in the case of some other countries branches and subsidiaries are taxed differently. Branch income, whether or not transferred to the United States, is taxed currently. Branch losses are currently offset against aggregate positive income from all sources within or without the United States. If income taxes are paid to a foreign country, the taxpayer has an option (which binds him with respect to income from investment in all foreign countries): He may deduct them from the tax base otherwise determined or credit them against a tentative tax. If credited, the credit may not exceed the proportion of United States tax determined by applying the ratio of income originating in the foreign country to the aggregate income from all sources. If two or more foreign countries are involved, the limit applies separately to each country. The effect of the limit is to prevent the tax credit from wiping out some of the tax that would result from income originating in the United States by reason of a foreign country imposing rates higher than the United States tax rates. In other words, the credit cannot give a greater benefit than complete exemption of the income from foreign sources.

In the case of partially or wholly owned foreign subsidiaries the income is not currently included in the aggregate income subject to the United States income taxes, unless the income is actually transferred to the United States. Similarly, losses of foreign subsidiaries are not currently offset against income subject to United States income tax. If the United States corporation owns 10 percent or more of the voting stock of a foreign subsidiary, the dividends actually received are aggregated with its income taxable in the United States and, for tax-credit

¹ France taxes dividends from foreign subsidiaries, but exempts income from branches. Canada taxes some branch income but exempts dividends of 25-percent-owned foreign subsidiaries. Sweden taxes all foreign income and does not allow a credit. The Netherlands and Belgium generally exempt foreign income.

purposes, the United States corporation is deemed to have paid that portion of income taxes imposed by the foreign country that the distributed profits are of the total taxable profits of the foreign subsidiary. The inclusion of only the actual dividends received—that is, the exclusion of tax on income from foreign sources—and the further allowance of a credit for the tax thus excluded has the effect of reducing the tax on foreign income below the level applicable to domestic income. Thus an incentive for foreign investment or at least an allowance for the extra risks and costs involved in foreign as distinguished from domestic operations is now provided, although it was not planned that way.

Incentives for private foreign investment should be strengthened, and the tax consequences flowing from the form of organization operating abroad should be minimized.

It is recommended:

(a) That United States corporations be permitted to elect subsidiary treatment for their foreign branches, which would result in deferral of tax on income and the denial of current offset of losses, as is now done for the profits of foreign subsidiaries. The definition of foreign income qualifying for deferral should be comprehensive, including the income from export business. In cases where the income is derived from a combination of domestic and foreign business activities it should be apportioned on the basis of expenses incurred here and abroad in the production of the income.

(b) That United States corporations be permitted to elect whether or not to consolidate their foreign subsidiaries with the domestic subsidiaries and the parent corporations, which would result in the current taxation of profits and the current offset of losses.

In situations involving great risk the foreign branch organization is advantageous to the American company, as for example, in the area of oil and mineral exploration and development, because it permits full loss offset against domestic income. However, foreign countries sometimes require the establishment of a foreign subsidiary. This is not a hardship where the risk of losses plays little role in the calculations of the investor before he commits his capital to foreign investment, but it is a hardship in other situations. In addition, subsidiary profits and foreign taxes are determined under the foreign tax laws of the respective countries. In most countries the allowances for depletion and depreciation are much less generous than they are in the United States. The result is that in the case of foreign subsidiaries, unlike the situation for foreign branches, the incentives from these generous allowances either do not exist or are greatly curtailed. If the United States corporation were given the option to consolidate its foreign subsidiaries with its domestic operations the profits would be determined according to the United States definition of income (with United States depletion, depreciation, and other provisions applicable) and taxed currently. In some situations these factors would outweigh postponement of tax, in other situations risk of losses would make consolidation attractive.

Certain problems would remain, as for example the wiping out by the operations of the foreign tax credit of tax incentive devices attempted by foreign governments in their efforts to attract American capital. What they relinquish, the United States Treasury takes away, for the United States tax applies to the aggregate of incomes from all sources, domestic and foreign. If the foreign country's tax incentives reduce the tax below the corresponding United States tax, the taxpayer does not benefit. The tax credit operates only to raise the revenue flow into the United States Treasury at the expense of the foreign government.

To meet these problems some have suggested that it would be desirable to repeal all existing provisions relating to the United States tax treatment of income from foreign sources and to impose a low rate uniform tax on all such income without distinction as to whether it originated in a foreign branch or a foreign subsidiary. Losses could be handled as at present. This proposal would discriminate sharply in favor of private foreign investment by comparison with income from domestic investment. It departs much further than the recommendations from the concept of neutrality in taxation. Under this proposal foreign countries could bid competitively for United States investment by making a wide variety of tax concessions not excluding complete exemption from taxation. It is not clear, however, that this type of competition would result in a deployment of United States private investment abroad that would be optimal either for world economic development or to ourselves. The power to bid for investment with tax concessions is not correlated with the need for capital. The results might even prove to be perverse. While, under the recommendations,

several vexing problems would still remain, it is suggested that it would not be desirable in the next step toward the promotion of private foreign investment abroad to go beyond the recommended dual optional system which would permit liberalized treatment of foreign subsidiary losses and postponement of tax on the profits of foreign branches.

Individual stockholders in foreign corporations, like corporations that own less than 10 percent of the voting stock in foreign corporations, do not get a deduction or credit for taxes imposed upon foreign corporations. They are double taxed, as they are with respect to investment in domestic corporations. Liberalization of tax loss offsets against ordinary income generally, as recommended above, would improve the investment incentives for individuals both with respect to foreign and domestic investment.

7. Retirement income of persons not covered by private pension plans

The basic retirement system in the United States is the social-security system. In 1955 the coverage extended to approximately 85 percent of the monthly average paid civilian employment. The largest groups still outside the system include the government workers—Federal, State, and local—and the doctors. With the enactment of the Social Security Amendments of 1956 all other self-employed professional groups, including the dentists and lawyers, are now covered.

Social-security benefits which reach to maxima of \$108.50 for the basic worker, \$162.80 for a couple and \$200 for a family with dependents, are geared to covered wages up to a maximum of \$4,200. The level of wage coverage has lagged persistently behind the upward shift in wages. In terms of original social-security objectives a figure of at least \$7,500 can now be defended. Since the social-security system has made inadequate provision for the retirement of the higher wage earners, workers have pressed for supplementary benefits from their employers through private pension plans. Still only about one-quarter to one-third of all employees are now covered by these plans financed wholly or in part by the employers. Many of these plans doubtless would have developed, in any case, but their rapid growth can be explained in large part by the fact that the social-security system provided only a low minimum of protection for the retired.

The plans qualify for special tax treatment so long as they do not discriminate in favor of the top few hired executives. To avoid disqualification it is adequate to provide retirement benefits for the executives that stand in about the same relation to their basic compensation as the plan provides for the group as a whole. That is, if the plan provides retirement benefits of a third (or \$2,000) for a \$6,000 employee, it will qualify if it also provides retirement benefits of a third (or \$200,000) for a \$600,000 employee. In fact eagerness to qualify and "voluntary" restraints have resulted in scaling down the retirement benefits of the top salaried personnel in relation to those with smaller incomes. The law and administrative procedures impose no limits on the size of the retirement benefit, except that it must be based on reasonable compensation. In any given case IRS can maintain that \$600,000 is not reasonable compensation and so refuse to qualify the plan set up to provide a retirement benefit of \$200,000 for that individual. But if the compensation is reasonable, the size of the highest benefits will not disqualify a plan so long as it does not discriminate in the relationship of the benefits to the basic compensation.

The special tax treatment under private pension plans includes three elements:

(a) The corporation gets a deduction for its contribution to the trust to finance the benefits.

(b) The earnings of the trust are exempt—this helps to finance the benefits, and

(c) The employee is not required to pay tax currently on the employer's contribution—only when the benefits are actually received.

Some self-employed groups, particularly the doctors and lawyers have campaigned vigorously throughout the postwar period for the postponement of tax on income set aside to provide retirement income for those not covered by private pension plans. They maintain that without such postponement the high tax rates make it impossible to set aside adequate retirement funds and further that postponement is necessary to equalize their tax treatment with those now covered by private pension plans, particularly the hired executives. They charge that the present law discriminates.

A reduction in surtax rates, as recommended above, would ameliorate the problem. It would facilitate accumulation of income for retirement, but it

would not be fully responsive to the charge of discrimination. Those covered by private pension plans enjoy the benefits of tax postponement whereas those not covered do not.

Tax postponement is inevitable under private pension plans. Because the great majority currently covered do not stay on their jobs long enough to acquire vested rights to benefits, they should not be taxed on income which they may never receive. If the plan is contributory, they do pay current tax on their own contributions because they can withdraw them upon leaving any pension plan, but they cannot withdraw the amounts of the employer's contribution accumulated to provide the retirement benefits. They forfeit their potential retirement income from this source upon leaving the employer, except in some cases and then usually only after a long period of employment. In private pension plans tax postponement is accepted as a necessity, not as a matter of principle.

Tax postponement is undesirable both in principle and for practical reasons. It means low taxation or complete exemption of the income involved in the postponement, depending upon the size of other income of the retired. In the long run the marginal tax rates will need to be kept higher than otherwise. High marginal rates are not only prejudicial to work and investment incentives but also breed all sorts of undesirable schemes to get out from under tax payment. Tax postponement is prejudicial both to economic development and to the enforcement of an equitable tax system. Tax postponement is also discriminatory. It scales down progression of the income-tax rates for the select groups included in the postponement, but not for others. Even when tied to the meritorious objective of providing for old age, it discriminates against those who must follow their own enterprising ways of providing for old age by using their savings as they see fit. This, as previously noted, includes the great majority of those now currently covered under private pension plans that ultimately forfeit their benefit rights and some 30 millions that are in no way involved in private pension plans.

The proposal would in general enlarge rather than reduce the area of discrimination. It is true that there is now discrimination between the high income groups covered and the high income groups not covered by private pension plans. The adoption of the proposal would ameliorate this discrimination. There is this difference, however, between the private pension plans and the proposal. In the pension plans the degree of access is prescribed; in the proposal access would in a sense be voluntary but in fact be highly variable because the savings potential and the free savings available for commitment to the special retirement plans increases sharply with the size of income. Individuals with smaller incomes usually have their earnings committed for current living, for retirement of the mortgage and for the payment of premiums on insurance. If instead of comparing the high income groups covered and those not covered by private pension plans, one looks to a comparison of the high income groups with the lower income groups, whether or not covered, it appears that the private pension plans and the proposal both discriminate against the low-income groups. Under a progressive tax they have less to gain from tax postponement. In the case of those covered by private pension plans, the great majority may lose their rights to the employer's contributions, rights which in a measure at least were in lieu of current income. Those not covered must supplement their social security out of savings that have not been shielded by tax postponement at all. The logical stopping point for tax postponement, if it is not to be discriminatory, is a general deduction for a limited amount of savings, and indeed some have proposed this for the purpose of stimulating savings, capital formation and the avoidance of secular inflation. A general savings deduction would, of course, augment retirement income incidentally. Such broad application of tax postponement would, however, radically change the revenues potential and distribution of the income tax. The proposal for a general savings deduction involves fundamental issues which go far beyond the context of this discussion.

The supplementation of social security with private pension plans is now generally accepted, but the economic consequences of retirement systems, including both public and private, are not altogether fortunate. In the case of private pension plans the vesting of pension rights is usually tied to seniority in a manner that entails loss of substantial rights should the employee shift employment. While this is desirable from the viewpoint of the firm seeking to reduce costs and to hold its employees, it impedes the mobility of labor. The social-security

system does not suffer from this defect. Private pension plans also tend to shift savings, particularly the savings of high income groups away from risky investment to safe investment. The institutionalization of savings has already proceeded to a point of concern, lest the capital markets lose the degree of fluidity and venturesomeness most compatible with economic growth. Beyond the minimum provided by social security, it may well be that the individual in his capacity as investor can, on the average, better provide for himself and for his community by directly investing his savings instead of investing them through an institution or an arrangement that is geared specifically to retirement objectives.

The proposals that are currently before Congress to postpone tax on income set aside to provide for retirement, H. R. 10, would allow self-employed people and employees not covered by pension plans to exclude from their gross taxable income, amounts up to 10 percent of their otherwise taxable earned income, provided they invested such amounts in certain specified types of retirement funds or annuities. The untaxed funds so invested could not be withdrawn until the taxpayer reached the age of 65 unless he became permanently disabled before that time. The bill provides for an annual ceiling on the exclusion of \$7,500 and a lifetime ceiling of \$150,000. Larger exclusions are allowed to people who are over age 55 when the bill would go into effect.

If all eligible people took full advantage of H. R. 10 the annual revenue loss would be \$3.4 billion. If they invested only part of the maximum allowable, ranging from 15 percent for the people whose incomes are under \$3,000 per year to two-thirds for the people whose incomes are \$25,000 or more, the revenue loss would be approximately \$1 billion annually. Under the bill the percentage of earned income which would qualify for exclusion from taxable income would be increased 1 percent for each year by which the taxpayer's age exceeded 55 at the time the bill went into effect. Thus a taxpayer, age 60, for example, could exclude up to 15 percent of his income each year. The annual ceiling of \$7,500 likewise would be increased by \$750 for each year by which the taxpayer's age exceeded 55. If these provisions were removed from the bill the revenue loss, on the same assumptions as the \$1 billion estimate, becomes a little over \$800 million.

If the plan were extended to include not only the self-employed and those not covered under private pension plans, but also to provide more adequately for those who would lose their benefit rights in the normal course under the private pension plans, the amount of the annual exclusions and the annual ceiling would need to be reduced substantially to keep the revenue losses within bounds. Thus, for example, if the annual exclusion were limited to 5 percent of earned income, and the annual ceiling set at \$1,000 for self-employed and people not covered by pension plans, and employees covered by pension plans were allowed exclusions of 2½ percent of earned income with the same annual ceiling, the revenue loss would amount to about \$600 million annually, assuming those eligible for benefits average one-third the use of the maximum allowances. It would of course be possible drastically to reduce the revenue losses but only at the expense of more substantial discrimination. Thus the revenue loss would be decreased to about \$275 million annually if H. R. 10 were limited to self-employed people, again under the assumption that the eligible persons would on average use about one-third of the potential maximum benefits.

There would, of course, be some recouplement of revenues in later years since the retirement income becomes taxable when actually received. However, the foregoing estimates of revenue loss would not be appreciably affected because incomes upon retirement normally drop sharply and those over 65 are entitled to double exemptions—\$1,200 for each spouse.

The proposal in H. R. 10 is not recommended.

It would enlarge the area of discrimination rather than reduce it. It is true that it would help some of the most well to do to escape the privations of inadequate retirement incomes. This it would seem is a very low priority item among the claimants for tax relief.

8. *Deferred compensation other than private pension plans*

Several methods are in use designed to postpone the tax on compensation and to convert ordinary income into a capital gain. A few will be discussed here.

A stock option is an arrangement to compensate a business executive, with the aid of reduced and postponed taxes, by letting him acquire a proprietary interest in the company at a bargain price for the stock. The objective is to provide an incentive for an all-out management effort. If this arrangement is effective, more effective, for example, than bonuses and salary increases in general, then it contributes to economic development.

To get the maximum benefit out of the arrangement the stock option must be restricted. The principal requirements of a restricted stock option are that the option price must be at least 85 percent of the value of the stock at the time the option was granted and the employee may not own more than 10 percent of the stock of the company. Provided shares acquired under a restricted option are held for at least 2 years after the option was granted and 6 months after it was exercised, tax is not imposed when the option is granted or exercised, but only when the shares are sold. If the option price is between 95 and 100 percent of the value of the stock when the option was granted, any gain realized at the time the stock was disposed of is taxed as a capital gain. If the option price was between 85 and 95 percent of the value of the stock at the time the option was issued, any gain realized at the time of the disposition of the stock is taxed as ordinary income to the extent of the difference between the option price and the fair market value of the stock at the time the option was issued, and the balance is taxed as a capital gain. If the stock options do not qualify as restricted, then the difference between the option price and the value of the stock at the time the option is exercised is taxed as ordinary income when the option is exercised and the balance of the gain is taxed when the stock is sold as capital gain, if the stock is held at least 6 months after it was exercised.

The chief advantage to the holder of a restricted stock option is that the tax on the part of the gain that is treated as compensation is postponed until the stock is sold. The company gets no deduction for such compensation. In the case of a stock option that does not qualify as restricted, the holder is taxed currently on the compensation, but the company gets a deduction for it. In some situations the combined tax benefits to the company and the holder of the stock option may not be as great for stock options that qualify as for those that do not. Whatever advantage lies on the side of the restricted stock option is not available, however, to the employees of small business and closely held corporations because of the 10-percent stock-ownership limitation and the difficulty of ascertaining the fair market value of the stock at the option date.

Other routes to the postponement of tax on the compensation of business executives and the conversion of ordinary income into capital gains are available even to small business, but the tax consequences are less certain than for stock options. In some cases preferred stock is issued as a dividend to common-stock holders with a view to depressing the value of the common stock so that it can be acquired by key employees at a favorable price and held for appreciation and ultimate sale at capital-gain tax rates. In other cases employees are given deferred compensation contracts whereby current salaries are reduced, but the employer agrees to pay, normally, a lesser specified salary for a specified period after retirement. Here the employee is not in quest of capital gains; he is merely seeking shelter from the steeper progressive individual income-tax rates. IRS has not ruled on these arrangements, and while the risk of disapproval exists it is receding as the practice becomes more prevalent.

The recommendation is that with the enactment of more reasonable individual income tax rates the law and regulations relating to the various deferred compensation methods now practiced, including stock options, be reexamined with a view to eliminating the tax avoidance which now results from tax postponement and the conversion of ordinary income into capital gains. If as the result of such reexamination preferential treatment of stock options is retained, then special study should be given to ways and means of extending the tax benefits equally to employees of small companies as well as to the employees of the larger companies.

9. Enforcement

Certain tests made by the Department of Commerce indicate great variations by sources in the percentages that income reported to IRS is of the amounts estimated for national income. There are many legal and technical factors that

affect these percentages and it would be more surprising if they were uniform than to find them highly variable, but the disparities are such as to suggest differences in the efficiency of enforcement among taxpayers with different sources of income. The lowest percentages are for interest, rent, and farm income. The highest is for wages and salaries.

Some have become unduly alarmed about the state of the income tax and fear that tax evasion is so widespread as to completely undermine the tax within a relatively short time. This alarm stems from a failure to appreciate that much of the evidence mixes tax evasion with tax avoidance. Tax avoidance can be cured only by appropriate legislation, including the adoption of some of the above recommendations. Tax evasion will shrink as tax morale improves with the blocking of avenues of tax avoidance, but in addition there must be adequate enforcement. The legislature must provide the funds for this, but it involves more than money, it requires in addition efficient organization, including personnel.

Some \$200 million to \$300 million of revenue is lost annually through the failure to withhold on interest and dividends. The Treasury has a workable withholding plan which it has recommended to the Congress. It is recommended that withholding on interest and dividends be enacted without further delay.

Even casual observers note important leaks in income tax enforcement. Notable examples are the deductions taken for expense accounts and advertising. Pleasure trips, the maintenance of vacation spots for top executives, full page ads expounding the virtues of the obvious, or the false, do not fit neatly into a concept of income tax enforcement when the tax burden is heavy on those who are not escapees. Some of these problems are very difficult and may require legislative rather than administrative steps for their solution, but such steps appear to be overdue. Here is where the practicing accountants and lawyers can render a great public service.

It is recommended (a) that the President appoint a task force drawn from these professions to develop the legislative and administrative measures needed to tighten the enforcement of the income tax law; (b) a separate task force should be established to deal with the taxation of farm income. The personnel should be drawn from IRS, the Department of Agriculture, and a few leading agricultural colleges.

As previously recommended, in connection with the discussion on averaging, it is believed also that enforcement would be greatly strengthened with the establishment of an individual account system for both individuals and corporations and the greater mechanization of the IRS administrative processes and procedures for the collation and storage of information relative to the determination of the proper tax liabilities. This may well turn out to be the most important byproduct of instituting an averaging system.

10. Other matters

In the limited time available it has not been feasible to cover even all the major matters that need to be considered in any extensive overhaul of the income tax. Omitted, for example, are such important subjects as the taxation of life insurance companies and cooperatives.

V. FEDERAL EXCISE TAXES

Federal excise taxes, including those levied to finance the highway trust fund, are estimated at \$10.6 billion for fiscal year 1957. The excises to finance the highway trust fund are estimated to account for 16.6 percent of total Federal excises and other automotive taxes remaining in the general fund account for an additional 14.9 percent, so that all automotive taxes (excluding lubricating oil) account for 31.5 percent.¹ Alcohol taxes account for 28.2 percent and tobacco taxes for 15.3 percent. These 3 categories account for 75 percent of the Federal excise taxes. Of the remaining excises 6.2 percent are on durable goods, 2.8 percent on nondurables and 15.0 percent on services (table 7).

The automotive taxes, the alcohol taxes and the tobacco taxes constitute the hard core of the Federal excise tax system. They are unlikely to be changed appreciably. In public and congressional opinion, the automotive taxes, both those in and those out of the highway trust fund, are firmly tied to highway finance. The liquor and tobacco taxes are as firmly tied to a quasi-moralistic, quasi-social theory of consumption. It is desirable that a tax system allow the freest choice to the individual so long as this does not result in excessive social cost, as for example, from traffic deaths or impaired health. It is unfortunate that because of the economic characteristics of the automotive, liquor and tobacco taxes they are not in all respects ideal to attain the legislative objectives. The inelastic demand for cigarettes, for example, makes this tax a good revenue producer but very ineffective for the purpose of rationing consumption. As a revenue producer it is highly regressive. In part of the automotive taxes (those applicable to passenger cars) burden the users directly, and in part do so indirectly as business costs of those that transport goods and persons, but it is altogether unlikely that these taxes in combination allocate the wear and tear of the highways very precisely according to the benefits received. If all taxes were business costs and shifted with equal ease for all items of transport involved, it would be easier to have confidence that the allocation of tax burdens was economic, than in the situation which actually prevails, where some taxes are shifted and others not. While the hard core of Federal excise taxes is not necessarily ideal, no recommendations are made specifically applicable to this area.

¹ As is shown in table 7, the fiscal year 1957 is a transition year as regards the division of the automotive tax revenues between the highway trust fund and the general fund.

TABLE 7.—*Excise taxes estimated for fiscal year 1957*¹

[In millions]

Source	Amount	Percent
Total	\$10,602	100.0
Automotive taxes: Total	3,339	31.5
Highway trust fund: Total.....	1,757	16.6
3 cents per gallon gasoline, diesel fuel and special motor fuel.....	1,285	
8 cents per pound of tires (only 5 cents to highway trust fund until July 1, 1957).....	² 279	
9 cents per pound of inner tubes (to highway trust fund July 1, 1957).....	² 18	
½ of the 10 percent tax on manufacturer's sale price of trucks, buses, truck-trailers, etc. (only 2 percent to highway trust fund until July 1, 1957).....	² 122	
3 cents per pound of tread rubber (camelback).....	8	
\$1.50 per 1,000 pounds of gross weight on vehicles over 26,000 pounds.....	45	
Other automotive taxes: Total.....	1,582	14.9
10 percent tax on manufacture of automobiles.....	1,300	
½ of the 10 percent tax on manufacturer's sale price of trucks, buses, etc. (Apr. 5 until July 1, 1957).....	² 125	
Parts and accessories.....	157	
Alcohol taxes: Total	2,990	28.2
Distilled spirits.....	2,086	
Fermented malt.....	771	
All other.....	133	
Tobacco taxes: Total	1,621	15.3
Cigarettes (small).....	1,556	
All other.....	65	
Other durable goods: Total	662	6.2
Electric, gas, and oil appliances.....	70	
Electric light bulbs.....	22	
Radio and television receiving sets, phonographs, phonograph records and musical instruments.....	177	
Mechanical refrigerators, quick-freeze units and self-contained air-conditioning units.....	58	
Business and store machines.....	67	
Photographic equipment.....	18	
Sporting goods, including fishing rods, creels, etc.....	15	
Firearms, shells, pistols, revolvers, etc.....	14	
Fountain and ball point pens: mechanical pencils.....	³ 9	
Jewelry.....	156	
Luggage, handbags, wallets, etc.....	56	
Other nondurable commodities: Total	298	2.8
Lubricating oils.....	75	
Matches.....	6	
Furs.....	27	
Toilet preparations.....	84	
Playing cards.....	7	
Coconut and other vegetable oils, processed.....	19	
Sugar tax.....	80	
Services: Total	1,691	15.0
Issues of securities, stock and bond transfers and deeds.....	100	
Telephone, telegraph, radio, and cable facilities, leased wires, etc.....	240	
Local telephone service.....	330	
Transportation of oil by pipeline.....	43	
Transportation of persons.....	220	
Transportation of property.....	430	
Admissions to theaters, concerts, etc.....	110	
Cabarets, roof gardens, etc.....	40	
Wagering, etc.....	7	
Club dues and initiation fees.....	48	
Leases of safe deposit boxes.....	6	
Coin-operated amusement and gaming devices.....	14	
Bowling alleys and billiard and pool tables.....	3	
Unclassified	101	

¹ January 1956 estimates of budget message adjusted roughly to current rates, except that later figures are used for highway trust fund taxes and where otherwise specified.

² This is a fiscal year 1956 estimate.

With respect to excises generally, however, it is recommended that where administratively feasible, the Federal excise taxes that are on a specific basis should be converted to an ad valorem basis.

This would improve the burden distribution and the built-in flexibility of the Federal excise-tax system. As a practical matter, revision of the Federal excise-tax system involves for the most part the remaining \$2.6 billion, the excises other than those on liquor, tobacco, and the automotive items. Of this amount 25.9 percent is on durables, 11.7 percent on nondurables, and 62.3 percent on services.

When the Federal excise-tax system falling in the area of potential revision is narrowed down in this way, it becomes clear that excises occupy a disproportionate role in the deliberations on Federal tax matters. The heated debate about the excises taxes is not altogether, not even chiefly about the structure of some \$2½ billion of excises as a literal reading of the arguments would indicate, but rather about the role of consumption taxes in the Federal system. The maneuvering is to adjust the structure of the excise-tax system so that it will be easier to maneuver with it. The primary objective of maneuverability is to increase the role of the consumption taxes relative to the income taxes and to reduce the overall progression of the Federal tax system. It would be easier to move a uniform rate excise tax applicable to a given base than a system of differentiated rates applicable to the same or even a narrower base. If the objective of maneuverability were to move the excises up and down with expansion and contraction of the economy as fiscal policy required, the uniform rate excise tax would have substantial merit. It would improve the flexibility of fiscal policy. Some fear that this advantage cannot be realized without running the risk of a fundamental change over time in the structure of the Federal tax system, with persistently increased emphasis on consumption taxes. In a democracy risks of this type must be assumed. The question whether the Federal excise-tax system should be changed to a uniform rate excise tax should be answered on more fundamental grounds than secular tactics.

In the first place it can perhaps be admitted readily that there is a prima facie question whether it would make sense to institute a new Federal sales tax to raise as little as \$2½ billion of revenue. The administrative machinery and personnel of IRS are keyed to the present type of excise-tax system. It would require considerable reorientation of existing talents and organization and perhaps some additional resources to accommodate a general sales tax. The tax is opposed by the States and it is opposed by organized labor and farmers. It would be an unpopular tax with the public in general, except business organizations, and not universally applauded even by business. The retailers, for example, are not friendly to a Federal sales tax. It would not make sense to buck the heavy opposition to a Federal sales tax except in a national emergency requiring the levy of many billions of additional Federal taxes. In any case, it is inconceivable that the margin of economic superiority of a general sales tax of the magnitude of \$2½ billion over a differentiated excise-tax system can be such as to warrant the assumption of the burden of instituting a tax which could not muster enough support for enactment in several past national emergencies, in World War I, World War II, and Korea.

In some respects a differentiated excise-tax system has more flexibility than a uniform rate tax. The severity of the tax on a given item can be adjusted to prevailing economic conditions and objectives. Some of the excise taxes in the present system are legacies from World War II, when it was necessary to curtail the demand for durables and services competing with war requirements for critically short materials, manpower, and facilities. In the context of an emergency and inflationary situation which then prevailed, these excises had merit. Most of them have long since outlived their usefulness. That they still exist is a fault which should not be charged to a differentiated rate system but rather to its abuse.

The chief charge against the differentiated rate system is that it discriminates against consumers' choice and optimum allocation of resources and output more than would a uniform rate tax. To appreciate fully the extent of the differentiation it is necessary to put the tax rates on a comparable basis, in terms of percent of retail price excluding tax. This is done in the following table for most of the excises, excluding the automotive taxes and the excises on liquor and tobacco (table 8).

TABLE 8.—Federal excise tax rates, exclusive of automotive taxes and excises on alcohol and tobacco

Excise	Current rates	Tax as percent of retail price, excluding tax
Admissions, general, over 90 cents.....	1 cent per 10 cents or major fraction.....	10
Billiards and bowling.....	\$20 per year, per unit.....	
Business and store machines.....	10 percent of manufacturers' price.....	6
Cabarets.....	20 percent of total charge.....	20
Coin-operated devices, amusement.....	\$10 per year per machine.....	
Coin-operated devices, gambling.....	\$250 per year per machine.....	
Documentary stamps, deeds.....	55 cents per \$500 or fraction.....	
Documentary stamps, issues of stocks and bonds.....	11 cents per \$100.....	
Documentary stamps, transfers of stocks and bonds.....	5 cents and 6 cents per \$100.....	
Dues and initiation fees.....	20 percent of amount paid.....	
Electric, gas, and oil appliances.....	5 percent of manufacturers' price.....	3
Electric light bulbs and tubes.....	10 percent of manufacturers' price.....	5
Firearms, shells and cartridges.....	11 percent of manufacturers' price.....	6
Fur articles.....	10 percent of retail price.....	10
Jewelry.....	do.....	10
Lubricating oils.....	6 cents per gallon (3 cents per gallon on cutting oil).....	5
Luggage.....	10 percent of retail price.....	10
Matches.....	2 cents per 1,000 but not over 10 percent of manufacturers price.....	
Mechanical pencils, ball and fountain pens, cigarette lighters.....	10 percent of manufacturers price.....	5
Musical instruments.....	do.....	6
Phonograph records.....	do.....	5
Cameras.....	do.....	5
Photographic film.....	do.....	5
Playing cards.....	13 cents per pack.....	20
Radios.....	10 percent of manufacturers price.....	6
Refrigerators, household.....	5 percent of manufacturers price.....	3
Sporting goods.....	10 percent of manufacturers price.....	5
Telegraph and telephone, radio, cable.....	10 percent.....	10
Local telephone.....	do.....	10
Wire and equipment service.....	8 percent.....	8
Toilet preparations.....	10 percent of retail price.....	10
Transportation of oil by pipeline.....	4½ percent of amount paid.....	4½
Transportation of persons.....	10 percent.....	10
Transportation of property.....	3 percent of amount paid.....	3
Leases of safe deposit boxes.....	10 percent.....	10

The data show that when the hard core of the Federal excise tax system is excluded the controversy over the superiority of a uniform as against a differentiated system largely becomes irrelevant, because the range of the rates of tax in terms of percent of retail price exclusive of excise tax is from 3 to 10 percent, with the exceptions of cabarets and playing cards, which are 20 percent. Moreover, if the present system were cleaned up to exclude business cost items the dispersion of the rates would be greatly reduced.

In discussing the relative merits of a uniform rate as against a differentiated system of excise taxes we deal largely with a paper point, but it is worth an additional observation or two. In the first place, the uniformity sought is fundamentally a sort of neutrality as regards consumers' choice, optimum allocation of resources and output. Presumably a uniform rate retail tax applicable to retail price exclusive of tax would make the closest approach to this objective. Yet most that seek uniformity do so by favoring a uniform-rate manufacturers' sales tax. This would be tantamount to a variable tax at the retail level because markups differ in number, size, and rigidity by industries and other classifications of the taxed items. In the second place, the range in the differentiated rates exaggerates the distortions resulting from differentiation because not all the taxed items are competitively interconnected. Also, without defending the present pattern of differentiation, some differentiation may be more harmonious with neutrality than uniform rates, given the competitive groupings of the taxed items, and differences in profitability and in supply and demand conditions. Finally, as soon as large segments of expenditure are excluded from the uniform rate, as, for example, liquor, tobacco, and the automotive taxes, and other large segments of expenditures are exempt altogether for practical reasons, as for example food and medicines, the excise tax even if at the retail level and at a uniform rate will be far from neutral in its economic impact on resource allocation and consumers' choice. While in general there should be no differ-

entiation in terms of retail price exclusive of tax unless it can be specifically justified, the present situation is far from intolerable in terms of attainable standards.

The Tax Rate Extension Act of 1956 extended certain excises which were to be reduced on April 1, 1956, to April 1, 1957 (table 9). The Federal-Aid Highway Act of 1956 removed the excise taxes on gasoline, trucks, buses, and trailers and on diesel and special motor fuels from the scope of the Tax Reduction Act of 1956, since the revenues from these sources at the level of current rates were tied to highway finance by the Highway Act. In present law then instead of \$1.2 billion of excises being involved in the tax reduction scheduled for April 1, 1957, the Federal excise system will be reduced by only \$0.8 billion on a full-year basis. It should be noted that of this amount, \$0.2 billion is on alcoholic beverages, \$0.2 billion is on tobacco, and the balance, \$0.4 billion, on automotive taxes that go into the general fund instead of the highway trust fund. All the scheduled excise-tax reductions affect the hard core of Federal excises, which is unlikely to be altered appreciably in the near future. The excises outside this area have a higher priority for revision.

It is recommended that the entire balance of Federal excise taxes amounting to some \$2.6 billion of revenue be eliminated as soon as budgetary and economic conditions permit. The items with highest priority for elimination are the excises that enter to an important extent into business costs. These include the following: Transportation of property; transportation of persons; transportation of oil by pipeline; telephone, telegraph, radio, and cable; issues of securities, transfers of stocks and bonds and deeds; photographic equipment; business and store machines; electric-light bulbs; and electric, gas, and oil appliances; and lubricating oils. In revenue these amount to \$1.3 billion out of \$2.6 billion of Federal excise taxes from sources other than the automotive, liquor, and tobacco taxes.

The State and local governments are hard pressed for revenue. They would relish the exclusive use of such taxes as the admissions and the tax on local telephone service. The residual \$1.3 billion of excises remaining after the system had been cleansed of patently undesirable items seems to fit better in State and local taxation than in the Federal tax system.

TABLE 9.—*Excise-tax rates extended by the Tax Rate Extension Act of 1956*

	Change in rate which would occur without bill	Estimated revenue gain (millions of dollars)	
		Fiscal 1957	Full-year effect
Excises:			
Alcohol taxes:			
Distilled spirits.....	\$10.50 to \$9 per gallon.....	90	128
Beer.....	\$9 to \$8 per barrel.....	64	85
Wine.....	Various rates.....	6	9
Total, alcoholic beverages.....		160	222
Tobacco taxes: Cigarettes (small).....	\$4 to \$3.50 per 1,000.....	145	194
Manufacturers' excise taxes:			
Gasoline.....	2 to 1½ cents per gallon.....	219	250
Passenger cars.....	10 to 7 percent.....	328	375
Trucks, buses, and trailers.....	8 to 5 percent.....	58	66
Auto parts and accessories.....	8 to 5 percent.....	46	52
Total, manufacturers' excises.....		651	743
Retail taxes: Diesel and special motor fuels.....	2 to 1½ cents per gallon.....	6	7
Total excises.....		962	1,166

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

VI. ESTATE AND GIFT TAXES

The estate tax and gift taxes yield about a billion dollars to the Federal Government and about a quarter of a billion dollars to the State and local governments. The graduated estate and gift taxes complement the progressive income taxes. They tax those who are economically successful more heavily

than those who are not. Inequalities in income and wealth are inevitable by-products of a dynamic free-enterprise system, where the rewards must match the responsibilities of leadership and of risk to provide the essential work and investment incentives. These incentives could be strengthened by substituting estate and gift taxes for part of the income taxes. Even if the recommendation to reduce the high marginal income tax rates is adopted, it would still be desirable to shift part of the tax burden from individuals with the higher incomes to individuals with substantial amounts of property transferred inter vivos or at death. The objective of such a shift would be not to step up the assault on inequality, but instead to make the combined income, estate, and gift tax burden more compatible with economic growth.

A persuasive case can be made for the exclusive use of the estate and gift taxes by the Federal Government, especially if, as previously recommended, the Federal Government were to surrender all the excises, except the automotive taxes and those on liquor and tobacco. In the first place the revenue from State death taxes is divided unevenly among the 47 States (Nevada does not levy one) because wealth is distributed unevenly. In most States the yield is not very important, but because it is highly irregular it makes for budgetary difficulties. Stability of revenue is a virtue in State and local finance, because the legal and practical requirements for a balanced budget are much more rigid than they are for the Federal Government. Second, the States have experienced serious administrative difficulties with these taxes. Notable are the jurisdictional conflicts with respect to intangibles and the valuation problem. In general, the State and local death taxes are among the most poorly administered. Finally, the larger accumulations of wealth are of regional or even national origin. The distribution of revenues by States may be more closely related to weather conditions and the unsettled controversial laws on domicile than to the geographic origin of the taxed wealth.

Short of amending the Constitution, there is no practical way of effecting an intergovernmental swap of taxes, such as the Federal excise taxes for the State estate and gift taxes. Something approximating a desirable swap can be attained, however, by adjusting the present obsolete credit for State death taxes. No credit is now provided for gift taxes levied by some dozen States. The present credit for State death taxes is effective only with respect to relatively large estates, because the maximum credit is 80 percent of the liabilities under the 1926 Federal law, which is retained only for the purpose of determining the credit. The exemption under the 1926 law was \$100,000 which, in effect, was increased in 1948 to \$200,000 if the estate is left to a spouse. In the poorer States this credit is almost completely inoperative because there are few, if any, estates that reach above these high Federal exemptions. With much of the base unprotected from interstate competition and migration, the States are not in a good position to exploit this source of revenue, even if they were inclined to do so.

The recommendation on the Federal credit is that it be divorced from the obsolete 1926 Federal estate-tax law. The maximum allowable credit should be set at 90 percent of the Federal estate tax before credit, limited, however, to an absolute maximum of \$25,000.

To be effective the revised credit requires a drastic reduction in the Federal estate- and gift-tax exemptions. The revised credit would reserve most of the revenue from large accumulations of wealth for the Federal Government, would induce the State to cultivate these taxes as they apply to the smaller estates more intensely, and would greatly change the distribution of the revenues from this source in favor of the poorer States.

If the Federal revenues from estate and gift taxes are to be increased appreciably the tax base must be broadened and the rates adjusted. The rates are too high at the top and too low at the bottom of the schedule. The exemptions and exclusions from the base are too high, particularly since they were, perhaps inadvertently, doubled in 1948 by the marital deduction for transfers to the spouse and the rule that gifts are made one-half by each spouse. The tax base could also be broadened by some abridgment of the privileged tax status of life estates, powers of appointment, employee annuities, and transferred life insurance. More fundamentally, the estate and gift taxes should be integrated to neutralize, insofar as possible, the tax effect of different time patterns of property distribution. At present it is excessively cheap to give away property during life by comparison with distributions at death.

The present estate tax ranges from 3 percent on taxable estates of \$5,000 or less to 77 percent on amounts of taxable estates over \$10 million. On amounts

in the bracket \$2,000,000-\$2,500,000 the rate is 49 percent. The nominal gift-tax rates, bracket by bracket, are three-fourths of the estate-tax rates. But the actual gift-tax rates are much lower, because, unlike the estate tax, the gift tax is excluded from the base. If, for example, \$1 million taxable estate is left by will to an heir, the tax is \$325,700. The heir would receive \$674,300. If the heir had received \$674,300 during the transferor's life the tax would have been only \$155,029. This is less than one-half, not three-fourths, of the estate tax of \$325,700. The gift-tax graduation operates on a cumulative basis with respect to each transferor. Both the estate and gift taxes are on the transferor, on the transfer of property rather than its acquisition. The property received by a transferee (whether from a decedent or a donor) will be taxed much less severely if several rather than one transferor is involved. There is much merit in the approach of an accessions tax, with graduated rates applying to the cumulations on the transferee.

The recommendations on the integration of the estate and gift taxes are as follows:

1. Pending the adoption of an individual income-tax averaging plan, the estate and gift taxes should be combined into one transfer tax based on the present gift-tax model, with a transfer at death treated as the last increment in the accumulation of the transfers. The accumulations should start anew with the date of enactment of the new transfer tax. The rates for this tax should be as follows:

If the taxable transfer is:

	<i>Rate (percent)</i>
Not over \$25,000.....	10
\$25,000 to \$50,000.....	20
\$50,000 to \$100,000.....	25
\$100,000 to \$250,000.....	30
\$250,000 to \$500,000.....	35
\$500,000 to \$1 million.....	40
\$1 million to \$2 million.....	45
\$2 million to \$3 million.....	50
\$3 million to \$5 million.....	55
\$5 million and over.....	60

2. After the adoption of an individual income-tax averaging plan, the rates for the new transfer tax in paragraph 1 above should be reduced by 50 percent, bracket by bracket, and in lieu of one-half the transfer tax thus surrendered an accessions tax should be imposed on one-half the property acquired by gift or bequest. This tax should take the form of including one-half of such acquisitions in the income-tax base of the recipient and be taxed at the income-tax rates in the same way as any other source of income. If there should prove to be a constitutional barrier to this simple form of an accessions tax, then an accessions tax separate from the income tax should ultimately be enacted. Nobody can be sufficiently certain in advance of testing the constitutional issue to warrant proceeding to this ultimate solution without first hearing the Supreme Court on it.

The tax base for the present estate and gift taxes is very narrow. For gift tax there are:

(a) An annual exclusion of \$3,000 per donee, without limit as to the number of donees. Since 1948 gifts are viewed as made one-half by each spouse, so that the \$3,000 exclusion is effectively \$6,000. A generous donor supporting 100 orphans could dispose of \$600,000 of property annually without tax, and if he did this through contributions to an orphan asylum he would, in addition, benefit from the income-tax deduction for charities.

(b) A specific cumulative exemption of \$30,000, but if the donor is married this becomes \$60,000 under the 1948 rule referred to above.

For estate tax and specific exemption is \$60,000, but if the estate is left to the spouse \$120,000 can be transferred free of tax due to the operation of the marital deduction enacted in 1948.

The recommendations on exclusions are exemptions for the new transfer tax are as follows:

(a) The exclusion should be limited to an amount of \$1,000 per donee and an aggregate of \$5,000 per donor.

(b) The cumulative specific exemption should be \$15,000 taken currently, in the same way as the present gift-tax exemption, that is, in the year elected by the taxpayer, plus \$15,000 applicable to the estate taxed at the death of the first spouse plus an additional \$15,000 applicable to the estate taxed at the death

of the second spouse. The unutilized exemption, if any, applicable to the estate taxed at the death of the first spouse should be added to the additional \$15,000 exemption applicable to the estate taxed at the death of the second spouse. No exemption is recommended for the accessions tax.

The extra exemption of \$15,000 at the death of the first spouse would be generally applicable whether the property was left to the spouse or to others. It is less generous than the marital deduction but more neutral in directing the dispositions. It would, of course, be possible to limit the first extra exemptions of \$15,000 to interspousal transfers and to increase the figure. Neither of these steps is recommended.

In present law an effort is made to equalize between community property and other States through the marital deduction and the splitting of gifts between the spouses. In the recommended transfer tax the direction of equalization would be reversed. The gifts of either spouse, irrespective of State of residence, would be part of the same stack of accumulated inter vivos gifts, except that interspousal gifts would be fully exempt. The increment resulting from the death of the first spouse would be added on top of that. The increment resulting from the death of the second spouse would be added as the final increment on top of the stack of accumulated inter vivos gifts of both spouses plus the increment resulting from the death of the first spouse. In community property States, as elsewhere, the determination of the amount of estate falling in at the death of the husband or the wife would be determined in accordance with the law that prevailed prior to the 1948 amendments. It would of course be possible to go back to the law before the 1942 amendments. While this is not recommended, it should be noted that under an integrated transfer tax the difference in tax consequences between the tax law as it prevailed before the 1942 amendments and before the 1948 amendments is substantially less than under an unintegrated transfer tax with separate estate and gift taxes.

In some dispositions of property only the right to the income is conveyed and in others only the right to appoint the future ownership of the property is given. These are two aspects of full property ownership. Either right alone may not be tantamount to full ownership but neither is it a worthless right to be ignored in the taxation of property transfers. This is now done with respect to life estates. They are excluded from the estate-tax base of the life tenant. Most general powers of appointment are now taxable; limited powers are not taxable. A big gate has been opened through the transfer taxes by the skillful use of the highly technical devices of life estates and powers of appointment.

It is recommended that a committee of experts drawn from the law schools and practicing lawyers specializing in estate and gift taxes be appointed by the Treasury to make specific recommendations on how the law on life estates and powers of appointment could be tightened with a view to broadening the transfer tax base. In this connection note is made of earlier studies on the estate and gift taxes made by a similar committee of experts.

Finally, and particularly if the estate and gift taxes are strengthened, there is the taxpayment problem—the general problem, and as it applies to small closely held family businesses. The general payment problem has two aspects. There is a drift toward liquidity in large estates as the terminal point of life expectancy is approached. This shift away from risk assumption could be prejudicial to economic development. Even if this tendency were not of significant magnitude, it would be desirable to differentiate the base in favor of risky investment to promote risk assumption. This could be done by including some items of property at less than 100 percent of value.

It is recommended that direct investment in small businesses, partnership interests and common stocks of corporations with assets of \$1 million or less, be included in the estate tax at 75 percent instead of 100 percent.

Such differentiation to promote economic growth would help the actual payment of taxes only incidentally by reducing the tax liabilities with respect to the specified types of property. This might, however, make for illiquidity and so aggravate the taxpayment problem instead of easing it.

The law now gives the Commissioner discretion to extend estate-tax payments over 10 years at 4 percent. This takes care of most hardship cases. In addition, closely held family corporations are allowed to make distributions for estate tax payment purposes through the redemption of stock without subjecting the stockholders to tax on these distributions as if they were dividends. The excess of such distributions over the fair market value of the stock at the date of the owner's death is, however, taxable at the capital gains tax rate. While this

provision is helpful as regards the estate tax payment problem, such redemption of stock tends to strip the business of liquid funds.

To avoid this, it is recommended (a) that where the estate is primarily in closely held family corporations, the 10-year extension be made to apply automatically at the election of the taxpayer, and (b) that the Federal Government be permitted to accept equities in the business as tentative payment for estate taxes and to share ratably in the profits, such profits to be applied to the tax liabilities plus interest due.

Mr. SHERE. I repeat that if inflation persists, there should be no net tax reduction. But even under such conditions it should be possible to proceed with desirable structural changes that would have offsetting revenue effects, or better, that on balance would yield net additional revenue. Perhaps more important, it should be possible to complete a number of major investigations without which we would be ill-prepared to move toward legislation when it becomes timely to do so.

The more important investigations which should be started at once include the following:

1. Averaging the individual income tax base. I doubt that there exists a practical averaging plan which could be recommended to the Congress for legislative action. It needs to be administratively feasible, be easy to comply with, and possess the right bounce as regards fiscal impact. Also, we need to be sure that it will solve important problems.

I believe that the institution of a practical averaging plan has high priority among the needed structural changes in our tax system.

2. Depletion. Present arrangements leave the public with a sense of gross injustice, a feeling that tax favors are bestowed upon those that need them least, without Uncle Sam getting his money's worth in terms of national security or economic development.

In my paper I suggest an alternative to percentage depletion, but if percentage depletion is retained, then with the aid of the extractive industries, a new system of percentages should be developed. I believe that these rates should vary so as to permit earlier recovery of the investment in the higher risk and more critical items, but that they should not be set so high as to recover the investment quicker than in one-half the life of the property. In no case should the taxpayer be permitted to recover more than 150 percent of the full cost of the property, including exploration and development expenses.

3. Estate and gift taxes and top individual income tax rates. The top individual income tax rates are excessively high. They should scale to a maximum of around 70 percent instead of 91 percent. A half billion dollars could buy a reasonable downward adjustment of these rates. The revenue loss should be recouped from the estate and gift taxes.

I recommend that a committee of experts drawn from the law schools and practicing lawyers be appointed to develop a better integrated and stronger transfer tax system. Much homework on this difficult subject was done in 1947 by an advisory committee of the Treasury.

4. Tax-exempt securities of State and local governments. The President made two recommendations in this area. I support these recommendations.

I believe, however, that the State and local governments would be helped more, and that simultaneously a long-standing defect in the Federal income tax could be lifted, if the Federal Government under-

took to pay annually a generous fraction of the interest cost to those State and local governments that agree to surrender the privilege of tax exemption.

5. Tax enforcement. The public must be given adequate grounds for believing in the fairness of the tax laws. This is a matter that can be handled only partly by legislation. The rest must be done by efficient and equitable administration of the tax laws.

I believe it highly desirable to establish a strong commission to make recommendations on the matter of eliminating tax evasion and the gross abuses that qualify as tax avoidance; for example, padding expense accounts.

I have indicated some possible structural revisions which would strengthen, not weaken, the revenues—for example, cutting down on the depletion provisions and overhauling the estate and gift taxes. There are other revisions that would strengthen the revenues and could be made in 1957. These include the following.

1. Elimination of many of the exclusions from gross income of individuals.

2. Elimination of deduction for nonbusiness personal interest and for all State and local taxes under the individual income tax. Simultaneously, I would cut the standard deduction 50 percent.

3. Elimination of special exemptions for the aged and blind. These are matters that can be handled better under social security. Also taxpayers should be required to include the amount of income (above some administrative minimum) received by any person he claims as a dependent.

Overall, by eliminating certain exclusions, deductions, and special exemptions, the yield of the individual income tax could be increased to 5 or 6 billion dollars. This would provide ample revenue to finance the structural reforms already mentioned, and others. Among them I would put high on the priority list:

The recommendations made by the President's Cabinet Committee on Small Business, and a number of proposals listed in my study that would strengthen the built-in flexibility of the tax system, reduce the burden of risk assumption and help small business. For example, a carry-back and carry-forward of unused surtax exemptions of corporations for a period of 5 years each way, and a higher annual limit for the offset of capital losses against ordinary individual income.

Unless the inflationary situation becomes more serious in 1957 than it is, any net increase in the revenues resulting from structural changes, after a proper accounting of the lags, should be compensated by a downward adjustment of rates.

But what if inflation goes away during 1957?

First, if there is a recession, top priority should be given to an overall revision of the individual income tax rates, particularly splitting the first bracket (making the rate lower than 20 percent applicable to the first \$750 or \$1,000 of income). This would strengthen the built-in flexibility and the fairness of the individual income tax.

In addition, full income splitting should be extended to all single taxpayers and heads of households. A change in marital status now results in unreasonable differences in tax. This proposal would not undo what income splitting has done to solve the community property problem and to equalize the tax treatment between earned and unearned income.

Second, if there is no recession in 1957, but inflationary pressures abate with a promise of stabilized growth, I would then throw into the tax-reduction mix a few other ingredients, shifting the emphasis somewhat away from stimulating consumption toward stimulating investment. I would make less sharp cuts at the bottom of the individual income tax and include some cut in the corporate income tax rate, combining this with 10 percent corporate dividend payment allowance, in lieu of the present dividend exclusion and credit under the individual income tax. It would be desirable also to repeal some of the excises, starting with the tax on freight.

Such are the types of tax adjustment and tax reduction appropriate for 1957 under different economic conditions. What cannot be done in 1957 should be done soon. Tax reductions should not be postponed unduly. To do so implies using a strong tax system to force savings to be turned over to the private sector of the economy as the public debt is retired. Under current conditions this is desirable, but if long continued, in less optimistic days, it could lead to recession.

(The full statement of Mr. Shere follows:)

STATEMENT BY LOUIS SHERE, PROFESSOR OF ECONOMICS, INDIANA UNIVERSITY, ON
FISCAL AND MONETARY POLICIES FOR 1957

The fiscal and monetary policies which are being pursued currently are sound. They are designed to restrain the mildly inflationary pressures that have developed from efforts to produce and consume more goods and services than can be made available quickly, even with our vast resources. To reverse these policies now—reduce taxes and ease credit—would inflate the economy without expanding it appreciably.

But as soon as there is no longer any threat of inflation, credit restraints should be relaxed. This should be given top priority. Taxes should be reduced. The state of the economy, rather than the size of the budget surplus, should determine the appropriate fiscal and monetary policies.

General credit controls do not have a uniformly effective and salutary impact upon all segments of the economy. There has been proper concern about the excessive potency of credit restraints as they apply to small business, housing, the financial requirements of State and local governments, and technological change; and, perhaps also, about their relative impotency in the consumer and speculative markets. General credit policy has been implemented and its scope shrunk by the adoption of a variety of devices which supply credit on especially favorable terms in various directions through the huge Federal credit programs that involve either direct loans, guaranty or insurance of private loans, or provide temporary markets for securities that otherwise would have difficulty making a timely entry into the private capital market. Beneficiaries of these devices include: housing, agriculture, foreign trade, defense, small business, health, underdeveloped localities, and, in all probability, soon will include school construction.

I doubt the need for new devices to reduce further the scope and perhaps the potency of general credit policy. While the control of credit must always be qualitative as well as quantitative the better to give effect to social goals and priorities, there is great danger that excessive encroachment upon general credit policy would enfeeble it unduly as a stabilization measure.

I strongly endorse the President's recommendation for a broad national inquiry into our financial system, covering public as well as private agencies. Among the important questions that such inquiry should help settle are the following:

(1) Is there need for a more formal arrangement to coordinate the monetary policies of the Federal Reserve Board with the economic recommendations of the Council of Economic Advisers?

(2) What is the proper scope for the powers of the Federal Reserve System in relation to nonmember banks and the financial intermediaries?

(3) What is the proper scope for public credit and the most effective mechanism for coordinating the policies of the public credit agencies with the objectives of the Employment Act?

(4) What steps, if any, should be taken by private enterprise, with or without the assistance of the Government, to pool the risks of making credit and capital more adequately available to small business, at reasonable rates?

I turn next to tax policy. Under the stimulation of the work of this Committee, I have prepared a paper on Federal Tax Revision To Promote Economic Growth and Stability. It contains some 40 specific recommendations. If it is the pleasure of the committee, I would like to offer this study for the record and in these remarks focus more specifically on the nature of the tax legislation and investigations that I recommend for 1957.¹ The recommendations are based on different assumptions about economic conditions that may prevail over the coming year.

I repeat that if inflation persists there should be no net tax reduction. But even under such conditions it should be possible to proceed with desirable structural changes that would have offsetting revenue effects, or better, that on balance would yield net additional revenue. Perhaps more important, it should be possible to complete a number of major investigations without which we would be ill prepared to move toward legislation when it becomes timely to do so.

The more important investigations which should be started at once include the following:

1. *Averaging the individual income-tax base.*—It is generally agreed that because the income-tax rates are progressive, the present law discriminates against fluctuating incomes, incomes that grow or decline over time, individuals who assume high risks or expend extraordinary effort in employment or investment. This discrimination is prejudicial to economic growth. Yet, after decades of discussion, I doubt that there exists a practical averaging plan which could be recommended to the Congress for legislative action. It needs to be administratively feasible, be easy to comply with, and possess the right bounce as regards fiscal impact. Also, we need to be sure that it will solve important problems.

I believe that the institution of a practical averaging plan has high priority among the needed structural changes in our tax system.

2. *Depletion.*—The law now allows percentage depletion, ranging from 5 to 27½ percent of gross income, to substantially all extractive industries, excluding soil, water, air, mosses, or similar inexhaustible sources. The permission to write off more than 100 percent of cost, which, for security reasons, started in World War I with discovery value, and later was converted to percentage depletion, was initially granted a limited few taxpayers, but has spread without regard to essential incentive objectives. Present arrangements leave the public with a sense of gross injustice, a feeling that tax favors are bestowed upon those that need them least, without Uncle Sam getting his money's worth in terms of national security or economic development.

In my paper, I suggest an alternative to percentage depletion, but if percentage depletion is retained, then with the aid of the extractive industries, a new system of percentages should be developed. I believe that these rates should vary so as to permit earlier recovery of the investment in the higher risk and more critical items, but that they should not be set so high as to recover the investment quicker than in one-half the life of the property. In no case should the taxpayer be permitted to recover more than 150 percent of the full cost of the property, including exploration and development expenses. These expenditures should be capitalized, not expensed, as now.

3. *Estate and gift taxes and top individual income-tax rates.*—The top individual income-tax rates are excessively high. They should scale to a maximum of around 70 percent instead of 91 percent. A half billion dollars could buy a reasonable downward adjustment of these rates. The revenue loss should be recouped from the estate and gift taxes. These taxes, like the top individual income-tax rates, affect the wealthier citizens. On the whole, they are timed more conveniently. The incentive effects of these taxes are less prejudicial to effort and risk assumption than the top marginal income-tax rates. The estate and gift taxes are now weakened by excessive marital deductions, excessive exclusions, exempt life estates and powers of appointment, exempt employee annuities, exempt life insurance, high specific exemptions and low rates for the bulk of the estates. Further, inter vivos transfers are unduly favored by comparison with transfers at death.

I recommend that a committee of experts drawn from the law schools and practicing lawyers be appointed to develop a better integrated and stronger transfer

¹ Inserted in Mr. Shere's oral testimony.

tax system. Much homework on this difficult subject was done in 1947 by an advisory committee to the Treasury.

4. *Tax exempt securities of State and local governments.*—The President makes two recommendations in this area: He urges the States to review State and local debt limits and other limitations upon borrowing, and he would permit regulated investment companies holding their assets in State and local securities to pass through to their stockholders the tax-exempt status of income received on these securities. I support these recommendations.

I believe, however, that the State and local governments would be helped more, and that simultaneously a long-standing defect in the Federal income tax could be lifted, if the Federal Government undertook to pay annually a generous fraction of the interest cost to those State and local governments that agree to surrender the privilege of tax exemption. The technical details for such grants, for example, procedures to be followed upon refunding, and others which would be vexing over a relatively long transition period, would need to be worked out between the appropriate Federal agencies and the State and local governments. Since the payments would be geared to the interest cost, the smaller and weaker jurisdictions would automatically receive favorable treatment.

5. *Tax enforcement.*—The public must be given adequate grounds for believing in the fairness of the tax laws. This is a matter that can be handled only partly by legislation. The rest must be done by efficient and equitable administration of the tax laws. The congressional practice of drawing upon practicing accountants and lawyers and those from universities for help on administrative and compliance matters is encouraging.

I believe it highly desirable to establish a strong commission to make recommendations on the matter of eliminating tax evasion and the gross abuses that qualify as tax avoidance, for example, padding expense accounts and diverting advertising expenses to personal nonbusiness purposes.

I hope that in 1957 it will be possible to emerge from the many minor technical tax avoidance matters that have persistently taken so much energy, and to focus again on the big issues in Federal tax revision.

I have indicated some possible structural revisions which would strengthen, not weaken, the revenues—for example, cutting down on the depletion provisions and overhauling the estate and gift taxes. There are other revisions that likewise would strengthen the revenues, and could be made in 1957. These include the following:

1. *Exclusions from gross individual income.*—The personal exemptions are designed to give the basic protection from the impact of income taxes. The income tax should be comprehensive in its coverage, otherwise, if the flow is from more than one source, some with more income might be taxed less than others with less income. Many of the exclusions allowed in present law should be eliminated. The details are specified in the paper which I submitted for the record.

2. *Deductions from individual income.*—I would eliminate the deduction from nonbusiness personal interest and for all State and local taxes. Simultaneously, I would cut the standard deduction 50 percent. The only case for the present high 10 percent figure is that the standard deduction tends to equalize the tax treatment of homeowners and renters. The property taxes and the mortgage interest on the home eat deeply into the 10 percent standard deduction. If the renter is also given this standard deduction, then the taxes and interest costs included in his rent, but not allowed as a deduction, are taken into account indirectly by the generous allowance for nonbusiness deductions. I would move toward equalization by eliminating the deductions for the mortgage interest and property taxes and simultaneously reducing the standard deduction.

3. *Special exemptions.*—(a) Present income tax law allows a special exemption for the aged and the blind. These are matters that can be handled better under social security. If necessary, social security benefits should be adjusted. The deduction under the progressive individual income tax rates results in an irrational system of variable hidden benefits that discriminate against the lowest incomes.

(b) Under present law, the earnings of dependents are not taxed if earnings do not exceed \$600. The excess over \$600 is taxed to the child as a taxpayer, but the parent may also claim the child as a dependent. Thus in effect there are two exemptions if the child is an earner, but only one if he is not. This is clearly illogical. The taxpayer should be required to include the amount of income (above some administrative minimum) received by any person whom he claims as a dependent.

Overall, by eliminating certain exclusions, deductions, and special exemptions, the yield of the individual income tax could be increased by \$5 or \$6 billion. This would provide ample revenue to finance the structural reforms already mentioned, and others. Among them I would put high on the priority list the following:

1. Reverse the corporate normal and surtax rates. This recommendation, first made by Senator Fulbright, was accepted in principle by the President's Cabinet Committee on Small Business, except that it went further and reduced the normal rate to 20 percent.

2. Extend the carryback of net losses from the present 2 years to 5 years. This would strengthen the built-in flexibility of the tax system, reduce the burden of risk assumption, and help small business.

3. For the same reasons allow the carry back and carry forward of unused surtax exemptions of corporations for a period of 5 years each way.

4. For the same reasons raise the annual limit for the offset of capital losses against ordinary income from \$1,000 to \$5,000.

5. Extend liberalized depreciation to old assets, including machinery and equipment, plants, and buildings, and residential rental buildings. The President's Cabinet Committee on Small Business made a similar recommendation adapted to its purposes by restricting the extension to a small amount of old assets.

6. To promote private investment abroad United States corporations should be permitted to elect subsidiary treatment for their foreign branches, which would result in deferral of tax on income and the denial of current offset of losses. They also should be permitted to elect whether or not to consolidate their foreign subsidiaries with domestic subsidiaries and the parent corporation, which would result in the current taxation of profits and the current offset of losses.

All the recommendations made so far should be adopted in 1957, even if, perhaps I should say particularly if the situation remains inflationary. In combination they strengthen rather than weaken the revenue system. Unless the inflationary situation becomes more serious, any net increase in the revenues resulting from structural changes, after a proper accounting of the lags, should be compensated by a downward adjustment of rates.

But what if the economic conditions change during 1957?

First, if there is a recession—Top priority should be given to an overall revision of the individual income tax rates, particularly splitting the first bracket (making a rate lower than 20 percent applicable to the first \$750 or \$1,000 of income). This would strengthen the built-in flexibility and the fairness of the individual income tax. Over three-fourths of the taxpayers, accounting for about 70 percent of the tax base and about 60 percent of the tax, do not have taxable income in excess of the first bracket which is subject only to the starting rate of 20 percent.

In addition, full income splitting should be extended to all single taxpayers and heads of households. A change in marital status now results in unreasonable differences in tax. This proposal would not undo what income splitting has done to solve the community property problem and to equalize the tax treatment between earned and unearned income.

Second, if there is no recession in 1957, but inflationary pressures abate with a promise of steady growth—I would then throw into the tax reduction mix a few other ingredients, shifting the emphasis somewhat away from stimulating consumption and towards stimulating investment. I would make less sharp cuts at the bottom of the individual income tax. The new ingredients should include:

1. Some cut in the corporate income tax rate.

2. A 10 percent corporate dividend payment allowance, in lieu of the present dividend exclusion and credit under the individual income tax.

3. Repeal of some of the excises (outside the area of liquors, tobacco, and the automotive taxes), starting with the tax on freight.

Such are the types of tax adjustment and tax reduction appropriate for 1957 under different economic conditions. What can't be done in 1957 should be done soon. Tax reductions should not be postponed unduly. To do so implies using a strong tax system to force savings to be turned over to the private sector of the economy as the public debt is retired. Under current conditions this is desirable, but if long continued, in less optimistic days, it could lead to recession. Moreover, even if this judgment is in error, filling in the backlog of public facilities, at the Federal, State and local levels of government should be given a high priority in the allocation of available resources over the next several

years. In the long run, such an expansion of public facilities may be critically important to preserve our free enterprise system, stimulate its growth, and defend it against our enemies. Moreover, I also doubt whether the American public is in a mood to use high taxation as a method of forced saving to accomplish some redress of a difficult-to-determine balance between the private and the public sectors of the economy. I am more inclined to the view that they will press for tax reduction and a slower long run approach to this balance, with suitable adjustments in the allocation of the growth increments.

Representative MILLS. Our next panelist is Prof. Lester V. Chandler, department of economics and sociology, of Princeton University.

STATEMENT OF LESTER V. CHANDLER, PROFESSOR, DEPARTMENT OF ECONOMICS AND SOCIOLOGY, PRINCETON UNIVERSITY

Mr. CHANDLER. Thank you, Mr. Chairman.

What ever may be the nature of cyclical developments later this year—and I am skeptical about our ability to make such longer-run forecasts—the prospects for the next few months appear to be for at least a continuation, and probably an intensification, of upward pressures on prices. With demands for output already so high as to raise prices, we are told that business plans to buy plant and equipment at an even higher rate, State and local governments to continue to raise their expenditures, and the Federal Government to increase both its spending and its commitments to spend in the future.

Forecasts of consumer behavior are less firm, but it seems unlikely that consumers will spend less as their money incomes are increased by rising business and Government spending.

I see no justification for any relaxation of either fiscal or monetary policy so long as this outlook continues. The present surplus in the conventional and cash budgets of the Federal Government provide no valid reason for a tax cut. We have inflationary pressures despite this surplus, and any reduction of the surplus would increase upward pressures on prices and put an even greater burden on monetary policy.

I recommend that nothing be done to decrease the present and prospective tax surplus. This means that any significant increase of Federal spending above the levels recommended in the Executive budget should be matched by tax increases, and that any significant tax reductions that may be made for tax reform purposes should be offset by additional tax revenues from other sources.

I believe that a restrictive monetary policy can deal satisfactorily with the remaining inflationary forces if a budget surplus of about the projected size is maintained, but I fear that any significant shrinking of that surplus might create very difficult problems for the monetary authorities.

So long as present conditions continue, monetary policy should remain restrictive. This means that expansion of the money supply should be carefully limited despite increases in the demand for credit. The result should be a continuation of high interest rates and perhaps even higher rates if the demand for credit continues to rise.

This does not necessarily mean that there should be no further increase in the money supply. As you know, the money supply has been allowed to rise very little during the past 2 years. The \$50 billion increase in gross national product during that period was financed largely by a rise in the velocity of money.

Households and business firms were highly liquid after the easy-money policy of 1954 and therefore able to increase their spendings by drawing upon idle balances or by spending their balances more quickly. So long as the velocity of money was increasing so markedly the Federal Reserve appropriately refused to allow any significant increase in the money supply. But it may well be that the upward elasticity of spending through increasing velocity is now nearing exhaustion and that further rises in spending to match increases in productive capacity will require in the future a somewhat faster increase in the money supply than we have had during the past 2 years. However, the major principle remains unaffected—that so long as inflationary forces continue the Federal Reserve should restrict the supply of money to the degree necessary to prevent the rate of spending from outrunning the Nation's productive capacity.

In the area of national credit policy, I suggest a thorough reconsideration of the practice of placing ceilings on the rates of interest applying to mortgages insured by FHA and VA. Perhaps ceilings on these rates served a useful purpose when insured mortgages were a new and unfamiliar instrument and when market rates of interest were relatively stable.

But there is mounting evidence that they now have serious disadvantages and may not achieve the results desired. For example, they may not protect the home buyer. If his mortgage is sold at a discount, what he gains from a lower nominal rate may be lost by having to take out a larger mortgage. And if the ceiling is effective, he may not be able to get any mortgage funds in a tightening money market where yields on other securities are rising. Though I am not an expert on the mortgage market, I suspect that attempts to put ceilings on mortgage rates when other money market rates are fluctuating are likely to have undesirable effects on the allocation of credit and perhaps even to injure both prospective homeowners and the home-construction industry.

I come now to question 2: "Should the scope of general credit controls be broadened to include financial intermediaries other than commercial banks which are members of the Federal Reserve System?" On this I have two general comments. The first is that all commercial banks—nonmember as well as member—should be subjected to the same reserve requirements. My principal argument for this is one of equity; that nonmember banks should bear their fair share of any burdens involved in holding reserves.

But the Federal Reserve already has a high degree of control over the volume of credit created by nonmember banks. When the Federal Reserve removes reserve funds from the market, nonmember banks as well as member banks lose reserve and lending power.

My second comment is that at the present time I see no reason to extend Federal Reserve controls to financial institutions over than commercial banks. This is because I believe that present powers are adequate and that the Federal Reserve can indirectly affect the volume and price of credit extended by these institutions. For example, Federal Reserve policies during the past 2 years have brought about increased interest charges by practically all lenders. In my opinion the Federal Reserve has had adequate control despite the importance of lenders other than commercial banks. However, realizing that my point of view on this matter is opposed by many others, I suggest

that this issue should be studied thoroughly if a national monetary commission is established.

In closing, I should like to recommend the creation of a body to make a broad and thorough investigation of the American monetary and financial system. Within the past decade we have had many partial investigations in this field.

This committee has sponsored at least three of them. All these have served a useful purpose. But we need a further investigation that will bring the earlier studies up to date and put them in a broader setting. Some of the highly important topics that merit study are not only the structure, powers, and policies of the Federal Reserve and the Treasury, but also the structure of the commercial banking system, including chartering, branching, mergers, and holding companies; the relative roles of commercial banks and other private financial institutions; the functions and policies of these other institutions; and the functions and policies of the various types of Federal credit agencies.

I take no position on the question of whether the Commission should be composed of Members of Congress, private citizens, or some combination. But if the Commission is made up in any considerable part of private citizens it should not, in my opinion, concentrate on making recommendations as to public policy.

Rather, its prime purpose should be to bring out clearly the relevant facts and points of view and to highlight the various policy alternatives. In this way it would be much more helpful to the Congress than it could be if it concentrated on arriving at its own compromises which it would present in the form of recommendations.

The third question asks, "What devices would you suggest to direct a larger proportion of the available credit supply to certain purposes with a high social priority—e. g., school construction—while retaining general credit restraint?" There is no easy solution of this problem. I know of no way to maintain easy-money conditions in the market for school obligations while maintaining tight money for every other type of borrower.

Nor would a general relaxation of credit restraint help the school authorities. If more and cheaper credit were available for every purpose—including other types of construction—the competition would merely be transferred to the markets for construction labor and materials.

The school authorities would then be plagued by greater shortages and higher construction costs. I fear that the only practical solution is for the school authorities to outbid others in both the credit market and the market for construction labor and materials. In short, the high social priority which we attach to schools must be evidenced by a willingness to spend the required amounts for the purpose.

This will probably require greater financial assistance from State governments and the Federal Government.

Representative MILLS. Mr. Patman has not yet been able to get to this session this morning. We will have to proceed to hear the other two panelists.

The next panelist is Mr. Alfred Neal, president of the Committee for Economic Development. Mr. Neal, you are recognized for 8 minutes.

**STATEMENT OF ALFRED NEAL, PRESIDENT, COMMITTEE FOR
ECONOMIC DEVELOPMENT**

Mr. NEAL. Thank you, Mr. Chairman. May I start by saying, as others have, that I am appearing here in my personal capacity, Mr. Chairman, and nothing I say should in any way imply that my organization is committed to it.

I am going to attempt to answer the questions that were posed to us on this part of the panel by directing my remarks around a citation in the Economic Report of the President which appears on page 3. It says:

The full burden of avoiding price inflation, which is an ever-present hazard in an expanding economy operating close to capacity, cannot be successfully carried by fiscal and monetary restraints alone. To place this burden on them would invite the risk of producing effects on the structure and functioning of our economy which might, in the years ahead, impair the vitality of competitive enterprise.

This statement and the paragraph preceding it, which calls for business and labor to follow wage and price policies consistent with price stability, raise some real questions about who has the job of controlling inflation.

Control of inflation can never be primarily the job of private business or of private labor. Inflation cannot be controlled without controlling the money supply, and in a modern economy, Government has that job.

So, if we have inflation, let us not get confused about how it happened; it will happen because governmental authority was not used to turn off the money spigot or to reverse the money pump.

There is a sense in which the statement quoted is true: failure of labor, business, and the public generally to support the measures needed to control inflation could result in capitulation by the monetary authorities. I hope that the business and labor organizations which appear in this series of panel discussions make clear their support of anti-inflationary measures. Then the monetary and fiscal authorities can take courage and put their backs into their jobs. They need support in their efforts, not alibis if they fail.

If fiscal and monetary policies provide sufficient restraint, labor and business will find it easier to settle for noninflationary wage increases. The key question is, Will labor support and take the consequences of monetary policies sufficiently restrictive to prevent further inflation?

The price increases from mid-1955 cited in the report (p. 32) look inflationary to me—producer equipment up 13 percent; construction materials up 7 percent; industrial prices up 8 percent; consumer durables up 6 percent; consumer nondurables up 3 percent. The real danger of failure to control inflation, however, lies ahead of us.

Many influential and economically sophisticated people believe that long-run inflation is in store for the United States. They argue: Build or buy now, because delay will cost you more. They argue against saving and for going into debt, because savings will be worth less and debt will be easier to repay later. If these views have had much influence on us in the last 2 years and if the 1957 level of business is predicated upon them to any extent, we will be in for trouble.

Fortunately, these views still do not dominate, and I think stability at a high level of business can still be preserved in 1957.

Fiscal policy for next year, as evidenced in the budget, barely meets the requirements of anti-inflationary fiscal policy. Federal cash payments to the public in fiscal 1958 will be \$83 billion, up almost \$5 billion from 1957. The excess of cash receipts, \$3 billion, provides a very small margin for debt reduction which inflationary conditions call for. This is considerably less than the nearly \$4.5 billion achieved in 1956, during which inflation made headway.

Monetary policy cannot be restrictive in the face of a cash deficit, and it could be more restrictive if the cash surplus were larger. The events of November 1955 and at other times have taught us that the Federal Reserve cannot remain impassively restrictive when the Treasury must go to market with large issues of new securities.

What if 1957 turns out to be a bad business year? Should fiscal or monetary policy lead the way toward fighting recession? The speed with which monetary policy can turn around clearly gives it the first blow at a recession. Fiscal policy will automatically contribute its assistance to the fight as Government revenues fall off. It does not now appear likely that any further measures would be needed to deal with any possible downturn of business in 1957, particularly in view of the strength presently being shown.

Now a final word about the second sentence in that quotation, which implies that a truly effective antiinflationary policy might impair our enterprise system. I do not believe it.

Does it mean that the damage to the enterprise system that would be inflicted by inflation is less than that which would result from restraint? If so, I should like to see the evidence.

We need to know a good deal more about the influence of restraint on various sectors of our economy. Who does what to whom, and how.

The Federal Reserve is surprisingly ignorant on such matters, or so it seems to me; it needs to do more research in this field, if only to test the validity of the statement quoted.

Better still, this whole question of the effects upon the structure of our economy brought about by anti-inflationary restraints is another which should be explored by the proposed National Monetary Commission.

The need for such a Commission was pointed out by the Committee for Economic Development as long ago as 1948. The need discerned then is urgent now. The range of ignorance about the effects of monetary policy is so wide that nothing short of such a commission is likely to dispel it.

Chairman PATMAN (presiding). Thank you, sir. Dr. Seymour Harris, chairman of economics, Harvard University.

**STATEMENT OF SEYMOUR E. HARRIS, CHAIRMAN AND PROFESSOR,
DEPARTMENT OF ECONOMICS, HARVARD UNIVERSITY**

Mr. HARRIS. Mr. Chairman, I have a statement which is fairly long, and a summary statement which is shorter, but I think I will not read too much of it and try to summarize in the time allotted me.

I might say at the very outset that the problems of monetary and fiscal policy are sometimes determined by difference of ideology. If

I may be in a slight way political here, I might say that over the history, Republicans are more distrustful of Government than are Democrats, and therefore tend to favor monetary against fiscal policy. This is just a matter of degree. But since fiscal policy depends on the size of the budget, adjustments in the amount and structure of taxes and public expenditures, a Republican administration is more disposed to rely on monetary policy which, perhaps wrongly, is associated with the operation of the free market. Surely, monetary policy received much more attention in 1952-56 than in the preceding 12 years. (But in contrast compare the excellent bipartisan report of the subcommittee of the joint committee, Tax Policy for Economic Growth and Stability.)

LIMITATIONS OF MONETARY POLICY

On the whole the dear money policy since 1952 has not been dramatically successful. Indeed, in contrast with past history, the rise in the supply of money was surprisingly modest; but one-third relatively that of GNP. (Over American history monetary supplies have risen many times as much as national income.)

The failure of monetary policy from 1952 to 1956 is evident in the expansion of banking debits and of activity of the financial intermediaries. Restraints on commercial banks were followed by abnormal expansion of other credit institutions.

Rise percent, 1952 to 1956

Gross national product.....	19
Adjusted demand deposits and currency.....	7
Banking debits (August).....	34
Insurance company assets.....	28
Savings and loan associations (1955).....	67
Federal credit agencies ¹ (fiscal year 1956).....	74
Ibid., commercial banks.....	33

¹The totals for 1952: \$40 billion; for fiscal year 1956, \$68 billion; fiscal year 1957 (estimated) \$76 billion; and 1958 (estimated) \$85 billion (budget, 1958, p. 1106).

I am not insisting that these failures to control lending were unfortunate. Had not the financial intermediaries, inclusive of the Federal Government largely operating independently, expanded at an unusual rate, would GNP have risen from \$283 to \$402 billion in 1955 prices, or \$12 per year?

A primary objective of the dear money policy was to lengthen the maturities of Government securities and get them out of the banks. Here again the objective was not attained. In fact, from 1945 to 1952, without the help of a dear money policy, the banks disposed of governments much more than from 1952 on.

FISCAL POLICY

Growth of the Government sector of the economy opens up possibilities of a wise and effective use of fiscal policy. In 1953-54, a drastic cut in expenditures, combined with a dear money policy, brought on a recession which may have cost the Nation \$30 billion; but fortunately a tax cut and an early reversal of monetary policy prevent further trouble. And despite the objectives, cash receipts are up by 13 billion and payments by \$6 billion from fiscal year 1953 to 1958.

It is not at all clear that the administration understands or is prepared to use modern fiscal theory. A strong statement by the President in 1954, not followed by deeds, is an exception.

I might also say that the President on January 23, 1957, sounded like Lord Keynes, but the question is, Is he going to act like Lord Keynes? Time and again in the last year, the administration leaders have insisted that a tax cut would only come if the budget were not unbalanced by the cut. In other words, cut taxes in inflationary periods and increase inflation. In his January statement that he would resign if deficit financing were used to deal with a depression, Secretary Humphrey revealed that folklore and mythology count for more than arithmetic with the Treasury. He also said that unless we cut Federal expenditures, we shall "have a depression that will curl our hair." In the light of modern economics if he remains determined, he is doing a disservice to his country and his party.

CONTRAST IN FISCAL APPROACH

How to use a rising GNP? The Democratic principle has been to absorb part in rising public services. From 1948 to 1952, Federal cash payments accounted for 40 percent of a rise of GNP of \$88 billion. The Korean war was, of course, a major factor. (In 1948-50 there was a rise of nonsecurity outlays; in 1950-52, a substantial decline.) From 1952 to 1956 GNP rose by \$65 billion and only 3 percent went into Federal cash payments. In fiscal years 1954-56, expenditures on civil benefits averaged less than in fiscal year 1953. A Democratic administration would have spent several billions more on schools, hospitals, slums, and so forth. With a rise of \$65 billion in GNP and a cut of expenditures by \$10 billion, they might have been wise to deflate the highway program and spend more on schools, and so forth. The public sector should grow with the private sector. From 1948 to 1957 the nonsecurity outlays have declined by 35 to 40 percent vis-a-vis GNP.

There is also some difference on how to spend the money. So much for highways, so little for schools? Is this for example the influence of Detroit? Billions for taking good land out of cultivation at the same time that much more is being spent per acre to put land into use in the Colorado River area. (See Senator Douglas in 1956 hearings on the economic report, pp. 419-421.)

Administration policy relatively favors a tax cut more than Democrats as the fiscal approach; the Democrats are more inclined to favor a rise of public outlays. This follows because tax cuts tend to favor high income groups.

EQUITY AND FISCAL POLICY

Stability is one objective of economic policy; equity another. Both may have to be sacrificed to some extent. As one reads the statement of Secretary Humphrey, one finds he is not interested in cutting inflation but primarily in cutting taxes. In 1953-54, both might have been served by an expansion of services; in 1957, the need of schools and other public services may make necessary a slight concession to instability.

THE BUDGET AND POLICY

Objectives of economic policy are presumably stabilization, growth, and equity. But then in the last few years the size and the balancing of the budget have become the primary objective. Yet the budget is a tool of economic policy, not an end.

The Government has shown itself interested not so much in balancing the budget as in balancing the budget account. Through sales of assets, through reduced purchases, through increased recourse to guaranties and insurance, through trust funds outside of the budget—in all these ways the Government has tried to give an impression of an improved budget contrary to the facts. That they would increase their loan guaranties and insurance from forty to sixty billion dollars in a few years (and even to \$85 billion by fiscal year 1958) even though through monetary policy they were being cautious, suggests their aversion is not so much to fiscal policy as to any policy which is reflected in a higher apparent budget.

For example, the highway expenditures in the 1958 budget are supposed to be around \$1,800 million. What does the budget show? The budget shows a decline of highway expenditures from \$783 million in 1956 to \$42 million in 1958.

I would make one dissent in relation to what Professor Heller said, namely, I am not sure that remitting taxes on the part of the Federal Government results in the State and local governments getting the cash.

I had a talk with the Governor of our own State on this issue and pointed out to him that the reduction of Federal taxes in 1954 would provide him with almost all the cash in the total State budget of almost \$400 million, but he does not feel that this money is available. The point is that these States compete among themselves, and they are not ready to absorb the tax remissions of the Federal Government. If the Federal Government wants to provide the State governments with cash the easiest way is to cut taxes somewhat less and use this money to distribute to States and local governments.

POLICY FOR THE FUTURE

Objectives: Prevention of inflation is one objective of monetary policy. It is not the only one. Both rising output and no inflation are unusual. Even in the past 8 years an annual rise of output of 4.0 percent was accompanied by an increase of prices of 1.3 percent per year.

Techniques of monetary policy: In 1953 a hammer was used when a scalpel might have been adequate. This mistake was not repeated in 1956. The emphasis should be on open market operations and member bank reserves, not on discount policy and the distaste of member banks for being in debt—a theory applied in the twenties with little success.

I might say disinterring the fear of being in debt as a fundamental factor in monetary policy seems to me a very dubious attack on the problem.

Limitations of monetary policy: In the last few years the large expansion of lending by financial intermediaries reflects a failure of monetary policy, or at least the inadequacy of the weapon. The

obstacle of dealing with these intermediaries, the great strains put on the monetary weapon by cooperative wage-price policies of big industries and big unions (even encouraged by the administration for political purposes in 1956), the large resources available to large corporations (and hence greater independence from banks) and also the reluctance to use fiscal policy—all of these weaken the position of the monetary authority. Finally, there is some question whether raising rates is the proper approach, since it introduces serious inequities and therefore brings much political pressure against the monetary authority.

Integration of monetary and fiscal policy: Too much is expected of monetary policy in view of the techniques of control available and the reluctance to use fiscal policy.

The President is wrong to support an independent monetary authority. Once it is admitted that the Government must take some responsibility for economic conditions, the idea of an independent authority is out.

My interpretation of the 1951 accord is merely that a rigid rate policy was out and that any policy should be determined on the basis of overall economic interests, not merely on the basis of the interests of the Treasury; and that the Treasury should not dictate to the Federal Reserve what rates should be; and that policy should be determined in terms of the overall objectives of the economic system.

I therefore feel that the accord is being misinterpreted.

Improved integration is a must. Note the Open Market Committee in December 1952 and March 1953, saw no evidence of inflation, but the Treasury embarked on a vigorous anti-inflation policy. In the spring of 1953 the Federal Reserve reversed its dear-money policy but the President said, in view of inflationary dangers, he would not support a tax cut. In the years 1953-56, the Federal Reserve was very cautious about monetary supplies, but the Government proceeded to insure and guarantee loans at a record rate. In the latter part of 1956 the Treasury and Council disapproved of the rise of rates.

In the hearings of 1956 before this committee, the head of the Federal Reserve System, Mr. Martin, made it quite clear that there was very little integration of policy between the Federal Reserve, the Housing Administration, and also the Treasury. In fact, Mr. Martin said he had only seen Mr. Cole once, the head of the Housing Administration, and he said Treasury policy was a problem of the Treasury and not his province.

The use of fiscal policy: A government that uses a fair share of the increase of output to provide required services will make it easier as a byproduct to use fiscal policy effectively. The only use of added tax receipts with rising income should not be tax cuts or repayment of debt. Even the increase in the budget to \$72 billion, or 3 percent above the revised 1957 budget, is not excessive.

As a matter of fact, the increase on a cash account is an additional 1 billion. This is less than the average percentage rise of income in the past 10 years; and in the past 4 years some public services have been started. I would suggest better allocation of these expenditures.

REPLIES TO QUESTIONS PUT BY COMMITTEE

Monetary and fiscal policy—which?

The discussion above reveals that we are depending too much on monetary policy. The great advantage that monetary policy has over fiscal policy is that it can operate day by day without congressional action. But 43 years of history reveals: (1) An unwillingness to take bold action; or (2) action too weak (1927-29), or too much (1953); or (3) political pressures following cautious policies (1956). Besides, there is the question of the wisdom of operating on interest rates to any great degree. As good a statement of the possibilities of fiscal policy as is to be had will be found in a statement by a subcommittee of this committee in 1955 (Tax policy for economic growth and stability, 1955, pp. 2-5). My analysis points to a much greater reliance on fiscal policy and especially if the tax system is adapted to the norms set by the joint committee.

Monetary and fiscal policy working at cross purposes?

To a considerable extent they are, as I show above.

Monetary and fiscal policy sufficiently stringent to prevent general price increases consistent with maintaining present high level of employment?

I doubt that over the years we can have such policies. In 1948-56 (aside from inflation due to Korean war) we were lucky. A vigorous policy aimed at assuring stabilization is likely also to bring on a depression. We have to risk small price increases to get potential growth. The wage-price spiral increases the difficulty.

(Mr. Harris' prepared statement and a supplementary statement follow:)

EFFECTIVENESS AND RELATIONSHIP OF FISCAL AND MONETARY POLICY

(By Seymour E. Harris,¹ chairman, department of economics, Harvard University)

SUMMARY

I. MONETARY VERSUS FISCAL POLICY

Republicans, more distrustful of government than Democrats, tend to favor monetary against fiscal policy. This is a matter of degree. But since fiscal policy depends on the size of the budget, adjustments in the amount and structure of taxes and public expenditures, a Republican administration is more disposed to rely on monetary policy which, perhaps wrongly, is associated with the operation of the free market. Surely, monetary policy received much more attention in 1952-56 than in the preceding 12 years. (But, in contrast, compare the excellent bipartisan report of the subcommittee of the joint committee on tax policy for economic growth and stability.)

II. LIMITATIONS OF MONETARY POLICY

On the whole, the dear-money policy since 1952 has not been dramatically successful. Indeed, in contrast with past history, the rise in the supply of money was surprisingly modest, but one-third relatively that of gross national product. (Over American history monetary supplies have risen many times as much as national income.)

The failure of monetary policy from 1952 to 1956 is evident in the expansion of banking debts and of activity of the financial intermediaries. Restraints on

¹ The responsibility for this statement is mine alone.

commercial banks were followed by abnormal expansion of other credit institutions.

Rise, percent, 1952-56

Gross national product.....	19
Adjusted demand deposits and currency.....	7
Banking debits (August).....	34
Insurance company assets.....	28
Savings and loan association (1955).....	67
Federal credit agencies (fiscal year 1956) ¹	74
Mortgage debts (June).....	51
Ibid., commercial banks.....	33

¹ The totals for 1952 equal \$40 billion; for fiscal year 1956 equal \$68 billion; fiscal year 1957 (estimated) equal \$76 billion; and 1958 (estimated) equal \$85 billion (budget, 1958, p. 1106).

I am not insisting that these failures to control lending were unfortunate. Had not the financial intermediaries, inclusive of the Federal Government largely operating independently, expanded at an unusual rate, would gross national product have risen from \$283 billion to \$402 billion in 1955 prices, or \$12 billion per year?

A primary objective of the dear-money policy was to lengthen the maturities of Government securities and get them out of the banks. Here again the objective was not attained. In fact, from 1945 to 1952, without the help of a dear-money policy, the banks disposed of Governments much more than from 1952 on.

III. FISCAL POLICY

Growth of the Government sector of the economy opens up possibilities of a wise and effective use of fiscal policy. In 1953-54, a drastic cut in expenditures, combined with a dear-money policy, brought on a recession which may have cost the Nation \$30 billion; but fortunately a tax cut and an early reversal of monetary policy prevented further trouble. And, despite the objectives, cash receipts are up by \$13 billion and payments by \$6 billion from fiscal year 1953 to 1958.

It is not at all clear that the administration understands or is prepared to use modern fiscal theory. A strong statement by the President in 1954, not followed by deeds, is an exception. Time and again in the last year, the administration leaders have insisted that a tax cut would only come if the budget were not unbalanced by the cut. In other words, cut taxes in inflationary periods and increase the inflation. In his January statement that he would resign if deficit financing were used to deal with a depression, Secretary Humphrey revealed that folklore and mythology count for more than arithmetic with the Treasury. He also said that unless we cut Federal expenditures we shall "have a depression that will curl our hair." In the light of modern economics, if he remains determined, he is doing a disservice to his country and his party. But the President, on January 23, 1957, sounded like Lord Keynes.

IV. CONTRAST IN FISCAL APPROACH

How to use a rising gross national product? The Democratic principle has been to absorb part in rising public services. From 1948 to 1952, Federal cash payments accounted for 40 percent of a rise of gross national product of \$88 billion. The Korean war was, of course, a major factor. (In 1948-50 there was a rise of nonsecurity outlays; in 1950-52 a substantial decline.) From 1952 to 1956, gross national product rose by \$65 billion and only 3 percent went into Federal cash payments. In fiscal year 1954-56, expenditures on civil benefits averaged less than in fiscal year 1953. A Democratic administration would have spent several billions more on schools, hospitals, slums, etc. With a rise of \$65 billion in gross national product and a cut of expenditures by \$10 billion, they might have been wise to deflate the highway program and spend more on schools, etc. The public sector should grow with the private sector. From 1948 to 1957, the nonsecurity outlays have declined by 35-40 percent vis-a-vis gross national product.

There is also some difference on how to spend the money. So much for highways, so little for schools. Billions for taking good land out of cultivation at the same time that much more is being spent per acre to put land into use in the Colorado River area. (See Senator Douglas in 1956, hearings on the economic report, pp. 419-421.)

Administration policy relatively favors a tax cut more than Democrats as the fiscal approach; the Democrats are more inclined to favor a rise of public outlays. This follows because tax cuts tend to favor high-income groups.

V. EQUITY AND FISCAL POLICY

Stability is one objective of economic policy; equity another. Both may have to be sacrificed to some extent. In 1953-54, both might have been served by an expansion of services; in 1957, the need of schools and other public services may make necessary a slight concession to instability.

VI. THE BUDGET AND POLICY

Objectives of economic policy are presumably stabilization, growth, and equity. But in the last few years the size and the balancing of the budget have become the primary objective. Yet the budget is a tool of economic policy, not an end.

The Government has shown itself interested not so much in balancing the budget but in balancing the budget account. Through sales of assets, through reduced purchases, through increased recourse to guaranties and insurance, through lease-purchase of new buildings, through financing of new programs, through trust funds outside of the budget—in all these ways the Government has tried to give an impression of an improved budget contrary to the facts. That they would increase their loan guaranties and insurance from \$40 billion to \$60 billion in a few years (and even to \$85 billion by fiscal year 1958), even though through monetary policy they were being cautious, suggests their aversion is not so much to fiscal policy as to any policy which is reflected in a higher apparent budget.

VII. RESPONSIBILITIES OF FEDERAL VERSUS STATE AND LOCAL GOVERNMENTS

A cardinal principle of the administration is to let State and local governments do it—this despite the fact that the expenditures of these governments rose 6 times as much relatively in 3 years as those of the Federal Government and their debt rose by 40 percent as compared with a rise of Federal debt of 5 percent. In construction, Federal outlays dropped by one-third and those of the other governments rose by one-fourth—a relative decline for Federal Government of one-half. The increased burden on State and local governments that rely on property and excise taxes for 85 percent of their taxes means an increased burden on the poor and an increased inflexibility of the tax system. Nor do these governments absorb taxes given up by Federal Government.

VIII. POLICY FOR THE FUTURE

(a) Objectives

Prevention of inflation is one objective of monetary policy. It is not the only one. Both rising output and no inflation are unusual. Even in the last 8 years an annual rise of output of 4 percent was accompanied by an increase of prices of 1.3 percent per year.

(b) Techniques of monetary policy

In 1953 a hammer was used when a scalpel might have been adequate. This mistake was not repeated in 1956. The emphasis should be on open-market operations and member-bank reserves, not on discount policy and the distaste of member banks for being in debt—a theory applied in the twenties with little success.

(c) Limitations of monetary policy

In the last few years the large expansion of lending by financial intermediaries reflects a failure of monetary policy, or at least the inadequacy of the weapon. The obstacle of dealing with these intermediaries, the great strains put on the monetary weapon by cooperative wage-price policies of big industries and big unions (even encouraged by the administration for political purposes in 1956), the large resources available to large corporations (and hence greater independence from banks), and also the reluctance to use fiscal policy—all of these weaken the position of the monetary authority. Finally, there is some question whether raising rates is the proper approach, since it introduces serious inequities and therefore brings much political pressure against the monetary authority.

(d) Integration of monetary and fiscal policy

To much is expected of monetary policy in view of the techniques of control available and the reluctance to use fiscal policy.

The President is wrong to support an independent monetary authority. Once it is admitted that the Government must take some responsibility for economic conditions, the idea of an independent authority is out.

My interpretation of the 1951 accord is merely that a rigid-rate policy was out and that any policy should be determined on the basis of overall economic interests, not merely on the basis of the interests of the Treasury.

Improved integration is a must. Note the Open Market Committee, in December 1952 and March 1953, saw no evidence of inflation, but the Treasury embarked on a vigorous antiinflation policy. In the spring of 1953, the Federal Reserve reversed its dear-money policy but the President said, in view of inflationary dangers, he would not support a tax cut. In the years 1953-56, the Federal Reserve was very cautious about monetary supplies; but the Government proceeded to insure and guarantee loans at a record rate. In the latter part of 1956, the Treasury and Council disapproved of the rise of rates.

(e) The use of fiscal policy

A government that uses a fair share of the increase of output to provide required services will make it easier as a byproduct to use fiscal policy effectively. The only use of added tax receipts with rising income should not be tax cuts or repayment of debt. Even the increase in the budget to \$72 billion, or 3 percent above the revised 1957 budget, is not excessive. This is less than the average percentage rise of income in the last 10 years; and in the past 4 years some public services have been starved. I would suggest better allocations of these expenditures.

IX. REPLIES TO QUESTIONS PUT BY COMMITTEE

(a) Monetary and fiscal policy—which?

The discussion above reveals that we are depending too much on monetary policy. The great advantage that monetary policy has over fiscal policy is that it can operate day by day without congressional action. But 43 years of history reveals (1) an unwillingness to take bold action, or (2) action too weak (1927-29) or too much (1953), or (3) political pressures following cautious policies (1956). Besides, there is the question of the wisdom of operating on interest rates to any great degree. As good as statement of the possibilities of fiscal policy as is to be had will be found in a statement by a subcommittee of this committee in 1955 (Tax Policy for Economic Growth and Stability, 1955, pp. 2-5). My analysis points to a much greater reliance on fiscal policy and especially if the tax system is adapted to the norms set by the joint committee.

(b) Monetary and fiscal policy working at cross purposes?

To a considerable extent they are, as I show above.

(c) Monetary and fiscal policy sufficiently stringent to prevent general price increases consistent with maintaining present low levels of employment?

I doubt that over 10 years we can have such policies. In 1948-56 (aside from inflation due to Korean war) we were lucky. A vigorous policy aimed at assuring stabilization is likely also to bring on a depression. We have to risk small price increases to get potential growth. The wage-price spiral increases the difficulty.

MONETARY AND FISCAL POLICY

I. MONETARY VERSUS FISCAL POLICY

In the last generation fiscal policy for stabilizing the economy and stimulating its growth has become a powerful weapon in the economic arsenal—with an accompanying sterilization of monetary weapons. But in the post-World War II period there has been a revival of monetary policy both in this country and abroad.

The issues are not merely economic; they are also ideological. Though this is no black and white matter, the Democrats tend to stress fiscal policy more and monetary policy less; the administration, monetary policy more and fiscal policy less. In part, this difference of emphasis is based on the theory that fiscal policy means Government activity and intervention through debt policy, through variations of the amount and structure of taxes and expenditures.

Hence Republicans tend to look with disfavor on the use of these weapons. They prefer monetary policy because to them this reflects the operations of the free market.

Technical considerations are, of course, also relevant. The supporters of monetary policy stress its adaptability, the possibilities of day-by-day operations without long delays awaiting congressional action. For the monetary school there is a simple relation between monetary supplies, output, and prices. For the fiscal policy group, the stress is on total spending and the capacity of government through tax and spending policy to influence it.

II. LIMITATIONS OF MONETARY POLICY

Early in 1953, the administration embarked on its so-called hard-money crusade. The Treasury led; the Federal Reserve cooperated. A fear of inflation and a determination to drive securities out of the banks and lengthen the maturities of Federal securities so that the Government would not be embarrassed by heavy refundings at inopportune times—these occasioned the new dear money policy. In 1956-57, inflationary pressures which were much more in evidence than in 1953 induced a second dear money episode.

In the years 1953-56, the rise of monetary supplies was surprisingly modest. Fearful of inflation, determined to protect savings, the Eisenhower administration concentrated on anti-inflation policy. The contrast of policies is evident in the following:

In the 7 postwar years, 1945-52, total demand deposits adjusted rose by \$3.7 billion per year and less than one-half the relative rise of gross national product (GNP). This seems like an unusually austere monetary policy for a Democratic regime. But it must not be forgotten that in part monetary supplies had been frozen during the war and now they thawed.

In the Republican years, 1952-56, the rise of adjusted demand deposits was \$1½ billion per year (through October 1956) and but one-third of the relative increase of GNP.

These recent events are in contrast to trends over American history. Over the years the democratic principles of adequacy of supplies of money have prevailed. According to the classic study of Dr. Goldsmith (*A Study of Savings in the United States*), the proportion of liquid assets (cash, deposits, Government securities) to total assets rose from 9 percent in 1900 to 11 percent in 1929 and 27 percent in 1949. Over a period of 150 years, our monetary supplies increased by 3,500 times, national income by 400 times, and population by 28 times. Yet despite this phenomenal expansion of money, prices over the 150 years moved net surprisingly little. The Democrats were determined to provide needed supplies of money and protect the debtor. Inflation was not their objective; but they were prepared to pay the price of an expanding economy with a modest dose of inflation.

In contrast, the Republicans tend to be orthodox and oppose expansion of monetary supplies. For example, from 1866-93 with the Republicans in control in all but 4 years, the price level declined by 43 percent. From 1929 to 1933, the drop was 40 percent. Yet the medicine was monetary contraction.

Yet despite the rather restrictive monetary policies of the Eisenhower administration, the effects were not so serious as they might have been. The reason is largely that monetary policy has not been effective. This is evident from the table below.

Various aspects of money and monetary activity, 1952-56

[In billions]

Year ¹	GNP	Demand deposits, adjustments and currency	Banking debits	Insurance companies' assets	Savings and loan association assets	Federal credit agencies ²	Mortgage debts	Ibid., commercial banks	Consumer's credit	Installment credit commercial banks
1952.....	\$345	\$125	\$1,643	\$73.4	\$22.7	\$39.3	\$91.2	\$15.9	\$27.4	\$7.5
1953.....	363	127	1,759	78.5	26.7	44.9	101.1	16.9	31.2	9.0
1954.....	361	130	1,887	84.5	31.7	49.9	113.6	18.6	32.3	8.8
1955.....	391	133	2,043	90.4	37.9	62.3	129.8	21.0	38.6	10.6
1956.....	³ 410	⁴ 134	⁴ 2,203	⁴ 83.6	-----	68.2	⁶ 137.6	⁶ 22.1	⁴ 39.9	⁴ 11.5

¹ End of year except 1956. GNP and banking debits relate to whole year.

² Loans, investment, insurance, and guaranties—fiscal years.

³ Estimated.

⁴ August.

⁵ July.

⁶ June.

Source: Federal Reserve Bulletin.

This table shows that monetary supplies expanded relatively little; but banking debits indicating the activity of money as well as the supply rose by close to 40 percent, insurance company assets by almost 30 percent, assets of savings and loan associations by two-thirds even from 1952 to 1955, operations of Federal credit agencies by more than 70 percent by 1956, and so on. In fact, by fiscal year 1958 Federal loans, guaranties, and insurance are estimated at \$85 billion, or a rise of close to 115 percent in 5 to 6 years.

In other words, if the Federal Reserve had some success in restraining commercial banks, they were unable to influence other lenders whose activities increased much more than those of the commercial banks. The large rise in banking debits, that is, monetary activity, reflects the failure to restrain the financial intermediaries. And until means are found to deal with these lenders, monetary policy is bound to be of limited usefulness.

Perhaps it is fortunate that these institutions were able to operate largely independently of the Federal Reserve. Had they been subject to the will of the Federal Reserve, would GNP have risen from \$283 billion in 1946 to \$402 billion, or 42 percent in dollars of stable purchasing power, an average rise of \$12 billion per year?

Nor did the administration succeed in getting Government securities out of the banks and strikingly change the maturities of bonds. These were avowed objectives of the Treasury. In fact, from 1945 to 1952, the banks disposed of 30 percent of their Governments; but from 1952 to 1954, despite Mr. Burgess' hard-money policy, the banks increased their holdings. That the policy was a failure is evident from the table below, which shows a rise in short-term securities (cols. 2-4) in contrast to long-term (col. 5).

Government securities

[In billions]

	Total marketable and convertible	Marketable			
		Treasury bills	Certificates	Notes	Bonds
December 1952.....	\$161.1	\$21.7	\$16.7	\$30.3	\$79.6
September 1956.....	167.3	20.8	19.5	35.2	80.6

Source: Federal Reserve Bulletin.

Nor is a great success to be found in the proportion of longer maturities.

Percent maturities

	Within 1 year	1-5 years	5-10 years	Over 10 years
June 30, 1953.....	44	22	12	22
July 31, 1956.....	30	28	20	21

Source: Computed from Federal Reserve Bulletin.

Even Burgess only claims a gain of an average maturity from 3¾ to 4 years.

Various aspects of money and monetary activity, 1952-56

[In billions]

Year ¹	GNP ²	Demand deposits, adjusted, and currency	Banking debits	Insurance companies, assets	Savings and loan association assets	Federal credit agencies ³	Mortgage debts	Ibid., commercial banks	Consumer credit	Installment credit, commercial banks
1952.....	\$345	\$125	\$1,643	\$73.4	\$22.7	\$39.3	\$91.2	\$15.9	\$27.4	\$7.5
1953.....	363	127	1,759	78.5	26.7	44.9	101.1	16.9	31.2	9.0
1954.....	361	130	1,887	84.5	31.7	49.9	113.6	18.6	32.3	8.8
1955.....	391	133	2,043	90.4	37.9	62.3	129.8	21.0	38.6	10.6
1956.....	⁴ 410	⁵ 134	⁶ 2,208	⁶ 83.6	-----	68.2	⁷ 137.6	⁷ 22.1	⁸ 39.9	⁸ 11.5

¹ End of year except 1956.² GNP and banking debits relate to whole year.³ Loans, investments, insurance, and guaranties—fiscal years.⁴ Estimated.⁵ August.⁶ July.⁷ June.

Source: Federal Reserve Bulletin.

III. FISCAL POLICY

One reason for the increased attention given to fiscal policy was the dissatisfaction with the workings of the economic system in the thirties; another, the large rise of Government spending and debt associated with depression and war, hot and cold. With such expansion of the Government sector of the economy, the possibility of using debt policy, taxes, and Government spending to stimulate an underutilized economy and contain an overextended economy became increasingly clear. Cut taxes and increase spending in depression; raise taxes and reduce spending in periods of inflation.

This is a simple principle generally supported by economists. But unfortunately the Eisenhower administration came into power on the promise that they would cut expenditures from \$70 billion to \$60 billion. (Actually cash payments are up from \$77 billion to \$83 billion from fiscal year 1953 to 1958 and cash receipts from \$71½ billion to 86 billion.) In 1953-54 they reduced security outlays a maximum of \$14 billion and Government purchases of goods and services by a maximum of \$10 billion. This cut plus the dear-money policy brought on a recession which cost the Nation about \$30 billion. Fortunately, the Government introduced a large tax cut and reversed its monetary policy and hence saved the country from a more serious decline. But in 1953-54 the armaments cut plus a related decline of investment more than offset the small rise of consumption related to the tax cut and a growth of activities of State and local governments.

Unfortunately, the administration has not shown a grasp of modern fiscal theories. In 1954, here and there a claim was made for the contribution of the tax cut to shortening and moderating the recession. But it was not at all clear that the tax cut was the result of a command of fiscal theories or a fulfillment of a promise to cut taxes. Besides, the previous administration had prepared the way for the tax cuts through cutoff dates on various taxes.

By 1956-57, it was clear that the Hoover approach had become the accepted one. Nowhere is there found a clear statement that taxes would be cut in order to deal with a depression. Taxes would be cut only if a sufficient surplus were promised and the budget would remain balanced. In other words, reduce taxes in periods of great prosperity so that inflationary forces may be strengthened.

Secretary Humphrey, early in 1957, confirmed the ascendancy of folklore and mythology over arithmetic when he announced that he would resign if the Government indulged in deficit financing to treat a depression. Unless Secretary Humphrey becomes more receptive to the teaching of modern economics, he is likely to do a disservice to his country and party. (The President, however, sounded like Keynes on January 23.)

IV. CONTRASTS IN FISCAL APPROACH

A table below suggests the contrast of Democratic and Republican fiscal policies. In the last Truman administration, gross national product (GNP) rose by \$88 billion, and Federal cash payments increased by 40 percent of the gain of GNP. In part, of course, the explanation was the Korean war. Nevertheless, the policy in 1952-56 is strikingly different: Only 3 percent of the gain of \$65 billion in GNP was diverted to Federal cash payments. In fiscal years 1957 and 1958, the administration seems to be yielding somewhat more to pressures.

Rise of GNP (billions) :	
1948-52 -----	\$88
1952-56 -----	\$65
Rise of cash receipts, Federal Government (billions) :	
1948-52 -----	\$26
1952-56 -----	\$7½
Percent increase in cash receipts to increase in GNP :	
1948-52 -----	30
1952-56 -----	11
Percent increase in cash payments to increase in GNP :	
1948-52 -----	40
1952-56 -----	3

Sources: Economic Report of the President, 1956; SCB, November 1956; and Budget, Midyear, 1957. The 1956 figures are estimates based on the first 3 quarters.

From 1952 to 1956, gross national product rose by \$65 billion, expenditures dropped by \$10 billion, and a tax cut which is costing at least \$9 billion yearly now prevailed. Yet in 1954-56 (fiscal year) civil benefits averaged less than in 1953; and by fiscal year 1957 (January budget) civil benefits, an index of welfare and resource outlays, had increased by but \$0.5 billion, or 1 percent of the increase of gross national product. For fiscal year 1958 an additional rise of \$1.4 billion is proposed. The Democratic policy surely would have been to absorb at least several billions yearly in these years in building schools, houses, hospitals, in urban redevelopment and flood control, etc. Largely as a result of the policies since 1952, nonsecurity outlays of the Federal Government dropped by 35-40 percent from 1948 to 1957 (estimated) vis-a-vis gross national product. From 1948 to 1950, the Truman administration continued to advance on the welfare front; but with the Korean crisis, the President contracted these outlays, the total declining substantially from 1950 to 1953 (fiscal year). Under President Eisenhower, the administration was unable to cut significantly in this area from 1953 to 1955; and from 1955 to 1957, the pressure of rising population, high costs, and deficient public services forced some advances.

The administration's policy is directed to cutting taxes. That is their fiscal approach. This is a wise policy in recession periods such as 1953-54. (I assume recession is not brought on by vigorous cuts in spending.) But this is not a wise policy in inflation periods, as the Republicans seemed to believe in 1947 and 1948. Why tax cuts rather than rising public outlays? On the whole, tax cuts favor the higher income groups. Also, they are easier to achieve and operate more quickly than increased expenditures. With a concentration on the disincentive effects of taxes and an aversion to Government spending and especially since it may involve competition with private spending, the Eisenhower administration, in its use of fiscal policy, leans toward tax cuts rather than expenditure rises.

V. EQUITY AND FISCAL POLICY

Obviously there may be conflicts between fiscal policy and equity. The objective of fiscal policy is to stabilize the economy and stimulate growth. In 1953-54, a policy of tax reduction and a rise of welfare outlays might well have satisfied both the criterion of equity and the needs of fiscal policy. But this is not always so. Compromises may have to be made. In view of the neglect of social services, the backlog of schoolrooms, of highways, or hospitals, of slums to be treated, etc., the case for increasing outlays by a few billion dollars a year for several years is great indeed. But the effects on stability may be unfortunate. Hence it may be necessary to yield to some extent on welfare outlays, to set up priorities (somewhat less on roads, more on schools) and even to accept a modest dose of instability.

VI. THE BUDGET AND POLICY

In recent years the administration has shown an almost neurotic interest in the size of the budget. Instead of considering the budget an accounting device or an instrument of policy, the tendency has been to make of the size of the budget and its balancing the primary objective of economic policy. This, I fear, is mistaken policy. Stability, growth, and equity are the major objectives of policy, not the size or the balancing of the budget.

In an attempt to keep the size of the budget down and the deficit down, the administration has had recourse to various techniques.

Whenever possible, the Government has disposed of assets and curtailed purchases of assets. For example, the sale of mortgages, property, and commodities has been a popular policy. The facts are presented concisely in the table below.

Acquisition of assets and credit programs, fiscal years

[In millions]

Budget expenditures	1954	1955	1956	1957
I. Addition to Federal assets:				
Civil, net expenditures.....	\$2,840	\$4,009	\$2,446	\$2,583
Loans, civil, net expenditures.....	1,582	1,668	299	358
Public works, civil.....	1,273	1,552	1,639	997
Other physical assets.....	-1	-283	21	39
II. Details of loans, civil:				
To domestic private borrowers:				
(a) Federal National Mortgage Authority (FNMA).....	481	196	-65	-231
(b) Commodity Credit Corporation—Price support and grain storage loans.....	765	551	-633	-183
(c) RFC.....	-4	-40	-148	-14
To quasi-public institutions:				
FNMA.....		93	2	1
Major commodity inventories.....	2,046	1,552	1,639	997
III. Major Federal credit programs:				
New commitments.....	15,942	18,880	21,343	21,295
New expenditures.....	-582	1,712	-292	203
Outstanding direct loans and investments.....	15,532	16,943	16,274	16,158
Outstanding guarantees and insurance.....	40,460	45,392	52,501	60,036

¹ Includes loans for security purposes.

Source: Computed from budget, 1957, pp. 1104-24; 1956, pp. 1166-67.

In general, since 1952, the Government has acquired relatively few assets and disposed of much. When it was necessary to obtain assets, the Government increasingly relied on private building (e. g., lease-purchase program for new buildings) or isolated disbursements from the regular budget. The trust accounts became increasingly popular, for outlays are not included in the budget. New purchases under the Federal National Mortgage Authority are treated as trust transactions, as are the outlays under the Interstate Highway programs. From fiscal year 1956 to fiscal year 1958 the budget shows a decline of highway expenditures from \$783 to \$56 million—despite the large expansion of the program. The announced intention of a \$60 billion budget has proved to be embarrassing.

One of the marked changes in budgetary practice in the last few years has been the increased recourse to guaranties and insurance. Note that, whereas net expenditures in 4 years under major Federal credit programs were but \$1 billion, outstanding Federal guaranties and insurance rose from \$40 billion on June 30, 1952, to \$68 billion in June 1957 and \$85 billion on June 30, 1958 (estimated). Whereas, from 1951 to 1953, Federal loans and investments were 56 percent of guaranties and insurance in 1955-57, the percentage was 23 (1956 estimated) and 23 percent in June 1958 (estimated). Here is a potent use of fiscal policy which many may find difficult to understand. In periods of decline, the administration boasted of its willingness to accelerate guaranties or even new contracts. This policy suggests that the administration was not so hostile to the use of fiscal policy as it often seemed to be: What they were hostile to was any use of fiscal policy which was reflected in a higher budget total or an apparent rise in deficits. They were interested not in a balanced budget but rather in an apparent balanced account now. They were not fearful of an unbalanced budget a generation from now, as their willingness to liberalize old age and survivors insurance in 1953 suggested.

Because so much of the operations of the Government are increasingly out of the budget, the full incidence of Federal fiscal policy is not revealed by the orthodox budget. In fact, even the cash budget does not reveal all fiscal operations. For the insurance and guaranties are not included; nor is it possible to estimate possible losses.

A cash budget is less appealing to the administration than the orthodox budget.

[In billions]

	Receipts (fiscal year)		Expenditures (fiscal year)		Surplus or deficit (fiscal year)	
	1953	1957	1953	1957	1953	1957
Orthodox.....	\$64.8	\$69.8	\$74.3	\$69.1	-\$9.4	+\$0.7
Cash.....	71.5	80.8	76.8	77.2	-5.3	+3.1

Source: The 1957 Federal Budget Midyear Review, pp. 1-2.

Note that the orthodox budget shows a rise of receipts of \$5 billion; the cash budget of \$9.3 billion; for expenditures, a decline of \$5.2 billion and a rise of \$0.4 billion, respectively. In fiscal year 1958 the estimate is a rise of \$3 billion in expenditures in orthodox budget and \$4 billion in cash budget.

VII. RESPONSIBILITIES OF FEDERAL VERSUS STATE AND LOCAL GOVERNMENTS²

Transferring responsibilities to State and local governments is a cardinal feature of the policy of the Administration. When the President commented on the large 1954 tax cut, he pointed out that now these governments could fulfill their responsibilities. But it is not so simple as that. Interstate competition is a restraining influence: What the Federal Government yields is not absorbed by these governments. In discussing the tough financial problems of the Commonwealth of Massachusetts with Governor Furcolo, I pointed to the President's statement. The release of Federal taxes equaled more than 80 percent of Massachusetts taxes and perhaps 5 times the additional 50 to 60 million dollars needed. But the Governor did not seem to be greatly relieved.

In the first 3 years of the present administration, expenditures of States and local governments rose by 30 percent; of Federal Government, declined by 5 percent. The former's debt rose by 40 percent in contrast to a rise of 5 percent for the Federal Government.

Even more striking are construction outlays. From 1952 to 1955, new construction expenditures of the Federal Government declined from 4.2 to 2.8 billion dollars, or by one-third; of State and local governments, a rise from 5.4 to 6.7 billion dollars, or almost one-quarter—a relative decline of the Federal Government by one-half.³

Finally, this transfer of responsibilities to State and local governments is unfortunate on grounds both of equity and economics. The State and local taxes are heavily on the poor. Excise and property taxes account for 85 percent of State and local taxes; and income, inheritance, and corporation taxes, only 9 percent. In Federal taxes, income, corporation, and inheritance taxes account for two-thirds, and excises for one-seventh.⁴

Heavy reliance on excise and property taxes also reduces the adaptability of our tax system to changes in economic conditions. The degree of built-in flexibility—that is, the response of increased revenues with rising incomes and hence the check on excessive expansion, and the reduction of taxes with falling incomes and hence the stimulus in periods of decline—is reduced by increasing the responsibilities of State and local government.

VIII. POLICY FOR THE FUTURE

On the basis of recent experience, we can draw some conclusions for the future.

(a) Objectives of monetary policy

Prevention of inflation is an important objective. But it is not the only one. When attempts to deal with inflationary threats interfere seriously with the expansion of output or the attainment of equity conditions, then it may be better to tolerate a minimum of inflation. In American history, the expansion

² Since this is to be discussed by others, I shall be brief here.

³ Survey of Current Business, July 1956.

⁴ R. Musgrave in Federal Tax Policy for Economic Growth and Stability, 1955, p. 98 (Joint Committee on Economic Report).

of output has been accompanied by a modicum of inflation. Experience of 1948-50 and 1952-56, with relatively little inflation and expanding output, may not be the persistent model.

In a forthcoming book, *The American Economy*, Professor Hansen presents the following:

Percent increase (per year) of output and prices

	1900 to 1925	1925 to 1950	1948 to 1956
Aggregate output.....	3.5	3.0	4.0
Price index.....	3.0	1.5	1.3

(b) Techniques of monetary policy

Whatever the objectives, the techniques can be improved. In 1953, the ominous signs of inflation were more apparent to the Treasury and possibly to the Federal Reserve than to most of us.⁵ The authorities used an ax, not a scalpel, and helped bring on a recession and a serious break in the Government-bond market. They learned their lesson, for in 1956 the Federal Reserve proceeded with caution in the face of an inflationary threat.

Long experience with Federal Reserve policy suggests to the writer that the crucial instrument is the control of the reserves of member banks. Hence the major reliance should be on open-market operations. That the Federal Reserve in recent years disinterred an instrument of the twenties related to discount policy, which surely did not help prevent the excesses of that period, namely the restraining effects of member banks being in debt, is surprising to the writer and to others.⁶ The amount of indebtedness of member banks should not be a crucial determinant of monetary supplies and the rate of interest, determined as it is by gold, currency, etc. movements, often of a fortuitous nature.⁷

(c) Limitations of monetary policy

Over our history, the supplies of money necessary to make the system work have been forthcoming; and in view of the tendency to hold a rising percentage of income in cash, the supplies have increased much more relatively than gross national product. In recent years, the expansion of money has been much less than that of gross national product.

But the price level has been sustained, and output has expanded. The explanation lies in part in the impotency of monetary policy. The monetary authority is trying to deal with a shortage of resources relatively to demand by withholding money through raising the interest rate.

This policy is not likely to succeed, though a case might be made out for trying. First, the inflationary pressures associated with the increasing tendencies of great industries and unions to send wages (and prices) up at the expense of the rise of the community is relevant. Prices then tend to rise, and it is not easy to withhold monetary supplies unless the risk of serious curtailment of output is to be courted.

Second, the modern corporation has vast savings which it can put to use. It is not dependent on the banks nor even on the capital market relatively as much as in the twenties. Here again business can disregard the importunities of reserve or other banks.

Third, the control over the financial intermediaries is most inadequate. Even if the Reserve banks succeed in restraining the commercial banks (and indirectly nonmember banks) and even if theoretically through control of the total supply of money they exercise some control over financial intermediaries, the experience of recent years shows clearly that financial intermediaries not only fill the gap as commercial banks moderate their expansion but even increase their activities at an unusual rate. Legislation is clearly required to deal with the financial intermediaries if the amount of lending is to be controlled.

⁵ Cf. E. Wood, *Monetary Policies*, Journal of Finance, September 1955, pp. 323-325, and S. E. H. in joint committee hearings on United States Monetary Policy, Recent Thinking, 1954, pp. 54-60.

⁶ See E. Wood, *op. cit.*, pp. 317-318; E. C. Simmons, *A Note on the Revival of Federal Reserve Discount Policy*, *ibid.*, December 1956, pp. 417-419; and S. E. Harris, *Twenty Years of Federal Reserve Policy, 1933, I*, pp. 256-265.

Fourth, there is far from unanimous opinion among economists that raising interest rates is the appropriate approach. I am not here commenting on the policies of raising rates in 1953 to be followed by statements by Burgess, Humphrey, Martin, and even the Open Market Committee that natural forces were at work.)⁷ Higher interest rates introduce serious inequities among borrowers: The free market does not provide adequate capital for small business, for schools, for housing, and for farmers. The hard money policy, directed partly to dealing with the effects of wage and corporate price policy, further strengthens the position of big business, with plenty of resources and access to the capital market.

(d) *Integration of monetary and fiscal policy and the accord*

This administration tends to put excessive strains on monetary policy. First, because the recent reaction in favor of monetary policy in itself tends to establish high hopes not likely to be attained. Second, because of the reluctance to use fiscal policy by an administration which on the whole decides against Federal Government responsibility whenever possible.

The very idea of an independent monetary policy is a strike against integration. It is not my view that the accord of 1951 meant that the Federal Reserve was to do as it pleased. My interpretation of the accord was that the interests of the Treasury had been weighted excessively in the years 1940-50 as against those of the economy, and that the economy had been denied the contribution of some flexibility of rates. (This does not mean a free market without interference as the authorities frequently interpret monetary policy in the postaccord period.) The accord was an announcement that the responsible authorities should consider the interests of the economy as a whole inclusive of the Treasury. Once it is admitted that the Government has a responsibility for stability and growth, then the idea of an independent monetary authority is out. There should not be public announcements that the Federal Reserve raises rates but the Treasury and the Council disapprove—as in 1956. They should work out a policy based on the interest of all.

Again, it is difficult to understand why, though the Open Market Committee in December 1952 and March 1953 could see no evidence of inflation, the Treasury supported by the Federal Reserve should early in 1953 introduce a hard-money policy.

It is difficult to understand why in the spring of 1953, as the Federal Reserve wisely reversed its policy, the President, announcing a fear of inflation, should come out against a tax cut.

It is difficult to understand how, in view of the restrained monetary policy from 1953 to 1956, at the same time the Government should increase its loans, guaranties, and insurance from \$40 billion to \$63 billion in a period of 3 years (and to \$85 billion by June 30, 1958).

(e) *The use of fiscal policy*

The contribution to be expected of fiscal policy depends upon the size of the Federal budget and the composition of both taxes and expenditures. In general, it is not to be expected that the magnitude of the Federal budget will be determined with a view to increasing the sharpness of this potent instrument. But insofar as an administration allocates a fair share of the increasing product for welfare outlays and does not shift responsibility excessively to State and local governments, so far will the tools of fiscal policy be more effective. So far as the increased resources made available out of a rising income are applied to a rise in services commensurate with the growth of the economy and not merely to tax or debt reduction, the tools of fiscal policy will be sharpened.

But it is also necessary to understand the use of these instruments. The fetish of the balanced budget, of minimum Federal expenditures as an end in itself, a failure to understand the contribution that may be made by flexible public expenditures and taxes and by a structure of taxes that makes for a maximum contribution to stability and growth—these are costly.

We still hope that the able Secretary of the Treasury will accept some of the great teachings of economics of the last generation, or he will be doing the country a disservice.

⁷ See E. Wood, *op. cit.*, pp. 324-325.

SUPPLEMENTARY STATEMENT BY S. E. HARRIS FOR THE JOINT ECONOMIC
COMMITTEE (FEBRUARY 1, 1957)

THE ROLE OF THE ECONOMIST AS AN ADVISER

In my experience over a period of 20 years as a witness before at least 10 different congressional committees, I have found the Joint Economic Committee the most interesting of all committees. The members are able and stimulating; the witnesses know what they are talking about. The staff is excellent.

But I am troubled by one problem. The committee tries as hard as it can to be nonpartisan. Economists who appear also tend to be experts rather than partisan. They tend to speak qua economists, not qua political economists.

I must confess that I find this difficult at times. Indeed, one can forecast or guess about future economic conditions qua economist. But when one has to explain past policies in order to understand the present and future, then the limitation to economics becomes difficult and misleading.

How much attention is likely to be given to fiscal or monetary policy? Here the ideology of parties is very important. The Democrats for reasons indicated in my paper will stress fiscal policy more and the Republicans monetary policy. Hence with a Republican administration fiscal policy will not be given adequate weight. The failures of monetary policy are more easily understood if the creed of the parties is considered.

Again, what are the objectives of fiscal and monetary policy? A Republican regime emphasizes stability of the currency; a Democratic regime tends to stress output, employment, and equity more. Hence, how can one discuss these problems of objectives and tools without getting into politics? Indeed, Milton Friedman will give you the pure economics and stop there. But will this really be adequate for the joint committee?

Indeed, one may disagree and say that the Democrats use monetary policy more and the Republicans are interested above all in jobs and equity. But this is not my interpretation of economic history.

The joint committee should have able economists, as they do, present their views. But I hope that they would always be political economists, and not from any one school.

Chairman PATMAN. Thank you, sir.

I shall be brief in my questioning, and then the Chair will yield to the members of the committee.

First, Dr. HARRIS, you stated on page 16 of your statement—

Mr. HARRIS. That is the big statement which I have not read.

Chairman PATMAN. I thought you read it.

Mr. HARRIS. I was reading from the summary.

Chairman PATMAN. I will read it to you: "Once it is admitted that the Government has a responsibility for stability of growth, then any idea of an independent monetary authority is out."

In other words, you believe that the Federal Reserve Board directly or indirectly must be influenced by whom—the Executive or Congress or by both?

Mr. HARRIS. I would say by both. It seems to me perfectly absurd that if you once admit that you have a policy that the Government is interested in stability or growth or whatever the objective is, the Federal Reserve can do anything it pleases without consulting the other agencies.

Chairman PATMAN. Particularly in view of the Employment Act of 1946.

Mr. HARRIS. That is right.

Chairman PATMAN. Have you ever known but one case in the history of the Federal Reserve System where the Federal Reserve Board and the System generally failed to do what the President of the United States wanted them to do? The one occurred when I think the

Board was looking for an opportunity over the years to declare itself independent from the Executive. Mr. Truman had his days of popularity and his days of unpopularity. When Mr. Truman's popularity graph went to its lowest point in February of 1951, was the time when the Federal Reserve Board declared their independence from the Executive, and Mr. Truman was not strong enough at that time to resist it. They failed to support the Government bond market, although we asked them to do it, and they promised to do it. Is that your understanding?

Mr. HARRIS. Yes.

Chairman PATMAN. Do you know of another time in history when the Executive's suggestion was not carried out?

Mr. HARRIS. I do not know of any important episode. I agree with the implications of your remarks, Congressman. As I sense your remarks, in a general way the Federal Reserve—and I think this is true of central banks everywhere, even in Great Britain, where there is such a tradition of a free central banking system—that the general idea is that the central bank operates in terms of the objectives of the Government and must reconcile its policies with all the other agencies that are involved in bringing about or determining the supply of money or the activity of money or the rate of interest or anything of that sort.

Chairman PATMAN. I want to ask you to comment and to bring us up to date on a statement I think you made at one time, that although we had 50-cent dollars, we had almost 4 times as many to buy goods and services with.

Mr. HARRIS. Yes.

Chairman PATMAN. And that meant that we were really about 100 percent better off.

Mr. HARRIS. The point I was making there was—I could quote Secretary Humphrey, who makes this statement about once a month—namely, that you have a rise in the price level in the last 15 years and so forth, and he says that is terrible, every dollar is worth half as much. But he forgets about the rise of output that has come with the increase in the supply of money. Over the American history we have had an increase of supply of money of 3,500 times, but we also had an increase of income 400 times and relative stability of prices over that long period up until World War II. If you are trying to give the whole story you should not merely talk about the value of \$1 but the question of how much is there available to be purchased with your dollars. Part of this rise of output is certainly associated with the rise in the supply of money. If you do not increase your money fast enough, you do not get an adequate increase of output.

Chairman PATMAN. I just wanted to leave the inference a while ago, too, that I do not believe the Federal Reserve Board's independence of the Executive is real independence. I firmly believe that if the President of the United States were to call on them to do something now about the high interest rates, they would not dare to refuse.

Representative BOLLING. Mr. Neal, in the last two paragraphs of your statement, you speak of the National Monetary Commission. My understanding is that the original proposal of the administration was for a nine-man commission appointed entirely by the President, to which apparently nobody from the Congress would be appointed,

with quite extraordinary powers—the power of subpoena and as I understand it, a waiver of any applicable antitrust laws or conflict of interest statutes.

Is that the kind of Monetary Commission that you would have in mind?

Mr. NEAL. Ideally, sir, the kind of commission I had in mind might be a commission made up of appointees, one third by the Speaker of the House, one third by the President of the Senate, one third by the President, all from the public, to avoid the difficulties of a mixed Commission with Senate and House of Representatives and the public combined on it. I think the latter is a difficult type of commission to operate with. I served with the Randall Commission which was made up that way. There were even constitutional questions raised about that form of commission, because the same people who later would be holding hearings on legislation and making recommendations with respect to legislation were being asked to commit themselves in advance on a commission.

Representative BOLLING. The implications which I draw from this, and they may be in error, are that the Congress is incapable of doing what is its primary responsibility, and that is to legislate. I do not understand how in the light of the history of previous efforts in this field exactly how this is going to work out. I think this particular effort is unique in at least one respect, however, because as far as I know in the past all such commissions or committees have worked after disaster and not before disaster, and I do not mean by that statement that we are inevitably going to have a disaster. I do not comprehend. The history of the Aldrich Commission was that they worked for 4 years and Congress worked for 2. I gather on the basis of the last paragraph that you think this is a matter of some urgency. Would you contemplate that the Commission would come up with a proposal in a period of a year or two and Congress would work for a couple of more years on it, or that the Congress would just accept what the Commission recommended?

Mr. NEAL. I am sure that the last one would be impossible. What I contemplate is a commission that might operate for at least 2 years in view of the intricacies of some of these problems, and the need for dispassionate investigation not interrupted by day-to-day business. I think that Mr. Chandler's concept of the Commission is one that is primarily a study commission that would arrive at conclusions, but no recommendations with respect to legislation. I would subscribe to his view on that. So this is not a commission that would in any way usurp any of the functions of congressional committees. It would merely provide background study and investigation in what is admittedly one of the most complicated fields that we have to deal with.

Representative BOLLING. I do not want to pursue this indefinitely, but in regard to the study function I know from personal participation of the work of one subcommittee of this committee under the chairmanship of our present chairman which in turn followed a similar subcommittee chaired by Senator Douglas, the immediate past chairman. My impression was that those studies were generally regarded as having been effective in exploring the field systematically, that they had been rather exhaustive and they had drawn some significant conclusions.

Mr. NEAL. I think those studies were good, sir, but I think there is need for even broader studies which will go into issues that it is very difficult for committees of Congress to get into without spending an awful lot more time at it than they normally have. They are interrupted by elections, sometimes, and changes in assignment, and they have the press of other business always upon them.

I would think this should be something that did not involve any conflict of time or interest on the part of the members.

Representative BOLLING. Do I understand, then, that the Commission members in this concept would spend full time on the Commission? Has this ever been true of any other commissions?

Mr. NEAL. Ideally I think that is the way it should be done.

Representative BOLLING. Has there ever been a commission of this nature that spent full time on it? Isn't such a commission, for various reasons, drawn usually from the type of people who in different ways are equally as busy as Members of the House and Senate?

Mr. NEAL. To that extent they fall short of the ideal.

Representative BOLLING. Thank you, sir.

Chairman PATMAN. Dr. Talle.

Representative TALLE. I will pass at the moment, Mr. Chairman.

Chairman PATMAN. Mr. Mills.

Representative MILLS. I will pass.

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. I wanted to pick up one of the other themes, first, that the panel presented, this question of State and local finances. I was very much interested in Mr. Heller's presentation, among others. But one matter I would like to comment on for your comment is the effect of inflation on the State and local financing situation. I think we frequently, all of us, condemn inflation and then forget to dig down into the details as to just what damage is caused. It seems to me, particularly in the local taxing authorities, like the school districts, the sewer districts, and so forth, they have been particularly hit because they are dependent upon real estate taxes primarily in order to get their revenue. Real estate taxation is dependent on appraisals, and appraisals cover a period of years on the local tax books. Most of the values were put on the books before the inflated dollar, in the thirties and forties. If we attempt to raise the rate, we impose an undue burden on the new properties that go on the appraisal books. Further, we have a very difficult political situation, as well as a technical problem, if we want to go to a complete reappraisal of all the real estate that is on the books.

I think every local taxing authority in the country has been confronted with that specific problem, coupled with the fact that many of them have reached the ceiling which was set, based upon the assessed valuation.

I wonder if you would comment on that, particularly as you said that you thought the greatest factor involved for the local communities was the growth of our economy. It would seem to me that probably maintaining a stable dollar is even more important to the local community.

Mr. HELLER. Congressman Curtis, a part of my statement that I did not have time to read deals directly with this question. I wonder whether I might just read the one paragraph that pertains to that.

Representative CURTIS. Yes.

Mr. HELLER. State and local governments have an equally vital stake in the avoidance of inflation. Their budgets are far more vulnerable to increases in the price level than the Federal budget. On one hand their reliance on generally more regressive revenue sources such as property and consumption taxes means that their revenues do not respond as readily to the upthrust of inflation as the Federal corporate and individual income taxes.

On the other hand, they spend a much higher proportion of their total budget in purchases of goods and services and much less on interest and transfer payments than the Federal Government. For example, for the calendar year 1956, the Economic Report indicates that State-local purchases totaled \$33 billion, in comparison with total cash payments by those same governments of \$30.4 billion, excluding Federal aid, while the corresponding Federal figures are \$47 billion in comparison with \$75 billion, including Federal aids. On balance, then, inflation reflects itself much more quickly and forcefully in State-local expenditures than in State-local receipts.

The example that you selected of the property tax is the most striking one. Assessors tend to have a concept of normal value. They do not believe that these inflationary increases are truly permanent and consequently, as you suggest, we have valuations that run 10, 20, 30, 40 percent of market price.

Representative CURTIS. Even more important than the assessors' beliefs are the people whose properties are involved who are in pretty close touch with the assessor. I thank you for reading that.

You agree, of course, because you included in your paper that is a very basic feature of this problem.

Mr. HELLER. I do.

Representative CURTIS. Mr. Ratchford, you were discussing the increased interest rates on the municipal bonds and so forth. I was wondering how much value would be obtained from the President's recommendation, which is contained on page 49 of the Economic Report, where he suggests that we extend the conduit principle to investment companies who might hold assets in State and local securities. That is a big market where these bonds could be sold as opposed to the present market that is available to them. Do you think that would have a noticeable effect if we were to effect that suggestion?

Mr. RATCHFORD. Mr. Congressman, I must say at the beginning I do not know what the facts are about the holdings. But my impression is that their holdings are so small that it would not have any significant effect.

Representative CURTIS. I might say that the argument is the holdings are small because there is no advantage to going into the market to buy a tax-exempt bond. In fact, that is the reason it is argued on page 49 of the President's report that there would be no revenue loss if we extended that revenue benefit, because now they are not buying.

Mr. RATCHFORD. Yes.

Representative CURTIS. The question would be, in your judgment, how much stimulation would there be to buy, if you can estimate, or anyone else on the panel.

Mr. RATCHFORD. I cannot hope to even approximate it, but generally I would say that the obligations of these funds are probably

not held in large amount by people with large income, who would be the ones to profit most by the tax exemption. For that reason, I would not expect any significant amount of relief or stimulation by this provision.

Representative CURTIS. Does anyone else on the panel care to comment on that? Mr. Shere?

Mr. SHERE. In my statement, I said that I endorsed the recommendation. I feel that it might be of some help. But I do not expect it to be of the first order of magnitude of importance.

Representative CURTIS. Thank you.

I have one other question. Mr. Chandler, in your statement you stated that you thought there should be no relaxation of either fiscal or monetary policies or any tax reduction. I was wondering if that remark is qualified by the thought that if the relaxation were in the nature of providing additional money that would go into capital investment, wouldn't it actually tend to check inflation, rather than being inflationary, on the theory that our present problem of the shortage of money is primarily in investment capital?

Mr. CHANDLER. I know of no way that one could reduce taxes with any assurance that all of the tax money left with the public, or even any large part of it, would go into investment. It seems to me that almost any tax dollar left in the hands of the earner is likely to go into consumption to a considerable extent.

Representative CURTIS. How about credit? Certainly the banks in lending could have control to a degree over what the money would be used for. If it was going into capital expenditures to increase production that would be helping the situation, rather than hurting it; would it not?

Mr. CHANDLER. As a matter of fact, if one wishes to direct money into investment purposes, the device of maintaining present taxes or even increasing taxes and using them to retire Government securities is likely to be more effective in stimulating investment than it would be to leave the money in the hands of the public in the first place.

Representative CURTIS. To increase taxes on the theory that the holdings in Government bonds would then be diverted into capital investment elsewhere?

Mr. CHANDLER. Yes.

Representative CURTIS. Thank you.

Chairman PATMAN. Mr. Mills.

Representative MILLS. Two of our panelists have commented on the matter of fiscal and monetary policies in 1957 by mentioning a portion of the statement of the President transmitted to us in his economic report. You referred to language, Mr. Neal, particularly on page 44 of that report. I want to read that again:

When production, sales, and employment are high, wages and price increases in important industries create upward pressures on cost and prices generally. To depend exclusively on monetary and fiscal restraints as a means of containing the upward movement of prices would raise serious obstacles to the maintenance of economic growth and stability. In the face of a continuous upward pressure on costs and prices moderate restraints would not be sufficient. Yet stronger restraints would bear with undue severity on sectors of the economy having little, if any, responsibility for the movement toward a higher cost-price level and would court the risk of being excessively restrictive for the economy generally.

As you read the first sentence of that statement, you might interpret it to mean, as some writers have, that the President is calling upon the Federal Reserve to use greater monetary restraint in 1957 than was exercised in 1956. But when you read the rest of the statement with the first, you wonder whether the President may not be indicating to the Federal Reserve that it would be unwise to exercise any greater restraint in 1957 than was exercised in 1956.

You have pointed out that you do not believe that greater restraint involves these dangers that are evidenced in this statement. But I wanted to ask you this question: Can this cost-price push occur without an accommodating expansion of aggregate money demand?

Mr. NEAL. In my opinion, sir, and I do not qualify my remarks as Mr. Harris has by saying that there may be political economics involved, these dangers, spelled out in the quotation you read, are not involved. Adequate monetary and fiscal restraints will set the basic conditions under which the price-cost pressures can be held in check. I do not know of any other way it can be done. I do not know of any inflation in history that could have been contained by any other measures.

Representative MILLS. Do you consider that the present restraints are moderate?

Mr. NEAL. I think so. A little more than moderate. They sort of lie in between the two conditions in that quotation.

Representative MILLS. The President in his economic message said that moderate restraints would not be sufficient. You agree with that. In other words, if we apply only moderate restraints in monetary policy in 1957, we are likely to have more inflation?

Mr. NEAL. I would rather answer that, sir, in terms of 1956, which is past, and to say that the degree of restraint exercised in 1956 was insufficient to prevent some increase in the price level. That is history. If 1957 is going to have the same pressures for capital expenditure and spending otherwise than we may have to have a little more restraint than we had in 1956.

Representative MILLS. Otherwise, we may have more inflation in 1957.

Mr. NEAL. Otherwise we may have more inflation; yes, sir.

Representative MILLS. What is your opinion with respect to whether this cost-price push can be prevented by making Federal fiscal and monetary policies sufficiently restraining?

Mr. NEAL. I think it can, sir.

Representative MILLS. I gathered from your statement that you thought our situation was not so serious that sufficient restraints could not deter these inflationary pressures.

Mr. NEAL. That is right.

Representative MILLS. Your purpose is to suggest that we utilize such restraints as are needed.

Mr. NEAL. Yes, exactly.

Representative MILLS. What are the sectors, as you visualize the situation, to which the President may have been referring when he said that such restraints might impose too great severity. What sectors would be involved? Would the agricultural situation be involved?

Mr. NEAL. Those most commonly mentioned have been small business, housing, and local government borrowing, as having been unduly restrained by the restraint of 1956.

Representative MILLS. Would greater restraints in 1957 have an adverse effect, in your opinion, upon the basis of your study, on agriculture and agricultural income?

Mr. NEAL. No, sir. I think that the Congress has more or less insulated credits to agriculture from general credit restraint through Federal lending agencies of various types. So I do not think that agriculture would be adversely influenced by a somewhat greater degree of credit restraint exercised by the Federal Reserve than we have had, when you combine the resources both of private lenders and of Government lending agencies.

Representative MILLS. But it is your thought that small business might be adversely affected?

Mr. NEAL. I would like to qualify that, if I might. I think that Congress has provided the Small Business Administration as an agency to take the edge off restraint in that field. You have presently before you, I think, a proposal for increasing the resources of the Small Business Administration. In addition there have been private agencies set up to improve credit availability for small business, and the Federal Reserve has on the books a provision which will permit them to assist in this field. So I think that small business can also stand a slightly greater degree of Federal Reserve credit restraint, without any increased damage to it.

Representative MILLS. I think what the President has said in his economic message, and to the extent with which you agree to it, causes me to be somewhat concerned over whether or not there is implied a conflict between the objectives of the Employment Act and of economic stability. In other words, is it possible for us to obtain in a given period of time the objectives of the Employment Act and still have economic stability?

Mr. NEAL. In my opinion the Employment Act calls for economic stability. So I think that the policy of credit restraint is carrying out one of the major objectives of the Employment Act.

Representative MILLS. If those types of restraints, that are not now being utilized, were to be utilized to control inflationary pressures completely and if they do have adverse effects in certain sectors and we compensate for that by other acts, then is not there the possibility of a conflict in the objectives?

Mr. NEAL. If we insist on a policy of credit restraint, and then we 1 by 1 remove all segments that are influenced by restraint from its effects, then we do not have restraint. In the areas that we have been mentioning, the leakage of restraint involved has been relatively small. So I do not think the policy of restraint need be diluted so much that it would be ineffective by these special provisions for agriculture and small business.

Representative MILLS. You understand what I am talking about is maximizing the rate of growth in employment and production versus stabilizing prices. You think it is possible to have both within a given period and that there is no conflict in objective?

Mr. NEAL. There may seem to be a conflict in objective at times because we look at the short run, rather than the long run. But in the long run growth requires continued capital accumulation and

capital expenditure. If we do not have relatively stable prices, we will eat into the very source of growth itself in the long run. That is your supply of capital. You will make savings unattractive to the American people. If savings are unattractive, then we simply will be unable to accumulate the capital that we need for further growth.

I think stability of the price level is one of the most important foundations for future growth. I fail to see any conflict between those two objectives.

Representative MILLS. History does not indicate that since World War II we have accomplished the two. We have had relatively full employment, but we have also had unstable prices. I wondered if we just had to take it as a necessary evil, that if full employment exists, we must continue to expect instability of prices.

Mr. NEAL. As I mentioned briefly in my statement, I think if we continue to have a creeping inflation that then we will get these adverse psychological reactions, everybody trying to beat the gun, everybody trying to protect himself against future price increases. This will increase inflationary pressures, because borrowing will be encouraged and the advantage of savings will be diminished. Once we get on that road, there is only one end, and that is a crash.

Representative MILLS. As I studied the President's economic message, I get the conclusion that there is such a conflict, and he is going to do what I or probably anybody else would do. We lay aside some of the desirable objectives, such as stable prices, because of the possibility that stable prices would defeat our other goals of full employment, and we place priority on the desire for full employment, and try to minimize these other prospective or possible consequences of it to some extent, but not entirely because if we did it entirely, we would defeat our major objective in certain sectors of our economy.

Do you have a different impression of what the economic report says?

Mr. NEAL. I am at a loss, frankly, to explain why the section that you read, and that I have quoted also, got into the economic report. I think if we are deeply concerned about those questions, then we need more than ever not one study, but any number of studies, such as has been proposed for a National Monetary Commission.

Representative MILLS. Mr. Chairman, my time is up. Just for the purpose of completing this thought, if I may, I want Mr. Neal to understand that my concern has to do with the possible financing of a very staggering budget request through revenue derived from actual growth to the extent of 3 or 3½ percent over gross national product of 1956, rather than through further inflationary trends and increases in prices. We can have it from either of the two, perhaps, but we prefer to have it from actual growth rather than from inflation.

I have my doubts that the situation justifies the degree of confidence that we will finance this budget without some degree of inflation entering into it. There are too many factors indicating increases in costs and therefore increases in prices to leave me comfortable about the year 1957.

Chairman PATMAN. Mr. Kilburn.

Representative KILBURN. Mr. Heller, in your statement you mentioned the percentage relationship of local and State taxes to Federal taxes. Do you feel that the local and State taxes are better able to finance the schools than Federal taxes?

Mr. HELLER. That raises an extremely difficult philosophical as well as practical question. If you say, are State and local taxes better able to finance schools than Federal taxes, I think the answer off-hand would have to be "no." The Federal Government has superior taxing powers. It can administer taxes more efficiently, and it can raise revenues more easily than State and local governments.

This does not, however, lead me to the conclusion that we should rather readily turn to the Federal Government for the whole solution of the State and local school financing problem. There is no question that the Federal Government has a very substantial role to play in terms of the kinds of program that H. R. 1 and the President's proposals bring to the fore.

Your question brings me to the difference between my esteemed colleague, Professor Harris, and myself, on this matter of the relative reliance on State-local taxation and Federal taxation. Understand, I do not want to be provincial about this and unduly influenced by the fact that I am serving as tax adviser to the Governor of Minnesota, and I certainly do not want to take a States rights position in the old narrow sense of people standing on their States rights mainly so that they could sit on them. But we are in a very different situation than we were in the thirties and early forties when the Federal Government had to take over many functions. Many of the jobs Government faces today can be handled either at the State-local level or at the Federal level, or shared. It seems to me that we ought to make a very conscious decision as to whether they are handled by the States and localities, or whether they are handled by the Federal Government, and in what proportions. That is what I meant by the philosophical question.

Then you come to the practical question: Can the State handle the job? Certainly their basic fiscal capacity is a lot stronger today than it was earlier. As Mr. Ratchford pointed out, they are not using as much of that fiscal capacity as they were. State and local taxes are about 8 percent now of gross national product, and they were 9 and 10 percent in the thirties and early forties. Besides, economic inequalities among the States have been reduced. They are nothing that we should be complacent about. But in 1932 the highest State per capita income in New York was over 5 times the lowest State per capita income in Mississippi. Today, the highest in Delaware is about two and a half times what it is in Mississippi. Even that, as I say, is nothing to be complacent about. But the disparities are narrowing and full employment and economic growth will continue to narrow them.

Furthermore, I would say that the States and localities are showing signs of much greater fiscal responsibility. In this case I do want to be provincial. In the State of Minnesota, we have just completed a unanimous report of a labor, agriculture, industry, university group which would shift part of our burdens from local personal property taxes to State personal income and corporate income taxes.

I think there are signs, in other words, that the States and localities are ready to take on a greater share of these responsibilities. As to the specific question of financing schools, they are already doing a much bigger job than they had been doing in the past.

I am sorry to have given such a lengthy answer, but the question can't be answered adequately in just a few words.

Representative KILBURN. We hear a lot about the tight money policy. Do you not think that the tight money situation is a result of the law of supply and demand operating?

Mr. HELLER. I think there is a great deal to that. In other words, that the Federal Reserve Board does not in and of itself create tight money, but it does create conditions of access to the available supply of money by different users. It can, of course, enlarge the money supply, but this is not the same thing as enlarging the flow of savings required to satisfy demands for investment funds.

Representative KILBURN. Mr. Ratchford, you said, if I understood you correctly, that State and local governments could reinvest their money in Government bonds in State and local bonds. I had always supposed that the big attractiveness of State and local bonds was the tax-exempt features. I would not think that the State and local governments would take advantage of that, and I do not think they would ever buy them.

Mr. RATCHFORD. That is true, and that is the reason why they have put their money into United States Government obligations in the past. But I pointed out now that the differential has narrowed a great deal, so in recent weeks or months there is not much difference, they could provide funds for themselves and their local governments in periods of stress by shifting some of their holdings from United States Government obligations to State and local.

Representative KILBURN. I have one more question of Mr. Harris. Of course, I gather from your statement that the Republicans can do no right and the Democrats can do no wrong. You make the statement that the Democratic administration would have spent several billions more on schools, hospitals, and slums, et cetera. In view of the fact that Congress appropriates the money, how do you know what the Democratic administration would have done?

Mr. HARRIS. I just base this on ideology and past history. Let me put it to you this way: If you have resources—look at what happened when the Democrats were in power; I quoted some figures in this statement—when the Democrats were in power, they used a substantial part of the rising income of the Nation to provide services that the Nation needs.

I also pointed out that from 1952 to 1956, when the Republicans were in power, that the proportion of additional resources going to these services was virtually zero. In fact, from 1954 to 1956, fiscal years, we were spending less on civil benefits than we had spent in 1953, despite the great rise in the gross national product and the very significant reduction in military expenditures. This, I take it, is not Democratic policy, if I know anything about Democratic policy.

I am sorry to raise this political issue, but I do not think you can understand the monetary and fiscal policy in the last few years unless you understand the ideology behind these policies. I think if anybody looks at the American economy, the thing that is striking in the last 10 years, with a decline of something like 40 percent of these non-security expenditures by the Federal Government relative to the gross national product, the thing that strikes you more than anything else is the extent to which we have purchased a lot of things like automo-

biles and television sets and racetrack services, and what not, and not Government services. Look at the Department of Commerce figures. How little of this money has gone into education, hospitals, housing, slum clearance, et cetera. Although this is a very difficult thing to prove, I think on the basis of the evidence it is quite clear to me then, and I am sure it is true that under the Democratic regime you would have a larger proportion of this rising income going to Government services.

The objective of economic life to Mr. Humphrey seems to be tax cuts. I do not take this to be the objective of the economic life of most Democrats.

Representative KILBURN. But you did not say that the inflation that we have had in this country in the last 20 years developed under the Democrats.

Mr. HARRIS. When I was working on the campaign, I worked up some figures, and I am willing to stand by them.

There are some figures in here which show that most of our inflation comes in wartimes. Eliminate the war and the demobilization periods and the Democrats since 1932 have had an average rise in the cost of living of one-half of 1 percent, and under Mr. Eisenhower the increase has been substantially more per year.

Representative KILBURN. I am sorry, Mr. Chairman, that partisanship has come up in this hearing.

Mr. HARRIS. I take the responsibility for this.

Representative KILBURN. That is all.

Chairman PATMAN. The Chair recognizes the first chairman of the Joint Economic Committee, Senator O'Mahoney.

Senator O'MAHONEY. Thank you, Mr. Chairman. I am very sorry that I was not here earlier in the morning. I understand from Mr. Mills that the papers have been uniformly very interesting. Before I ask any questions may I explain that I am getting ready for a hearing which opens next week on Tuesday on the Government policy of providing substitute oil for our allies in Western Europe for the Middle East oil which has been shut off by the blockade of the Suez Canal. This policy was accompanied shortly after it was initiated by an increase in price posted by the Humble Oil Co., an increase which then produced a chain reaction throughout the entire economy which uses petroleum and petroleum products.

There descended upon Congress in both House a flood of letters and telegrams protesting against the increase in the price of fuel oil by public utility companies making electric power with fuel oil as a fuel, and by the drivers of automobiles who complain about the increase in the price of gasoline when, as a matter of fact, the refiners have stated that they are swimming in gasoline which they cannot sell.

Then I received a letter only yesterday from Mr. Walter Hallanan, the president of the National Petroleum Council, in which he most persuasively listed the various commodities in which prices have risen in the last few years. Steel was at the top. The percentage of increase in crude oil was about 28 percent. The increases in some other cases ran as high as 60 percent, thereby indicating that the monetary policy which has been followed has not stopped inflation. It is more than creeping inflation, Mr. Neal, if the figures that Mr. Hallanan

gave me are authoritative, and I think they are. It is inflation that affects the entire economy. Increasing the price of steel not only increases the price of every bit of defense equipment that the Government buys, into which steel goes, it increases the cost of the roadbuilding program, which the President and the Congress last year initiated.

Contractors have testified before the Subcommittee on Roads of the Senate that they cannot begin to bid on these road projects now, what they were willing to bid a year ago on road projects, because of the increase in cost of the commodities which they must use.

We have looked at the bonds or borrowings of the mortgagees of FFHA. Here are two opposing points of view. I want to ask you to discuss both these opposing points of view once again in the light of the inflation in the cost of money to the Government of the United States. The rising cost of money to the Treasury is just as much inflation as the increase in rate on mortgages for homebuilders, as great as the increase in the rate of mortgages for those communities which want to build schools.

This morning the newspapers carried the Treasury statement which was issued yesterday, Thursday, January 31, 1957. And in considering this, we must bear in mind that the amount of Government securities which must be issued and which must be refinanced during the succeeding calendar year is running over \$77 billion. Here is the first paragraph of the Treasury statement:

The Treasury Department announced today an optional exchange offering of 3½ percent 1-year Treasury certificates of indebtedness maturing February 14, 1958, and 3½ percent 3-year-and-3-month Treasury notes, maturing May 15, 1960, open to the holders of \$7,219 million 2½ percent certificates maturing February 15, and \$2,997 million 2½ percent notes maturing March 15. The new certificate offering will also be open to holders of the \$531 million 1½ percent notes maturing April 1. Cash subscriptions will not be received.

I emphasize that for a remark to be made a moment later.

We have, therefore, 3½ percent, 1-year certificates which will take up the 2½ percent certificates maturing February 15. There is an increase in the cost of money to the Government on refinancing from 2½ percent to 3½ percent.

That is a rather extraordinary rise in the cost of money.

This is on one issue. On the second issue, the increase is from 2½ percent to 3½ percent, and these are 3-year-3-month Treasury notes.

That is inflation in the cost of money. I think it warns us that we must not attempt to secure a solution of the problem of inflation by dealing only with the prices of commodities. We have to find how we may be able or we should be able to stabilize this inflation in Government securities which seems to be getting out of hand. I know what happens. I have before me the case history of a certain bank—a small bank—which, within the last few months, sold \$100,000 worth of United States 2½-percent long-term bonds, 64-69 bonds, due in December 1969, for \$90,187.50. The loss, of course, was charged against the tax of that bank payable to the United States. But immediately after the loss was created, this same bank bought \$100,000 worth of United States 2½s due on June 15, 1969, for \$90,375. They took a tax loss, as I said, on the first sale, but if the bonds go up their tax upon the difference will be a capital gains tax, or 25 percent.

Now, compare that incident, which I can verify, but I do not want to give the name of the bank on a public record, with a letter I received

the other day from a constituent who, at the beginning of World War II, because of his patriotic instinct, a farmer without any great profit ahead of him, but who had saved a little over \$1,000, bought a thousand dollar bond to help finance the Government in its war. Now he writes me that he and his wife are much older than they were when they bought that bond. They cannot sell it except at a loss. He asks me what he should do about it? So I turn that question to you, gentlemen.

From the farmer, belonging to an industry which we all know is not a profitable industry because it has to have supports from the Government, up to the Government itself, this financing difficulty is becoming greater and greater all the time. The administration suggests that we create a monetary commission to bypass Congress to make a recommendation as to what shall be done. If that commission should be set up, the Congress will cease to give attention to the matter and a year or 2 will pass, maybe 3 years, before the monetary commission makes any report, but in the meantime the cold facts that now face us will continue to confront us.

Will you two gentlemen at either end of the table enlighten me on this matter?

Mr. CHANDLER. Mr. Senator, may I take a few moments to describe the basic situation as I see it? We have concentrated here on what has happened in the credit markets. I think it is well to recognize that manifestations in the credit markets are only symptoms of more basic things that have been going on in this economy for the last year or so. The really basic fact is that when you add up all the demands for output—the consumer demand, investment demand, and Government demand—it is in excess of the productive capacity of the economy. It means that somebody is not going to get all he wants.

These various agencies have gone into the money market to get the money with which to buy these commodities, which are not available in adequate amount.

Senator O'MAHONEY. And the Government has gone into the money market.

Mr. CHANDLER. Yes. Everyone has. The result is that very marked increase in the demand for credit. Unless the supply were increased with the rise of demand, a rise of interest rates was an inevitable result.

The Federal Reserve could have prevented any rise of interest rates whatsoever by following the policy of passively increasing the money supply. If they had done that, there would have been no rise of interest rates. Everybody would have been able to get a lot more money to take into the commodity markets. Then we would have heard the kind of thing that we heard at certain times during the war and other times, that there are people who are being unfairly treated in the commodity markets. Time after time I heard small manufacturers complaining that they could not get steel, that they were being discriminated against by the big companies. It was also alleged that some State and local governments could not get construction materials they wanted because favoritism was being shown to the big construction projects.

Whether we call this rise of interest rates in the market inflation or not, what we really have to choose between is a rise of interest rates

in the credit market and more inflation in the markets for commodities and services. There is no escaping this dilemma.

Senator O'MAHONEY. Just a moment, let us see if there is not an escape from the dilemma. When the Federal Reserve Board was here and we were trying to study the problem with them, I pointed out to Chairman Martin that I read in the papers that in order to stimulate the Christmas trade retail buying the Federal Reserve through its Open Market Committee had purchased Government securities so as to keep the price up and provide more money. But now since Christmas has passed, the Federal Reserve Board has been selling about a billion dollars worth of Government securities, thus driving the price down and increasing the Government rate.

Mr. CHANDLER. Senator, I read that exchange.

If I might make a brief answer to that, it seemed to me that Mr. Martin failed to make the proper response to your question on that occasion, and that was that the purchase of Government securities in the pre-Christmas period was not to increase the level of expenditures or to increase the supply of credit in general. It was rather to supply funds to match the outflow of coin and currency from the banking system. If they had not bought securities at that time, there would have had to be a rather marked restriction of the credit supply. I would say that was in the nature of a defensive action to avoid a contraction, rather than to encourage an expansion.

Senator O'MAHONEY. What about the selling?

Mr. CHANDLER. That has been largely the reverse action to prevent the inflow of coin and currency from people's pockets into the banking system from having a positive expansion. This is an action of a more or less mechanical nature which occurs a few weeks before Christmas and a few weeks after the holidays.

Senator O'MAHONEY. Mr. Neal?

Mr. NEAL. Senator, I would much rather listen to you talk than myself, but I am compelled in answer to your question to make this comment, in substantiation of Professor Chandler's answer to the same question, that interest rates are a price and everything you say about that price going up is true. But this is a price that is an index of prosperity. You will recall that when interest rates were very low in this country—at one time they were virtually zero on short term—the country was in the worst depression in its history. So this price of prosperity, if we can sustain prosperity, I think is a price well worth paying. I do not think anybody would want to return to the days of very low interest rates, which were accompanied by depression conditions. That is what we are likely to have if market forces bring about the decline in interest rates. The higher interest rate is not the same thing as higher prices of other things.

Along that same line, let us take your farmer who bought the \$1,000 Government bond. Maybe it is worth 90 in the market now because interest rates have gone up, but a fellow who bought a thousand dollar Government bond in 1939 and still holds it has now only one-half of what he contracted to get when he bought that bond, because the buying power of that bond has gone down on the average about one-half.

I think that is the kind of depreciation of Government bonds that really needs to be worried about. The farmer who has a bond today worth 90, if he holds onto that bond will be paid off at 100 because it

will mature. The loss of buying power caused by inflation of other prices cannot be recovered.

Senator O'MAHONEY. Yet the bank statements will show very great profits in the handling of Government securities under this tight money policy.

Mr. NEAL. That is a tax problem, sir, on which I am not expert. If the Congress does not like that, I think they might be able to fix it.

Senator O'MAHONEY. I am just asking for advice. We have before us a resolution authorizing the President to spend \$200 million in the Middle East without regard to any provision of existing law or any regulation of Government. This is an illustration of the crisis or dilemma in which we find ourselves. The Government has to expend money for defense, expend money for economic aid, and the Federal Reserve System does not help in that respect, it would seem. To use your phrase, at best we still have creeping inflation, but to use the figures offered to me by Mr. Hallahan, the inflation is anything but creeping. According to your own answer to me just now, the dollar is worth only 50 cents, or less than it was before. That is not creeping inflation at all.

Give us the solution, please. Let us try to go beyond the theories and get it down to realistic solution.

Mr. NEAL. I am very happy to emphasize, Senator, what I think is the only real solution of that problem and always has been the only real solution, and that is a fiscal and monetary policy which work together to provide restraint on the increase in the supply of money when you have full employment and prices are rising.

Senator O'MAHONEY. Mr. Chairman, my time having more than expired, I would conclude by asking you to write me a letter, brief but pointed, and in answer to my question.

(The letter referred to follows:)

COMMITTEE FOR ECONOMIC DEVELOPMENT,
New York, N. Y., February 5, 1957.

Senator JOSEPH C. O'MAHONEY,
Joint Economic Committee,
Congress of the United States, Washington, D. C.

DEAR SENATOR O'MAHONEY: You have asked me to extend my remarks, made before the joint committee on February 1, in answer to your question, "How can we avoid inflation while still providing for increased Government expenditures such as emergency expenditures for defense?"

I hope that you will forgive me for concentrating on essentials rather than going into extensive supplementary argumentation in this answer. It seems to me that the most important question now is not to get involved in specific cases but to take an overall view because effective control of inflation can never succeed in bringing about a specific result in a specific case. Thus, if you are concerned with an increase in the price of petroleum, or an increase in the price of steel, or an increase in the price of peanuts, anti-inflationary policy is not the policy that can most effectively be used to deal with these specific situations.

Anti-inflationary policy is broad in its impact. Its effectiveness is measured by what happens to the general level of prices and costs, not what happens in specific cases. Against the background of overall anti-inflationary policy specific cases can be dealt with in terms of the supply and demand of the specific good or service with which you are concerned. When the price level is stable individual prices will show both increases and decreases, some of them large, in response to the particular supply and demand situations.

What, then, would be an effective overall anti-inflationary policy? Such a policy has two main arms: monetary policy and fiscal policy.

Monetary policy is made effective primarily by influencing the supply of money and credit through influencing the volume and, to a lesser extent, the cost of bank reserves. So long as inflationary pressures exist generally in the

economy, the Federal Reserve, which is the agency charged with primary responsibility for directing monetary policy, should restrain the creation of new reserves for the banking system. When the banks are under pressure on their reserve positions, they are forced to hold their lending down. When they hold their lending down, they hold down the process of creating deposits, and thereby they hold down additions to the money supply. If, because of an increased velocity of money or a too liberal supply of reserves injected in some past period, inflationary pressures seem to be getting out of control, then the Federal Reserve may have to contract the volume of reserve funds. The Federal Reserve has been making a seasonal contraction in the past month. It could continue this contraction beyond seasonal requirements if the situation demanded it.

When the Federal Reserve is exercising restraint in the manner described either by not providing additional reserve funds, by providing them at a rate less than that demanded in the market, or even contracting the supply of reserve funds, the pressures of market demand for credit will tend to force up interest rates. Higher interest rates will further discourage borrowing by some borrowers and will create conditions in the capital market that will be discouraging to the issuance of new securities. This discouragement to additional borrowing both from the banks and through the capital market will affect all types of borrowers, including the Government itself.

Because of the overriding importance of preserving the credit of the Government of the United States, however, if the Treasury must borrow new money to meet a cash deficit in the budget at a time when the Federal Reserve is exercising credit restraint, then a difficult situation arises. The Federal Reserve as a part of the Government will probably have to accommodate the Treasury in some way. Since accommodation of the Treasury will usually mean nothing less than making reserves available to the banks so that they can buy Government securities or lend to others for the purposes of acquiring them, it is plain that Government borrowing of new money during a period of anti-inflationary restraint will tend to weaken that restraint, if not destroy it altogether.

That is what fiscal policy is an indispensable second arm of anti-inflationary policy. So as to avoid borrowing new money with the disruptive effects upon credit restraint described above, the Treasury should have a cash surplus in a period when anti-inflationary policy is desirable. This means that if large, new expenditures must be made for defense or other purposes, either other Government expenditures must be cut or Federal revenues must be increased. I believe, myself, that other Federal Government expenditures could be screened to delay or eliminate entirely certain types of expenditure which are most inflationary. I have had an opportunity to read the statement which Frazar B. Wilde, Chairman of CED's Research and Policy Committee, has delivered to your committee Wednesday, February 6. I believe that what he has said about possibilities of reducing expenditures in this connection should be most helpful to the joint committee.

It was a privilege to be invited to appear before you and to have this opportunity of amplifying my remarks.

Sincerely yours,

ALFRED C. NEAL.

Chairman PATMAN. Mr. Neal, I believe you discussed the proposed Monetary Commission.

Mr. NEAL. Yes, sir.

Chairman PATMAN. I am sure you read the history of the Monetary Commission in the past, or at least the proposed one—in 1908, after the 1907 depression or panic, it was proposed to have a Monetary Commission composed of people outside of the Congress. At that time the Republicans were in power in the executive branch and also in the legislative branch. I have read the debates in the House and Senate, and I discovered that they discussed the question of having outsiders on the Commission, and they turned it down on the theory that the legislative committee could call these outsiders before them and get the benefit of their knowledge and information without having them on the legislative committee.

Now we have this situation. I hope I am not going to get politics into this discussion, but we must mention political parties. Mr. Curtis mentioned a while ago something about a "political pitch" or words to that effect, and it kind of reminded me that the President himself gave the economic report a mild political pitch when he discussed the status of the economic situation from 1953 to 1956, inclusive. But we are trying not to put any politics in this discussion.

Last year we had an election in this country and although the President was elected by an enormous majority, the people trusted Congress and elected a Democratic Congress. I wonder if it could be said that the administration is not trusting the Democratic Congress, although the people did. The people trusted them and elected them. The executive branch is displeased with that, and the executive wants to get the Congress composed of Democratic majorities in the two Houses to permit the use of outsiders on the Commission.

It occurs to me that the same arguments that were used in 1908 to exclude outside members should apply now, that any commission which is organized should get the benefit of all outside views, which is best done by not having outsiders on the policymaking committee.

The separation of powers provision is a very definite provision of our Constitution, and I believe in it. In fact, when the President refused to put into effect a bill because the House and the Senate reserved a veto power, I think the President was right about it. I think it was an invasion of his powers. Likewise, I think it is an invasion of the legislative powers for the President, who is the Executive, to insist on having on a legislative committee, people of his choice who are not elected by the people at all.

Further, the Constitution specifically charges the Congress with the power to print money or to coin money and regulate the value thereof. By the expressed language of the Constitution, then, this power is outside of the executive entirely. Does not the Commission proposal look to you just a bit like an invasion of the legislative rights by the executive?

Mr. NEAL. Mr. Patman, I am afraid I am going to give you a very unsatisfactory answer, for this reason. I believe in bringing to bear on these problems all of the brains and research that we possibly can command.

Chairman PATMAN. I agree with you on that.

Mr. NEAL. I believe that the Congress is amply endowed with those qualities. I think any study that they made of this problem would be a good one. I think that they certainly have the responsibility for any action that must be taken.

On the other hand, I think outside the Congress also there is a great deal of wisdom and intelligence. I think this problem is so serious that we can afford—in fact, I do not think we can fail to take advantage of both the best outside wisdom and the best wisdom that there is in the Congress.

So far as I am concerned, a congressional investigation and a National Monetary Commission would not be too much to have to go to work on this problem.

Chairman PATMAN. In other words, let the President have his commission and let the Congress have its own commission.

Mr. NEAL. Yes, sir.

Chairman PATMAN. The Congress will certainly call before it all of these outsiders you speak of. We need the best brains we can get and we always use them just like we are using the best brains here today. We call on you and we ask you to give us advice. We would do that in any monetary committee or commission. It just occurs to me that it is rather far afield for the executive to insist on getting into areas where the duty is placed upon the Congress specifically.

Could we have a show of hands on how many believe that credit will be tighter this year or easier this year, or about the same? How many believe it will be tighter? Four.

How many of you believe it will be easier? None. How many of you believe it will be the same? Two.

I shall be glad to recognize the gentleman from Iowa, Dr. Talle.

Representative TALLE. Thank you, Mr. Chairman.

Inasmuch as the proposed National Monetary Commission has gotten into this discussion, I plead guilty to introducing both of the bills proposed by the administration—the one which sets up a commission outside of the Congress altogether, and subsequently a revised plan which includes the chairmen of the 2 banking committees and the ranking minority members of the 2 banking committees, or their designees—which would be a Commission that includes 9 members outside of the Congress and 4 members within the Congress.

As far as the Constitution is concerned, we, who serve in the Congress, of course, reserve our legislative powers. These Commissions would do nothing more than study an A-1 problem in my opinion that needs attention in our country today. Is there anything wrong in utilizing the best brains we have, whether in or out of Congress, for making a study? Certainly that does no violence to the Constitution of the United States. When the hour comes for us to legislate, if indeed we choose to do it, Members of Congress will do that job. We will hold onto our legislative powers. We will not surrender them.

That is all, Mr. Chairman.

Chairman PATMAN. Thank you, Dr. Talle.

I would like to place in the record, if there is no objection, at this point, a recommendation made by the Douglas committee in 1950—

Representative TALLE. Mr. Chairman, may I have just a second more?

Mr. Neal, I am glad you mentioned that E-bond. The loss of 50 percent in purchasing power occurred between 1939 and 1953. Any loss that may have occurred since has been negligible. The loss in purchasing power between 1939 and 1953 was terrific.

Chairman PATMAN. In this report—the Douglas committee report, a unanimous report—we recommend S. 1559 which would provide for the establishment of a National Monetary Commission be not enacted, and give good reasons why it should not be enacted. Approving that report was our good friend, Representative Jesse Wolcott, from Michigan, and Senator Flanders, of Vermont, as well as Senator Douglas.

Representative CURTIS. It is not a Republican report.

Chairman PATMAN. No. It is a unanimous report. At that time they took up the question of a mixed commission and decided unanimously against it. Without objection I will insert the report in the record.

I should like to say, too, that Mr. Chandler, who is here today, was with the committee at that time and probably wrote that report. (The report follows:)

We therefore recommend that the Banking and Currency Committees of the two Houses of Congress and the Joint Committee on the Economic Report be given adequate funds for the purpose and that they be requested to make a comprehensive study of the monetary and credit systems and policies of the United States. We believe it important that the study be made by a committee composed exclusively of Members of Congress rather than, as proposed in S. 1559, by a mixed commission composed of Members of Congress, members of the executive department, and members drawn from private life. The study should draw upon the information, judgment, and points of view of people both within and outside the Government. For this purpose the investigating committee should engage experts to make thorough studies and reports on various phases of the problem, and it should invite presentations from all who can be helpful. But the committee that receives the information, weighs it, forms judgments about it, and submits reports concerning it to Congress should be composed exclusively of Members of Congress, for only in this way can the study contribute a maximum to congressional understanding of all these complex problems and to the quality of the resulting legislation. Congress should not abandon its function of legislation, and to legislate wisely it must fully understand the reasons for its legislation. It should not be put in a position of accepting on faith the recommendations made by private citizens without knowing thoroughly the facts and reasoning that led to those recommendations. There is no substitute for thorough congressional investigation and hearings.

Chairman PATMAN. I would like to insert in the record, too, if I may, at the conclusion of today's hearings, a statement showing increases in prices, including the price of money which has gone up 200 percent in the form of the Federal discount rate, 266 percent for 90-day acceptances, and 3-month bills 434 percent. Without objection I will put this entire table in the record along with the other price increases, including labor and commodities.

Representative MILLS. Mr. Chairman, earlier I had asked a series of questions and obtained responses from Mr. Neal to a few of those questions. Perhaps the panel has been asked other questions now and forgotten the subject we were discussing. Before going to any other questions, are there any members of the panel who would desire to comment on the questions that I raised with respect to a possible conflict in objectives of our economic policies having been implied in the Economic Report and the budget message. Do you recall the points we were questioning on?

Mr. RATCHFORD. If I may make one very brief remark, to my mind there are several goals here, and we want to attain all of them insofar as feasible. At certain times attaining one may involve giving up some measure of another.

For example, if we wanted to assure full employment and we are determined to do that irrespective of everything else, I would think we would all agree we could do it. It would involve a substantial inflation. This is a short-run analysis. It would be different perhaps in the long run. On the other hand, if we were really determined to prevent price increases, and were determined to do that irrespective of everything else, we could do that. I think that frequently attaining one goal may mean giving up some part of another goal.

Representative MILLS. I am disturbed about this question. Do you see in the situation that exists now, and especially with respect to the future, an existing conflict in our goal of full employment and full production and stable prices?

Mr. RATCHFORD. Yes, I do, Mr. Congressman. I think we are prone to take or to accept some degree of inflation. It is less painful at the moment. In fact, it is positively pleasant for many segments of our economy. Whereas unemployment is distinctly unpleasant. We tend to take the short-run view of these things and accept the inflation in preference to some degree of unemployment.

Representative MILLS. Therefore, if the administration and Congress are determined to maintain full employment for the year 1957, we may well have to become reconciled to some more inflation occurring at the same time.

Mr. RATCHFORD. That would be my view.

Mr. HARRIS. Mr. Congressman, of course, there is always a conflict between these two objectives. On the whole, as I said before, we have been very lucky, and partly the luck, if you call it luck, the fall in agricultural prices which made it possible to have stable prices. In the discussion you had with Mr. Neal, I think this point should be brought out. You can by restraining bring about a depression. This was made quite clear in 1953, for example.

We talk about the objective of full employment or stability of prices, and there is some conflict here. If you look through American history, you will find that there generally has been a rise of output and a rise of prices at the same time. Especially in recent years the increase in output has been much greater than the rise of prices. One might say, if you have a 5-percent rise in output and 1-percent rise in prices, this not a bad picture, although we would prefer that we did not have the rise of prices.

There is one other issue that has come up in hearings a great many times and a great deal has been said about it, and Senator O'Mahoney mentioned it, and this is the objective of equity. What is your policy doing to various people. You increase the rate of interest, and what do you get? You find the plans for investment for next year are greater than ever. There are some people who are not deterred by a rise in the rate of interest. There are other people who are deterred. There is a question of the distribution of these resources. Therefore, there is some question as to why the Federal Reserve does not try a little harder and why the Federal Reserve does not urge Congress to provide certain qualitative controls, and why there is not better cooperation between the Federal Reserve and the various finance agencies so that, insofar as you have higher rates, the Government comes in and makes it possible for those who are excluded from the market to get some part of these monetary resources from which they are being squeezed out.

There is one other point that is relevant here in terms of the discussion we have had so far. A good deal has been said, and I agree in a general way with what Dr. Neal and Professor Chandler have said, and that is, when you are looking at a high rate of interest, it is true that this high rate of interest can restrain. It may bring about lower prices than you otherwise would have, and this has certain important advantages for the economy. As several Members of Congress have suggested, there has been a very significant increase in the cost of the national debt. This increase is roughly about \$800 million a year from fiscal 1953. If the present outstanding debt were refinanced—and its average maturity is about 4 years—at the present

rate of interest, this would cost the Federal Government \$2 billion a year.

This is a small price to pay for avoidance of inflation, but we should remember that this is an economy administration which came in on the principle of keeping the public expenditures down; and yet, despite that fact in the one area where you would least like to see an increase in expenditures because on the whole the bondholders are the relatively wealthy people, you get an increase of possibly \$2 billion in the cost of the national debt.

This is a price you pay, and it may be worth paying that price. But we should not lose sight of the fact that this is a factor in the situation. So in a general way what I would like to emphasize is that this high-money-rate policy might bring about a recession; it does raise certain problems of equity; and that it does certainly increase the cost of the budget so far as the rate of interest is concerned. It may save money in other ways. It may not save money because if it cuts down the total amount of income, it also cuts down the total amount of savings. As Mr. Neal knows, so awfully well, from his studies as a student, he knows that the rise in the rate of interest may bring lower income and lower income means less savings.

We are not all sure that a rise in the rate of interest brings an increase in the total amount of savings, as Mr. Neal suggested.

Mr. CHANDLER. I would like to comment on 3 points raised by Professor Harris, and 1 or 2 others.

The first has to do with the possible conflict between stable prices and maximum output. I think one needs to remember the period he is talking about. If you take the 1939 situation, for example, where you have widespread unemployment and unused resources, it may well be that some rise of prices is an absolute necessity if you are going to get full employment. But if you take the situation in which unemployment is already at the minimum, and you are running the economy at practically full speed, it does not follow that you are going to get the same kind of increase in output. We are talking about 1957 instead of 1939.

The second point has to do with the question of equity. I am very glad that Mr. Harris brought that up. It may well be that the rise of interest rates created certain inequities, somehow defined, but I would point out that a rise of prices can also create inequities for every holder of life-insurance policies, savings accounts, beneficiaries of social security, and these are not necessarily all wealthy people.

The third has to do with the great concern for the interest rate on the Federal debt. It seems to me that we are likely to be in trouble in our economic policy so long as the height of the interest rate on the Federal debt is a major consideration in debt management. If we ever get to a point where we have more formal coordination of monetary policy, debt management policy, and fiscal policy, I sincerely hope that as a prerequisite there will be the same objectives in debt management that the monetary authority has for its monetary policy. Merely throwing them all in the same tent is not going to solve any problems if their philosophies are different, their objectives are different, and they do not have the same understanding.

It seems to me that the only thing we can do in terms of sensible debt-management policy is to agree that we are going to pay what is

necessary on the debt to give us the kind of behavior of employment, output, and prices that we want. The height of that interest rate is of decidedly secondary importance as compared with the health of the whole economy.

Representative MILLS. Let me go to another question that I have in mind.

Mr. Brundage a few days ago in appearing before this committee was asked about the prospects for the budget of fiscal 1959. The one recently submitted was for fiscal 1958. He said his group had already begun work on the budget for fiscal 1959. Their objective was to confine that total to somewhere between 71 and 72 billion dollars. The one we are thinking about now will not be fully realized for some 18 months. That will be 12 months beyond that.

If present economic conditions continue—with a high level of economic activity and full employment—I assume that all of you would be in agreement that the best fiscal policy for the administration and the Congress to follow would be to retain a balanced budget over that period of time, with some surplus that might be used for debt retirement. Would that be the thinking of all of you?

Mr. NEAL. Yes.

Mr. HARRIS. Yes.

Mr. HELLER. Yes.

Mr. RATCHFORD. Yes.

Mr. SHERE. Yes.

Mr. CHANDLER. Yes.

Representative MILLS. Then I come to this question. If we are faced with that prospect for the next several months or 2½ years, at least, should we finance that expenditure of money under our present program of raising revenues, or should we make changes in our present program for raising revenues, not reducing the overall amount, because you have indicated that we should balance the budget, but should we get percentages from some sources in greater amount than we do at the present time? Should we make shifts such as you, Professor Shere, have suggested in the areas from which we take these revenues to finance these expenditures, thinking, of course, in terms not only of the short run program of stabilization, but of the long run program that we are always interested in, of economic growth?

Mr. SHERE. I am inclined to think that you should proceed with shifts and the types of shifts that would be appropriate would depend on economic conditions—what is happening in the consumption area, and what is happening in the capital-formation area. I indicated in my statement, and in greater detail in the study, I believe that many changes are essential to promote the economic growth of the economy and to build into it more flexibility.

If I may go to the point of investigations, I stressed the need for at least five important investigations. I do not pose as an expert on Government organization. My testimony on whether the Congress or the Executive should proceed to undertake these investigations would not be worth much. But I believe that it is important that the investigations be undertaken to pave the way for sound legislation in the tax area and in the monetary field.

As I see the work of the Monetary Commission, it will break down into a series of studies on major questions, the relationship between

the Federal Reserve and the Economic Council, the problem of providing capital for small business, the Government credit programs, the control of the financial intermediaries. Ultimately whether the investigations are undertaken by the Executive or by the Congress you will need to rely on experts outside the Government as well as the technical people in the Government, working in a coordinated way under the guidance of able directors of research.

The problem is to focus the best available talent on the investigation, and to make them expeditiously so that the Congress would be in the best position to legislate effectively.

There are many things that could be done in advance of completing these five major investigations. Since I have spelled them out in detail in the report submitted for the record, I will not impose further upon the time of the committee.

Chairman PATMAN. Thank you, sir.

Mr. Curtis.

Representative CURTIS. Professor Harris, I gathered from your answer that possibly you are in disagreement with Mr. Heller, that the reason for the tight money situation is essentially the economic law of supply and demand. Am I wrong in that?

Mr. HARRIS. Yes, sir, you are wrong, Mr. Congressman.

Representative CURTIS. You do think basically it is the economic law that lies behind it?

Mr. HARRIS. I think as Professor Chandler suggested, there is an issue of supply and demand here. Every economist always depends on this vital law. One of my colleagues, I cannot remember which one, did say something about the general point that the Federal Reserve has something to do with this. I was very much annoyed myself, and I think Congressman Patman will agree with me, because he and I are perhaps the oldest students on the Federal Reserve in the country—I wrote a book on it in the early 1930's and he was back in 1914 working on the Federal Reserve System—what was the question I was trying to answer?

Representative CURTIS. I wanted to get on to another question.

Mr. HARRIS. I wanted to answer your question. I lost the train of my thought.

Representative CURTIS. What I had asked was whether or not you believed basically behind the tight money was the law of supply and demand.

Mr. HARRIS. Yes.

Representative CURTIS. I wanted to ask it because I wanted to go on.

Mr. HARRIS. I wanted to answer that part because I have a point that I think is important. I will take just a half second. That point is that although it is true the law of supply and demand is very important, the Federal Reserve to some extent determines the supply and demand situation, particularly the supply situation. When the Federal Reserve goes out and announces it will have a dear-money policy and makes it known to everybody, and, for example, following the leadership of Treasury in 1953, it was partly responsible for dear money, and goes out and makes speeches, as Mr. Martin and Mr. Burgess did, saying this is the law of supply and demand, and we had nothing to do with it, and this was done in 1956, it seems this is a bit of nonsense. Fundamentally you are probably right, but you must

not assume that the law of supply and demand is not influenced by these underlying forces, including the Federal Reserve.

Representative CURTIS. I think it can be influenced. I was trying to get at what might be the cause of the shortage of investment capital. When we conducted hearings on our subcommittee a year ago, I drew the conclusion that one reason for the shortage of capital was that our Federal tax policy was taxing the investment dollar too heavily. Do you think that might be one reason for a shortage of investment capital?

Mr. HARRIS. I do not think there is a shortage, myself.

Representative CURTIS. Let us stop there.

Mr. HARRIS. Let me say this.

Representative CURTIS. So I can follow what I am trying to pose, let us stop. You say you do not think there is a shortage. Do you think it is excessive demand rather than a shortage?

Mr. HARRIS. Let me put it this way. If you look at the history of investment in the last 10 years, there has never been anything like it. There has been a tremendous investment.

Representative CURTIS. You would say it is the excessive demand?

Mr. HARRIS. Yes. I know you are not trying to trap me.

Representative CURTIS. No; I am trying to get the picture. I will get to my conclusions if I can get the picture. I was going to go on and suggest this. Maybe one reason for the excessive or unusual demand for capital investment comes from inflation. I will tell you just why I suggest that. A great deal of the expenditure of capital funds of our private-enterprise system is not for expansion, but merely replacement of plant and equipment. Due to the inflated dollar, their depreciation accounts and reserve accounts are hardly adequate. Would you agree with that?

Mr. HARRIS. I think in a general way when you do have inflation or rising prices there is a tendency to perhaps expand your investments more than you otherwise would. I think, as Professor Chandier said, you run up against the problem of limited resources.

Representative CURTIS. I said not expanded, but to keep what you have in the way of plant and equipment.

Mr. HARRIS. That is perfectly true. If you go back to the history of the last 10 years, you would find a rise of 75 or 80 percent of investment. There has been this tremendous increase in the total amount of investment. I would say that this is a rate that cannot be maintained. I know other economists will disagree with this. I therefore do not feel that what you need so badly is any stimulus on investment. I think investment is not influenced so much by taxes or the rate of interest.

Representative CURTIS. Let me say this, that if you do not have the investment, how can you get the production that you need in order to meet the demand? We had some testimony in the Tax Committee to the effect that nowadays, with the cost of equipment, it requires about \$14,000 of capital investment to employ 1 person. How, in the long run, are you going to employ people if you don't have the investment in plant and equipment?

Mr. HARRIS. The answer to that, Mr. Congressman, is a long story, but I will say briefly that we have to depend more on jobs that do not require so much on investment. For example, Government services,

other kinds of services, do not require that much in the way of investment.

Representative CURTIS. Wait a second. That is not where your demand is. Your demand is for new homes, and you cannot do that out of Government services. You have to do it out of bricks and cement and steel.

Mr. HARRIS. You take the tremendous housing boom we had and you remember the figures I gave in this paper, an increase of insurance and guaranties from \$40 billion in 1953 to \$85 billion in 1958. This is a Government contribution.

Representative CURTIS. Yes, because there was a capital shortage. If the Government had not done it, it would have had to come from somewhere. It is entirely possible that private enterprise could have supplied that.

Mr. HARRIS. I doubt that. I think the pricing situation would have prevented it. You had a rise in construction costs $1\frac{1}{2}$ times as large as before World War II. With that kind of a situation the price of new housing is so high that the Government had to come in. I think this was partly both Republican and Democratic policy.

Representative CURTIS. That is essentially inflation and that comes to my key question. I was very disturbed at your answer that the reason for inflation was World War II. In my own conception I think there are ways of financing a war other than inflation. Do you think the only way to finance a war is through inflation?

Mr. HARRIS. May I get political here again?

Representative CURTIS. Surely, if you will stick to economics, too.

Mr. HARRIS. I will. The reason I say I get political is the fact that if you go back to the Civil War, World War I, and World War II, you will find in the Civil War the inflation was 14 times as great as in World War II if you take into account the proportion of resources going to war. In other words, we have learned a lot about how to handle a war without large amounts of inflation.

Representative CURTIS. Wouldn't you regard the inflation that we have experienced as pretty drastic? It is not as drastic as some inflations, but certainly the economic effects are inflationary.

Mr. HARRIS. It was very serious. I myself would have preferred less inflation. I think this was possible if we had the proper policy. But, on the other hand, given the size of the war and perhaps spending \$500 billion or something of this sort for the war, and compared to what we had in earlier years, we made a pretty good record. We could have done better.

Representative CURTIS. That is the main thing I am getting to. I think essentially, to get political in turn, this administration has been grappling with a situation that was created by the use of inflation to finance World War II. Maybe a better job has been done than before and maybe another administration could not have done a better job on financing World War II, but I do think you are a little off base in criticizing this administration when it tries to meet the problems that were created by the preceding one. I mean economic problems.

Mr. HARRIS. Let me answer that in one word. There is the fundamental difference between you and me, and I would say between Democrats and Republicans, although I am sure some of my Democratic friends may disagree with me on this.

Representative CURTIS. Senator Ellender or some of the southerners.

Mr. HARRIS. The Republicans on the whole are more interested in stable price level. There are differences. It is not black and white.

Representative CURTIS. Wouldn't you say that these times require an emphasis on stability just as I would be willing to grant that possibly after World War II, with that problem, or rather during the war itself, we have to emphasize winning the war? I will grant you that. Would you not say likewise that now with this situation that emphasis must be on stability?

Mr. HARRIS. Suppose you get a situation in the next year or two where you have a small amount of inflation and the Republicans come along and take some drastic measures to deal with this, as Mr. Humphrey might very well do? You might bring about a certain amount of unemployment. My theory is that if this happens in the Democratic regime, there would be somewhat less concern about the stable price level and a greater concern about the amount of unemployment. Whereas in the Republican regime, the tendency would be more in relation to maintaining the value of the dollar than the matter of employment.

Representative CURTIS. I will tell you why I disagree with you. I think the Republicans would try to evaluate the economic facts and pay less attention to the political implications, and therefore probably would come more closely to getting a correct answer. I think we are all human, and we have a difficult time. I think if we will follow the best we can what the economic facts are, and pay a little less attention to what the political vote might be, we would gain from it.

I would say, to end our political discussion, that Republicans would pay more attention to what are the facts of life, and a little less attention, I will agree with you, to what people might be thinking at the time, while the Democratic Party would probably be paying attention to what might be being said throughout the country by the people.

Mr. HARRIS. Mr. Congressman, my distinction is not exactly the same as yours. An economist discussing public policy cannot divest himself of ideological issues.

Representative CURTIS. You should not. I agree with you.

Mr. HARRIS. I say there are questions of equity here. I would say that Republicans are more interested in people with savings and property. The Democrats are more interested in the little man. That is my interpretation.

Representative CURTIS. That is all right. I think we are all interested in the little man. The question is a question of how you go about helping him. I think we should both grant that we are interested in the welfare of our country. All I feel is that the best way to pursue it is not to ignore facts and do the best you can to face up to what your situation is. That is where I happen to be very happy at being a Republican.

Mr. SHERE. Mr. Chairman, I would like to make one more comment in further reply to Congressman Mills and try to switch the emphasis from monetary policy, a little more in the direction of fiscal policy.

I believe that the next turn of the screw, if there is to be one, should be in the area of fiscal policy, rather than in monetary policy. If tax adjustments resulted in net additional revenue, then if inflationary

pressures are greater than they are now, I would not give back the additional revenue in rate reduction.

The other comment I would like to make is with reference to something that Professor Chandler said. It is true that if the economic situation is inflationary, and optimism prevails, and you use a surplus to retire debt, it is not going to be very effective in containing the inflation. But that does not mean that there are no ways left to make a given amount of surplus more restraining than it would be if you merely turned it back quickly for debt retirement. It could, for example, be impounded in larger treasury balances. In that way the potency of the surplus from the point of view of anti-inflation control would be increased.

Chairman PATMAN. Mr. Mills, would you like to ask some more questions?

Representative MILLS. Mr. Chairman, as you know I always stay completely removed from politics, but I just wanted to observe that I had difficulty in reading the economic report, and finding these distinctions between Republicans and Democrats that Mr. Curtis and Professor Harris are trying to read into the report.

I had in mind, Professor Shere, when I asked you the question earlier with respect to the shift of tax policy to finance these expenditures, whether or not we should endeavor to obtain more or less from the income tax, more or less from excise taxes. I am certain you know that a great change occurred during the 15-year period from December of 1941 to 1956 with respect to the raising of Federal revenue. For example, in December of 1941, at the time of Pearl Harbor, we were obtaining about 36 percent of our total receipts from excise taxes. In 1956 we were only getting 13 percent from excise taxes. Our corporate income tax in 1941 yielded us around 29 percent of our total, and in 1956 it yielded about 30 percent of our total. The individual income tax brought us about 20 percent of our total in 1941 and now brings to us about 50 percent of our total.

I take it that the two panelists, Professor Heller and Professor Ratchford, as they view the situation affecting the State and local governments, would suggest to us that we not increase our take from excises or other areas that are largely dependent upon by State and local governments for financing.

Mr. HELLER. Yes.

Mr. RATCHFORD. Yes.

Representative MILLS. We would get the bulk of our required revenues, whatever the budget demands might be under conditions such as we might have, from the income tax on individuals and corporations rather than the excise tax.

Mr. RATCHFORD. I would endorse that. Particularly I would endorse Professor Shere's recommendations that we get it from the income tax, not by raising the rate, but in fact by cutting the top rate, but by making these various changes which will stop some of the revenue from escaping.

Representative MILLS. I was more concerned in my question as to the percentage of our total from various areas. Do you think it would be well for us not to increase the percentage of our total from the field of excises?

Mr. SHERE. Congressman Mills, I would endorse the position that the relative role of the Federal excise should not be increased. Those

that are concerned with the problem of balance from the point of view of the overall Federal system, would do well to bear in mind that we have the payroll taxes, which are substantial, and which are scheduled to be increased in the future. When you take that into account, I think the emphasis which is now being given to the individual income tax should not be lessened. Over the long pull, as the size of the economy grows, there should be some decrease in the corporate income tax, preferably starting with a dividend payment credit, adopting the President's Cabinet Committee report on small business, and later some reduction in the rates.

Representative MILLS. Pardon me for interrupting, but would you do that during the period I have outlined when our expenditures over the next 2½ years may be as high as predicted?

Mr. SHERE. No. Corporate income tax rate reduction is a long-range recommendation. I would not do it during 1957.

Representative MILLS. You also mentioned that we might revise some excises. Would you do it during this period?

Mr. SHERE. I would not do it during this period. Excise tax reduction like corporate rate reduction should be considered under conditions of stabilized growth. Under those conditions I would reduce the corporate taxes somewhat, and under the same conditions I would also start to eliminate some of the worse Federal excises like the tax on freight, the tax on transportation, and perhaps some others. I would not do it so long as the situation is as inflationary as now or worse than now.

Representative MILLS. You visualize as I do, I am sure, that you may have inflationary pressures from tax reduction calculated to encourage investment as readily as you can from reductions in taxes calculated to increase consumption.

Mr. SHERE. I do recognize that. There is nobody that can give you a formula in advance, Mr. Congressman. What has to be done is, when you are considering a tax reduction program, at that time to make a judgment whether the economic situation is one where investment is proceeding too rapidly in relation to what is happening in the consumption area. At that time you decide whether the tax reduction should be weighted more to lift taxes from consumption or more to lift taxes that impinge primarily on savings and investment.

I might add that in a recession there is a strong case for lifting first the taxes that weigh against consumption. But in a period of stable growth, if there is a healthy investment boom, it would be better to defer the lifting of taxes that impinge primarily on savings and investment. If per contra, looking at past relationships and current and prospective requirements, there is need to stimulate investment under conditions of stabilized growth, then you would make your tax reduction by lifting some of the taxes like the corporate taxes and the upper bracket individual taxes that favor savings and investment.

Representative MILLS. We cannot tell what will happen in 1957.

Mr. SHERE. That is why I made my recommendations different for different economic conditions.

Representative MILLS. What happened in 1956 did not denote any need for a reduction of taxes to increase investment.

Mr. SHERE. No; I don't think you will need to be concerned with that problem in 1957.

Representative MILLS. As you know, I am a member of the Ways and Means Committee that has to initiate these matters on taxes, and they tell us right now the problems of small business are so acute that something has to be done immediately with respect to the tax take from small businesses, both corporate, individual and proprietorship.

Mr. SHERE. On that matter, I believe there are enough things that can be done to readjust the tax system and at the same time increase the revenue potential of the tax system to give you more money than enough to go forward with the recommendations in the President's Cabinet Committee on Small Business.

Representative MILLS. He said he recommends that to us for study, but asks us to be careful in the process of enacting it that we do not lose too much revenue.

Mr. SHERE. If I might venture a mild criticism, I think the recommendation is made in a very cautious way and I think without taking adequately into consideration the potentialities for strengthening the revenue potential of the system in some places, and overall, to provide the financing for tax reductions in other segments of the tax system.

Representative MILLS. I am beginning to wonder frankly whether or not the primary concern with respect to tax revision should be one of the needs that exist at the present time for revenues, or whether we should not begin to think somewhat in terms of long-run implications of a continuation of some of our present methods of raising taxes. I have in mind particularly some of our excise taxes which the Treasury Department pointed out to us were imposed in World War II, when you were in the Treasury along with Dr. Heller, and were then very regressive. In other words, they were having a bad effect. They were pointed out to be such taxes as the taxes on freight and some of the others, which may well pyramid in price, bringing about some instances I have heard of where profits have been figured 7 times on the basis of the 1 payment of the freight and the tax on the freight.

Is that the type of thing that we should begin to try to eliminate even in a tight budget situation?

Mr. SHERE. Congressman Mills, I do not believe that you can approach the problem which faces the Congress in that way. The Congress has always to look at the current short-run situation. It has in mind the long-run objectives. But you cannot in the short-run move toward a long-run goal if it is in sharp conflict with immediate requirements.

Representative MILLS. My concern is this: I admit that we have always looked at it in the short-run, but should we continue to look at it in the short-run? Should we not try to formulate tax policy on the basis of some of the long-run implications, and when you see something that has to be done immediately, regardless of what the budget situation is, try to take action there and maybe compensate for it by shifts?

Mr. SHERE. May I address myself to that point?

Representative MILLS. Yes.

Mr. SHERE. Economic conditions will change and there will be ample opportunity for the Congress to move in the direction of long-run goals. For example, we are in a mildly inflationary situation now. You do a certain kind of tax adjustment. If the situation gets worse, you do something different. If it turns into stabilized growth

with no inflation, you do something still different. But in the kinds of adjustments that you make, and they will be different adjustments depending on the different economic conditions with which you are confronted in the short-run, you can gradually and without too great a delay move in the direction of long-run objectives. If you start out with a sort of ideological approach as to what ought to be the ideal American tax system, and try to get there in a hurry, I believe you set yourself an impossible task, because the short-run situation may prevent you from taking the first steps.

Representative MILLS. Always if we continue the policy that we have had historically of letting actions by Congress on the revenue side of it be after and subsequent to completion of considerations of actions on the expenditure. I have wondered, and I do not throw this out as a fixed position of mine, about the advisability of taking action today, let us say, with respect to some of these most onerous provisions that we have, that we say are regressive and are defeating our objective of growth, to eliminate partially or completely eliminate them with respect to a future date, beyond the date covered by the present budget or even beyond the date of a budget under consideration. In other words, serve notice that revenues will be affected to this extent at that time in the future. Notice must be taken that this law will go into effect at that time in the future when consideration is given to budget requirements for that period.

Mr. SHERE. Mr. Congressman, tax adjustments can be made to make the total revenues come out to the amounts appropriate for given economic conditions. It is important to start right away on some of these major structural revisions, not to postpone the job of getting going on the tough questions, like percentage depletion, tax enforcement, tax-exempt securities. I see no difficulty in embarking immediately on the investigations which will permit the Congress to legislate in an appropriate way as soon as they know what they want to do.

There are many things that can be done to adjust the short-run revenue requirements to economic needs whatever the impact of these long-run structural changes. Also, I see no difficulty in going forward with all sorts of changes which would improve the built-in flexibility of the Federal tax system.

Some changes will cost money; some will bring in money. If you do all the things that are desirable to promote economic growth and stability, you will find yourself with more money than you want. Your problem will be to reduce tax rates, and to time the tax rate reduction in such manner as to give you the desired overall amount of revenue to fit the economic conditions that prevail at the time when these changes have an impact on the economy.

Representative MILLS. I would not want you to continue under any delusion that we can make adjustments downward where they are alleged to be needed and compensate for those downward adjustments by upward adjustments elsewhere. The magnitude of the requests for downward adjustments would stagger your imagination if you would come by my office and get some idea of the demands that are presently upon us for such reductions. I am looking at the present time in a subcommittee into some technical changes. I do not hold out any hope that those technical changes that we will bring to the full com-

mittee will produce sufficient revenue for any reductions that the members of the committee are being plagued to enact. It is just not feasible.

For example, you point out that we do something about the depletion allowance. If we could eliminate the depletion allowance we could pick up some four or five hundred million dollars. You know and I know we are not going to do it. At least I know it.

It is suggested that if we limit the area of definition of capital gains that we could pick up a billion or two billion dollars. You and I know that we will not get as far as we would like to go in that direction.

You have heard a lot of talk about the need for eliminating the tax exemption or partially taxed treatment that extends to a great number of segments of our economy. You know from the pressures that are always on the Congress whenever we endeavor to do anything about increasing the rate of taxes in those areas what happens. It has been impossible over the years for Congress to find enough public acceptance to overcome the disapproval of those desires and suggestions. I think we had better face up to facts as we approach this next 24-month period or 2½-year period that there are likely to be very few reductions that can be made in taxes because of the lack of ability to compensate for those reductions if expenditures are to remain high, and we are to have a balanced budget. We have to face up to the fact that Congress is not going to be able to reduce taxes in those periods except if we do it at the expense of an unbalanced budget.

Chairman PATMAN. Gentlemen, I am sure we have held you longer than we should have. I have two questions here that I am not going to ask you to answer now, but I shall appreciate it very much if those of you who have time to do so will answer them in the extension of your remarks in connection with your testimony.

The American Bankers Association Economic Policy Commission has recommended that reserve requirements be reduced to enable banks to supply the credit needed by an expanding economy.

My first question is, could not the credit be supplied by the Open Market Committee purchasing these Government securities in the open market and would you comment on the difference between the two methods of releasing the future money supply.

Of course, the papers have been filled in the last few days with the American Bankers Association Economic Policy Commission suggest-

ing we should have about \$10 billion available in needed credit. The question is whether or not we should reduce reserve requirements to where they would have a billion dollars of high-powered money which would enable them to expand the credit to \$10 billion, or whether it would be better for the Federal Reserve banks through the Open Market Committee to purchase Government securities sufficiently to give them the needed reserves, and to have the same amount of credit.

The next question is a request for a comment on Mr. Martin's statement, that the one objective of raising interest rates is to close the gap between savings and investment by stimulating savings.

Again, gentlemen, I want to express my sincere appreciation to you for giving us the benefit of your testimony. You have been very helpful. Your words will be studied not only by the members of this committee who could not be here, but in printed form the hearings go to public libraries over the country, to interested people in colleges and universities and, of course, to all the Members of the House and Senate and other people interested in government.

We are pleased to have had all viewpoints expressed here today. You have made a great contribution to our hearings and to the Joint Economic Committee's efforts to get basic and important facts upon the record for the benefit of the people.

Monday we will have a discussion of fiscal and monetary policy for the coming year, and we will have as our witness the Secretary of the Treasury, Mr. George Humphrey.

We have had many inquiries about the hearings of last Monday so I want to make this announcement now. On last Monday this committee met in executive session with the Council of Economic Advisers. The transcript of this meeting has been edited and will be available tomorrow morning to the press for release on Monday morning, February 4. A limited number of copies will be placed in the Senate press gallery tomorrow.

Without objection, we will include in the record at this point the material to which I alluded earlier.

(By direction of Chairman Patman the following tables are made a part of the record:)

Selected economic indicators 1947-56 with percentage changes

Item	1956 ¹	1947	Percentage increase or decrease (-)
Gross national product.....	\$412,400,000,000	\$232,200,000,000	77.6
Personal consumption expenditures.....	265,800,000,000	165,000,000,000	61.1
Gross private domestic investment.....	65,300,000,000	29,700,000,000	119.9
New residential (nonfarm) construction.....	15,300,000,000	6,300,000,000	142.9
Producers' durable equipment.....	28,700,000,000	16,700,000,000	71.9
Government purchases of goods and services.....	² 79,900,000,000	² 28,600,000,000	179.4
Federal.....	² 47,000,000,000	² 15,800,000,000	197.5
State and local.....	32,800,000,000	12,800,000,000	156.3
National income.....	342,300,000,000	197,200,000,000	73.6
Compensation of employees.....	239,000,000,000	128,800,000,000	85.6
Income of unincorporated enterprises.....	29,800,000,000	21,400,000,000	39.3
Income of farm proprietors.....	11,700,000,000	14,500,000,000	-19.3
Rental income of persons.....	9,700,000,000	6,500,000,000	49.2
Corporate profits before taxes.....	43,400,000,000	29,500,000,000	47.1
Capital consumption allowances.....	34,000,000,000	14,100,000,000	141.1
Corporate dividend payments.....	12,000,000,000	6,500,000,000	84.6
Income of business and professional proprietors.....	29,100,000,000	19,900,000,000	46.2
Personal interest income.....	17,400,000,000	8,200,000,000	112.2
Nonagricultural personal income.....	309,900,000,000	172,800,000,000	79.3
Disposable personal income.....	286,600,000,000	169,000,000,000	69.6
Personal saving.....	20,800,000,000	4,000,000,000	420.0
Savings as percent of disposable personal income.....	7.3	2.4	204.2
Per capita disposable personal income.....	\$1,705	\$1,173	45.4
Per capita personal consumption expenditures.....	\$1,581	\$1,145	38.1
Population.....	168,100,000	144,100,000	16.7
Civilian labor force.....	67,500,000	60,200,000	12.1
Employment.....	65,000,000	58,000,000	12.1
Unemployment.....	2,500,000	2,100,000	19.0
Unemployment as percent of civilian labor force.....	3.8	3.6	5.6
Average gross hourly earnings:			
Manufacturing.....	\$1,980	\$1,237	60.1
Building construction.....	2,790	1,681	66.0
Retail trade.....	1,570	1,009	55.6
Wholesale trade.....	2,010	1,268	58.5
Agriculture (composite).....	697	647	27.4
Average gross weekly earnings:			
Manufacturing.....	80.13	49.97	60.4
Building construction.....	101.32	63.30	60.1
Retail trade.....	60.42	40.66	48.6
Wholesale trade.....	81.21	51.99	56.2
New nonfarm housing starts.....	1,120,200	849,000	31.9
Total manufacturing and trade sales.....	\$54,000,000,000	\$33,200,000,000	62.7
Wholesale price indexes by economic sector (1947-49=100):			
All commodities.....	114.3	96.4	18.6
Crude materials.....	95.0	98.6	-3.7
Intermediate materials.....	122.1	96.2	26.9
Consumer finished goods.....	108.0	96.8	11.6
Producer finished goods.....	138.1	92.8	48.8
Consumer price index.....	116.2	95.5	21.7
Commercial bank loans.....	\$90,600,000,000	\$38,100,000,000	137.8
Business loans.....	\$38,700,000,000	\$18,200,000,000	112.6
Short- and intermediate-term consumer credit outstanding.....	\$42,000,000,000	\$11,600,000,000	262.1
Mortgage debt (end of year).....	\$144,500,000,000	\$48,900,000,000	195.5
State and local government debt (end of year).....	\$225,300,000,000	\$223,300,000,000	.9
Federal Government debt (end of year).....	\$42,700,000,000	\$14,400,000,000	196.5
Net public and private debt (end of year).....	\$688,000,000,000	\$417,900,000,000	65.8
Common stock price index (SEC) (1939=100).....	345.0	130.9	163.6
Railroad freight rate index (1947-49=100) ³	130.0	88.0	47.7
Transportation bill for farm food products ⁴	⁵ \$3,700,000,000	\$2,110,000,000	75.4

¹ Preliminary.² Less Government sales.³ Combined index for railroad freight rates on livestock, meats, vegetables and fruits, wheat and cotton. The 1956 figure is estimated.⁴ Estimates of total expenditures, including Federal tax by shippers for transportation (except local hauling) of farm products for civilian consumption by rail and truck, including private trucks.⁵ For 1955; 1956 not available.

Sources: Economic Indicators; January 1957 Economic Report of the President; U. S. Department of Commerce; U. S. Department of Agriculture; staff, Joint Economic Committee.

Bond yields and money market rates 1947, and week ending Feb. 2, 1957

[Percent]

Item	Week ending Feb. 2, 1957	1947	Percentage increase
U. S. Government securities (taxable):			
3-month bills ¹	3.283	0.594	442.7
9- to 12-month issues ²	3.11	0.88	253.4
3- to 5-year issues ³	3.34	1.32	153.0
Bonds: Due or callable from 10 to 20 years.....	3.20	⁴ 2.25	42.2
Local housing authority temporary notes (tax exempt) ⁵	2.147	0.845	154.1
High-grade municipal bonds ⁶	⁷ 3.34	2.01	66.2
Corporate bonds: ⁸			
A.A.A.....	⁹ 3.73	2.61	42.9
B.A.A.....	⁹ 4.48	3.24	38.3
Prime commercial paper, 4 to 6 months.....	3.63	1.03	252.4
Prime bankers' acceptances, 90 days.....	3.38	0.87	288.5
Federal Reserve bank discount rate ¹⁰	3.00	1.00	200.0

¹ Rate on new issues within period.² Includes certificates of indebtedness and selected note and bond issues.³ Includes selected note and bond issues.⁴ 15 years or more.⁵ Last sale of notes in 1947 and sale of Jan. 23, 1957.⁶ Standard & Poor's Corp.⁷ Week ending Jan. 30.⁸ Moody's Investors Service.⁹ Week ending Jan. 25.¹⁰ Advances of member banks secured by Government obligations and discounts of and advances secured by eligible paper.

Source: Board of Governors of the Federal Reserve System; and Housing and Home Finance Agency.

Average prices paid by farmers at independent stores Dec. 15, 1956, compared to Dec. 15, 1947

Commodity and unit	Dec. 15, 1956	Dec. 15, 1947	Percentage increase or decrease (-)
Food: Coffee.....pound..	\$1.030	\$0.515	100.0
Clothing:			
Men's overalls.....pair..	3.48	3.26	6.7
Women's shoes.....do....	5.63	5.21	8.1
Household operation: Detergent 1956, soap flakes, 1948.....pound..	.273	.297	-8.1
Household furnishings: Living-room suites.....each..	194.00	167.00	16.2
Building materials: Framing lumber (2 x 4 x 16).....1,000 board-feet..	143.00	115.00	24.3
Motor supplies: Gasoline.....gallon..	.304	.239	27.2
Motor vehicle:			
Automobile ¹.....each..	2,200.00	² 1,430.00	53.8
Tractor: 20 to 29 belt horsepower.....do....	2,160.00	1,530.00	41.2
Farm machinery: Combine, 5 to 6 foot cut, power takeoff.....each..	1,590.00	1,010.00	57.4
Fertilizer: 3-12-6.....ton....	40.80	38.10	7.1
Livestock: Feeder cattle.....100 pounds..	15.00	20.70	-27.5
Feed: Mixed dairy, 16 percent protein.....do....	3.77	4.57	-17.5
Iron and steel items:			
Milk can, 10-gallon.....each..	12.90	7.69	67.8
Nails: 8-penny, common.....pound..	.157	.10	57.0
Barbed wire:			
2-point.....spool of 80 rods..	9.56	6.59	45.1
4-point.....do....	10.70	7.10	50.7
Poultry netting (5 x 150 feet).....roll..	10.20	6.63	53.8
Fence posts, steel.....each..	1.10	.761	44.5
Gates, farm, galvanized, 14-foot.....do....	27.20	18.40	47.8
Iron pipe, galvanized, 1¼-inch diameter.....foot..	.424	.262	61.8

¹ In 1947 the car priced was an 8 cylinder, 2-door Ford sedan. In 1956 the average price of the (low-priced model) 6-cylinder, 4-door Ford, Plymouth, and Chevrolet was used.² July 1947.

Source: Department of Agriculture.

Average prices received by farmers for farm products in United States, Jan. 15, 1957, compared to Jan. 15, 1948

Commodity and unit	Jan. 15, 1957	Jan. 15, 1948	Percentage increase or decrease (-)
Wheat.....bushel..	\$2.09	\$2.81	-25.6
Corn.....do.....	1.23	2.46	-50.0
Cotton, American Upland.....pound..	.3021	.3313	-8.8
Tobacco, types 11-37.....do.....	.527	.458	15.1
Potatoes.....hundredweight..	1.56	2.93	-46.8
Hogs.....do.....	17.30	26.60	-35.0
Beef cattle.....do.....	14.90	21.30	-30.1
All milk, wholesale.....do.....	4.41	5.16	-14.5
Eggs.....per dozen..	.332	.487	-31.8

Source: U. S. Department of Agriculture.

Chairman PATMAN. Without objection, we will stand in recess until Monday morning at 10 o'clock in this room.

(By direction of the chairman, the following material is made a part of the record:)

PRINCETON UNIVERSITY,
DEPARTMENT OF ECONOMICS AND SOCIOLOGY,
Princeton, N. J., February 4, 1957.

HON. WRIGHT PATMAN,
*House of Representatives,
United States Congress, Washington, D. C.*

MY DEAR CONGRESSMAN: At the end of the hearings on Friday, February 1, you asked the panel members to comment on two questions. The first related to the ABA proposal for reducing member-bank reserves as a means of permitting an expansion of the money supply to serve the expanding economy.

The money supply could be increased to the desired extent by the proposed reduction of member-bank reserve requirements, by Federal Reserve purchases of securities, or by some combination of the two devices. In choosing among these methods, at least two major considerations are relevant:

1. The present law relating to member-bank reserve requirements is a hodge-podge, illogical, and sadly in need of review. It distributes inequitably the burden of carrying reserves.

2. The choice will affect both member-bank earnings and Federal Reserve earnings. To the extent that the Federal Reserve solves the problem by purchasing Government securities, the earnings will accrue to the Reserve banks. But to the extent the problem is solved by lowering member-bank reserve requirements, these earnings will accrue to the member banks.

This raises important questions that should be investigated.

Do member banks earn enough to pay salaries sufficient to attract efficient personnel and to attract enough capital to assure the adequacy and safety of the banking system?

The second question related to Mr. Martin's statement that one objective of raising interest rates is to close the gap between savings and investment by stimulating savings. We know very little about the responsiveness of saving to changes in interest rates, but most economists are inclined to believe that saving is rather unresponsive. However, increases of interest rates may serve to close the gap by holding investment down to the level of available savings.

Sincerely yours,

LESTER V. CHANDLER.

DUKE UNIVERSITY,
DEPARTMENT OF ECONOMICS AND BUSINESS ADMINISTRATION,
Durham, N. C., February 4, 1957.

HON. WRIGHT PATMAN,
*Chairman Joint Economic Committee,
Senate Post Office, Washington 25, D. C.*

DEAR CONGRESSMAN PATMAN: This is in reply to your request, made at the hearing of the Joint Economic Committee last Friday, February 1, 1957, that the members of the panel comment on two topics.

First, as I understand it, you requested us to comment on the proposal of the American Bankers Association economic policy commission for a reduction of required reserves and the desirability of that means of supplying credit as contrasted with the providing of credit through the operations of the Open Market Committee. Let me say first that I assume you refer to a situation in which it would be desirable to have more bank credit available. Under existing conditions I do not believe that it would be desirable to have additional credit from either source; on the contrary, until present trends are reversed it is highly desirable that any substantial increase of bank credit should be avoided.

When it does become desirable to have more bank credit I would favor making it available, as a general rule, through the operations of the Open Market Committee. It is a much more flexible and accurate method than the changing of reserve requirements. Both the timing and the amount of the credit can be adjusted quite precisely to the requirements of the situation. On the other hand, it is not feasible to make minute or frequent changes in the reserve requirements. Since timing is often of great importance, this gives a definite advantage to open market operations. Further, the effects of open market operations hit the banks through normal market operations which permits the banks to adjust to them more easily and gradually. A change in reserve requirements is an administrative change which hits all banks in a given category suddenly and may require or precipitate extensive changes rather quickly. However, if there were a clear case for a large and a fairly permanent change in the amount of reserve credit I would favor a change in reserve requirements, but the Board of Governors already have the power to make such a change, so I see no need for any additional legislation on this point.

Secondly, you asked us to comment on Chairman Martin's point that the purpose of raising interest rates was to close the gap between savings and investment and that higher interest rates would stimulate savings. The interest rate is a price, and, like every other price, has an effect on both the demand and supply sides. When the demand for savings is greater than the supply at a given rate of interest, some of those seeking funds must necessarily be disappointed. An increase in the interest rate is an impersonal and automatic method of rationing the limited supply of savings; those who are not able or willing to pay the higher rates are eliminated and the demand and supply then are brought into inequilibrium at the higher rate. If interest rates do not rise, then some more arbitrary and subjective method of rationing must be employed. This, then is the effect of higher interest rates on the demand side; it is effective more quickly and, in the short run, is probably more important than the effect on the supply side.

But higher interest rates do have an effect on the supply side. Frequently this effect is depreciated by considering an individual who is making a conscious decision about saving and pointing out that he is not likely to be influenced to any significant extent by the difference between, say, 3½ and 4 percent. This is true, although even here there will be marginal cases and they may be important in the long run. But it is far more important to realize that very little of our savings originate in the way described above. A large majority of our savings today are institutionalized and automatic; they originate in our insurance companies, savings banks, pension funds, sinking funds, mortgage and consumer credit institutions, trust and endowment funds, and other similar organizations. Higher interest rates will mean an increased flow of funds to these organizations. In some cases the increase will be permanently retained by these organizations and offered for investment, thus increasing the supply of savings. In other cases some part of the increase will be paid out to depositors, policyholders and other beneficiaries, but even here there will be a considerable lag and in the meantime the supply of savings will have increased. For this reason I do believe that higher interest rates increase savings during a period of high employment like the present. (Of course, during a depression an increase in the interest rate could not be counted upon to increase the volume of saving—but in such a period there is no shortage of savings.)

If savings are not to be stimulated by higher interest rates, how are they to be stimulated? It is generally admitted that today the supply of savings is not equal to the demand at present interest rates. Those who favor lower interest rates say that the lower rates will increase national income and the larger income will automatically provide the larger savings. But today many competent economists are beginning to question the long-accepted hypothesis that the rate of saving rises with rising income. But in any case the rising income will stimulate demand for investment funds to a greater degree than it will stimulate

savings, producing a greater disequilibrium between the supply of and demand for savings.

I trust that these comments are pertinent to the questions you asked and may provide some help in arriving at an answer. It was a pleasure to appear before your committee and I thank you for the privilege.

Sincerely yours,

B. U. RATCHFORD.

COMMENTS OF LOUIS SHERE ON QUESTIONS BY REPRESENTATIVE PATMAN

1. Reserve requirements

In the present situation I would oppose a reduction of reserve requirements. I would also oppose open market operations designed to ease credit. The reserve requirements should be lowered only after it is determined that the long-run outlook is for credit ease and that there is no substantial contingency that such policy of credit ease may need to be quickly reversed. To lower reserve requirements to permit credit expansion to take care of the 1957 growth of the economy at a time when the current situation is inflationary and the outlook is for more of the same, would be highly undesirable. The current situation requires flexibility and use of open-market operations to prevent any undue restraints developing with economic expansion during 1957.

2. Interest rates, savings, investment

I doubt that interest rates should be raised with the objective of increasing the volume of savings to close the gap between savings and investment. An increase in the interest rate is more effective in curbing investment than it is in expanding savings. The gap between savings and investment can be closed, but it may turn out to be at a level of investment that is too low to fulfill the requirements of the Employment Act for growth and stability.

(Thereupon at 1:20 p. m., a recess was taken until Monday, February 4, 1957, at 10 a. m.)

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 4, 1957

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

The committee met at 10:08 a. m., pursuant to recess, in room P-63, the Capitol, Hon. Wright Patman presiding.

Present: Representatives Patman (presiding), Bolling, Mills, Talle, Curtis, and Kilburn; Senators Sparkman, O'Mahoney, Flanders, and Goldwater.

Present also: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Chairman PATMAN. The meeting will come to order.

The Joint Economic Committee has already held 1 week of intensive hearings on the President's Economic Report. We have heard the Council of Economic Advisers, whose executive-session testimony has been edited and made public this morning. We have heard the Director of the Bureau of the Budget and three panels of experts on the economic outlook, prices, and monetary and fiscal policy.

We continue our hearings this morning with the Secretary of the Treasury, George M. Humphrey, as our witness. The financial operations of the Federal Government, which are budgeted at \$71.8 billion for fiscal 1958, have tremendous direct and indirect impact upon our national economy. The Federal Government's expenditures and receipts will in no small way determine whether or not the objectives of the Employment Act of 1946 are to be achieved. Therefore, we look forward to hearing the Cabinet officer with primary responsibility for the financial management of these vast programs of the Federal Government.

In the committee's letter of invitations we set forth a number of questions suggestive of the type of information we would welcome from the Secretary.

Mr. Secretary, before we start the questioning we would like to give you this opportunity to make an introductory statement in any way you desire. You can read it or state it or in any way that you desire to present, Mr. Secretary. We are delighted to have you here this morning.

STATEMENT OF GEORGE M. HUMPHREY, SECRETARY OF THE TREASURY, ACCOMPANIED BY W. RANDOLPH BURGESS, UNDER SECRETARY; DAN THROOP SMITH, DEPUTY TO THE SECRETARY; WILLIAM T. HEFFELFINGER, FISCAL ASSISTANT SECRETARY; AND ROBERT P. MAYO, CHIEF, ANALYSIS STAFF, DEBT DIVISION

Secretary HUMPHREY. Mr. Chairman, I am very happy to have the opportunity to be here with you. I have a very short statement to make which will cover the questions which you asked in writing.

Chairman PATMAN. Very well.

Secretary HUMPHREY. Mr. Chairman and members of the Joint Committee on the Economic Report, I am very glad to accept the invitation to be present today to discuss any points which you wish to raise with me on the President's Economic Report. In the material which you sent me with your letter of January 23, Mr. Chairman, you gave me four questions. I shall start by answering them as follows:

The first question was: Do you have any recommendations for general or structural revisions in tax policy at this time? Do you have any long-range recommendations for tax revision for promoting steady economic growth?

My answer is this: There are no recommendations for general or structural revisions in the tax policy at this time. The Mills subcommittee of the House Ways and Means Committee is now considering various recommendations which we have made for minor technical revisions and to remove some unintended benefits. We hope these changes can be made in the near future because they will improve the law technically and remove some loopholes. They will not, however, have any significant revenue effects nor do they constitute major changes.

The most important change that could be made to promote steady economic growth is to reduce the rates for all taxpayers. The present rates are so high that they will in the long run hamper our economic growth. My chief concern is to avoid any new special-relief provisions for particular groups of taxpayers because such relief provisions not only complicate a law that is already too complicated, but they also in the aggregate can involve so much revenue loss as to postpone indefinitely the time when it will be possible to have general relief for all taxpayers.

The second question: Could we have improved upon the division of labor between tax policy and monetary policy as instruments of restraint during the past year?

My answer is that I don't believe so, but I would like to add, Mr. Chairman, and interpolate at this point in addition to the answer that I made in writing so that we will be perfectly clear on the subject, that this question relates to tax policy, the relation of tax policy and monetary policy, and does not relate to other phases of fiscal policy. There are some matters of fiscal policy that I think might have been useful that were not employed.

The third question: If inflationary pressures abate during the year, would you recommend priority be given to fiscal or to monetary easing?

The answer is this: As I have said many times, it does not seem to be useful to try to anticipate what might be done in hypothetical situations. Any actual decision should be based upon all the facts and circumstances that exist in whatever specific situation does actually develop. When inflationary pressures do abate, there will, of course, automatically be an easing in the monetary situation. Any tightness in the monetary situation during an inflationary period arises because of the excess of demand for funds over the supply of savings. A reduction in inflationary pressures will operate in the direction of restoring the balance with a consequent monetary easing.

The fourth question: What do you foresee as the Treasury's principal debt-management problems in the year ahead, assuming the continuation of tight money?

The answer: Mr. Burgess has some charts which will indicate the present situation regarding the debt. His analysis of them will indicate the problems as we see them. I should like to have Mr. Burgess present that material. After he has done so, we shall be glad to attempt to answer any questions that you may wish to put.

Chairman PATMAN. You may do so now, Mr. Secretary.

Dr. BURGESS. Mr. Chairman, members of the committee, and others: It seemed to us that we could show the Treasury's debt management problem best in the light of the whole debt situation that we face in this country (chart 1). This chart shows the total public and private debt over a span of years. We start in 1939 just before the war, which shows a total debt of \$208 billion. Of course during the war that debt was increased largely but mostly in the Federal sector. The Federal debt rose from \$48 billion to \$260 billion. During the war, when civilian activities were kept under wraps, the other debt increased very little. The State and local debt, of course, actually decreased because the short debt ran off and they were not able to carry forward public works. The corporation debt increased only a little. The individual debt again increased only a little for a span of seven years.

The change from 1946 to the present time is shown by these columns on the right. The Federal debt increased \$17 billion since 1946, and in terms of percentage of the total debt structure, it declined from 58 percent of the total to 35 percent. The total debt is now \$793 billion, which is not quite twice the debt right after the war. That is partly affected by the level of commodity prices, which are up nearly 50 percent from 1946 to 1956. But even after that allowance of course there is a very large increase in total debts.

State and local government debt increased greatly as the States and localities went ahead with programs which had been held back during the war. So the total is now about \$50 billion. The corporate debt also increased greatly as corporations went ahead with postwar programs. That of course is still rolling at the rate of a very large figure. The individual debt more than tripled, from \$61 billion to \$213 billion, mostly in the form of 2 big items: Mortgages on homes and consumer credit.

Chart 2: We will break down these figures and show them by years on this chart. This shows annual changes in public and private debt. The Federal figures you are all familiar with. The figures above the line are increases in the Federal debt, those below the line are decreases.

The high year was fiscal 1953. These figures don't correspond exactly with the budget deficits because they reflect changes in the Government's cash balance. So actually a deficit of over 9 billion corresponds with a 7 billion increase in the public debt for fiscal 1953.

The amounts of increase in the debt were decreased for the next 2 years and then we had a surplus for these last 2 years (1956 and 1957) and we expect that again in 1958.

The State and local debt has increased steadily from just after the war; and the past 3 years have been showing very heavy increases

in State and local debt. If you add those 3 years together, there is \$14 billion. Just in the past year, 1956, in various elections there were authorizations of \$4½ billion of additional borrowing of States and localities.

As that comes into effect we can expect this high level to continue. That \$4½ billion of election approvals compares with about \$3 billion in 1955. That huge amount of borrowing accounts for the difficulty that States and municipalities are having now in getting money at cheap rates. The amount of that borrowing has overflowed the tax-exempt market, so they are having to put up rates which would attract borrowing from other sources.

Corporate borrowing has fluctuated a great deal. That reflects both the short-term and long-term borrowing, as I will show on the next chart. The past 2 years have been years of very heavy corporate borrowing. You are familiar with the figures of the amount of new plant and equipment plans carried forward by business—something like \$35 billion this past year—and the outlook for next year is also a very large figure.

Individual debt has increased very rapidly in the past 2 years, particularly after a rather steady rate of increase over some years back. I will show the breakdown of those figures. It is interesting that in both of these cases the 1956 increase was not quite as large as the increase in 1955. Perhaps that is the working of the monetary policy. Perhaps it is the working of natural forces. We will show the breakdown of these in the next chart.

Chart 3: The corporation debt is of two sorts, long-term debt and short-term debt. A large part of the short-term represents bank borrowing and trade debt. With the corporate markets receptive to a very heavy amount of borrowing, corporations issued \$10 billion of new securities in the market this past year, which was larger than the year before and larger than any year over this span of years. That, with the heavy amount of State and local borrowing of about \$5 billion, accounts for the \$15 billion of securities sold in the market during the past year, which is the largest year that we have known and about a billion dollars ahead of 1955.

The ability of our market to take that amount of securities is one of the notable factors. In January of this year it absorbed an enormous amount of securities.

Short-term debt is largely bank and trade debt. In 1955 there was a very large increase after an actual reduction in 1954. But that has tapered off, so the increase in 1956 was smaller, partly the result of monetary policy, if you will, partly the result of corporations going a little more lightly there and trying to do their financing out of their own funds.

The breakdown of net increases in individual debt is shown next. Here are the mortgage figures. The big figure here is \$15 billion in 1955, reflecting an enormous volume of building for individuals, with \$14 billion in 1956. In spite of tight mortgage money conditions, 1956 was a very big year of building of houses for individuals. That is shown by the mortgage figure. It should be said that the year was a year with a downward slope. The heaviest figures were in the early months of the year and they decreased somewhat in the latter part, but it is still going on at the rate of a million homes a year against a smaller family growth.

So, while we may think that the mortgage market is tight, really an enormous volume of building is still going on if you look at it in terms of the past.

On consumer debt, 1955 was again a tremendous year, with a \$6 billion increase in consumer debt, largely due to the very heavy sales of automobiles. This year, in 1956, it was less, \$3 billion, with smaller sales of automobiles.

These two very large figures on mortgages and consumer debt mean, of course, that the average individual in this country has a lot of debt to repay, and every month he is paying back a great deal of debt. I think our current situation is greatly affected by that fact.

Here are other debts simply to make up the total. That would be unincorporated business borrowing from banks and other sources, farm debt, and other miscellaneous forms of debt.

Senator SPARKMAN. Before you remove that chart may I ask a question? Does that represent fiscal years?

Dr. BURGESS. These are calendar years. On the Federal portion we put in fiscal years because that is what we are all familiar with. We thought on the Federal debt it would be confusing to use the calendar years. All the rest is by calendar years.

Chart 4: When you look at those figures for enormous increases in debt some people have said the American people are borrowing more money than they are saving. That just isn't true. In spite of the fact that the people have been borrowing these huge amounts, they have also been saving a great deal of money. Some of that is the involuntary saving which I just mentioned, paying back their debts each month. The fact is that in the past year the savings have increased, which is a good sign, from \$16½ billion—I might say these are all estimates and we don't guarantee them within, say 10 percent, but they are the only available figures—to \$21 billion in 1956. So the savings are gradually moving up, some of it involuntary but a good deal of it in the form of liquid assets, which are bank deposits and so on. The repayment of debt would come in here in the top part of the bars.

The other chart will break this down further to show you the form of individual savings.

Before we turn to the next chart, I might call attention to the fact that savings as a percentage of disposable personal income is now 7 percent compared with 6 percent the year before. Seven percent is a fairly high figure, but we had 8 percent in 1953 and 8 percent back in 1951. We are a saving people. We do save a lot. At the moment we are not quite saving enough to pay for all that we want to do, and that is one of the major reasons for firm money.

Chart 5: Along that same theme these are the liquid assets of individuals—their cash and Government securities. Since 1946 these savings are estimated to have gone up from \$200 billion to \$267 billion, not quite as much as the increase in prices. So while we have increased our savings, we have not increased them quite fast enough to keep up with the changes in prices, the cost of living. These figures show the breakdown of the total figure. Starting at the bottom, we hold in our pockets \$25½ billion in currency. That is the estimate as to what individuals hold. Checking accounts in banks total \$57 billion. Savings accounts in commercial and savings banks and postal savings—

\$81 billion—about \$30 billion of that is in savings banks and the balance is mostly in savings accounts in commercial banks.

Of course, in most areas of the country you don't have savings banks, so the savings go into commercial banks. About \$37 billion is in savings and loan shares. That is the one area that is growing most rapidly. It was only about \$8 billion back in 1946. The growth has been enormous. The dollar increase in assets of savings and loan associations each year is just about as much as the growth in assets of our life insurance companies, which have been at it for a long time.

These are the figures for the Government debt. Individuals hold \$67 billion of Government securities, \$41½ billion in E and H savings bonds, and \$25½ billion in other Government securities.

We are lodging a very substantial part of our debt with individuals and we would like to lodge even more in that way because it is safer. It doesn't have to keep rolling over in the market. It doesn't have to be refunded so rapidly. It also gives the people a consciousness of participation in the affairs of Government.

Chart 6: Now we come down to the Q. E. D. This is our debt management problem against the background of this whole debt business. This is the breakdown of ownership of the public debt. These are the private nonbank investors: Individuals, pension funds, institutions—that is largely life-insurance companies and savings banks—corporations and miscellaneous. The corporations of course invest their tax reserves in Government securities. Then the holdings by the banks, the commercial banks and the Federal Reserve, and then the other item, the Government investment accounts.

Now let us look at how those have been changing during the past year.

Let us start at the bottom. The corporations have decreased their Government security holdings by \$5 billion. Part of that is due to the fact that we collect our taxes from corporations a little more evenly through the year. We collect a billion dollars more in the autumn than we used to. We have shifted that over from spring to autumn. Part of it is due to the fact that with their tremendous expansion programs the corporations have had less surplus funds to invest in Government securities. That has constituted one of our problems in handling the debt, because we don't have as large a ready buyer there to take it.

Institutions have also decreased their holdings of debt by a billion dollars. Life-insurance companies have sold Federal securities in order to increase their holdings of mortgages, and savings banks have moved the same way.

Pension funds have been a steady market for our bonds. They have increased their holding from \$7½ billion to \$8 billion the last year, and we count on them as one of our good customers.

Individuals are a major market. They have increased their holdings by \$2 billion this last year.

Commercial banks decreased their holdings of governments by \$3 billion in 1956. That is to take care of the huge demand for loans from their customers. That of course has decreased the liquidity of the commercial banks. That is one reason they are more careful about their loan and investment policy, because they have their governments down to a smaller figure.

The Federal Reserve has held its governments constant from year to year, with changes of course during the period. Their so-called tight money policy gives this end result with no net increase in their governments.

Here is one of our best customers, the Government investment accounts, which of course is the social-security, veterans' life-insurance, and civil-service pension funds. That has been a steady absorber of Government securities, with \$2½ billion increase during the year.

To sum it up, we had to scratch to find a market for our bonds in 1956. The commercial banks have been sellers. The institutions and corporations have been sellers. We have had to make that up as I have said, by sales to individuals, sales to pension funds, and sales to Government investment accounts. Fortunately we have had a surplus to decrease the total amount of governments. So our debt-management problem has been a difficult one in the past year. We have not had an unlimited market to work on. We have had to carry it forward as best we could to find buyers without calling on the commercial banks to increase their holdings and so increase inflationary pressures.

I think if one were to summarize this whole story of the debt he would have to say that with the terrific growth and prosperity of the country we have been increasing our debts very rapidly. We have been doing it more rapidly than we were saving money to meet it, and that has constituted our difficult problem, as to how we could do that without creating bank money to fill the gap and so bring about inflation.

I think the record of the past year shows that we have made a little headway with that problem. That is, savings have increased. Bank loans have not increased so rapidly. We are moving in the direction of restoring balance, partly by reason of the fact that individuals have gone into debt so far that they have had to pay some back and thus increase their savings. But in spite of that move in the right direction, the pressure is still inflationary. We still are not saving quite enough money to do what we would like to do in this country and to meet all the needs, most of which seem very genuine.

I thank you.

(The charts referred to follow:)

CHART 1

PUBLIC AND PRIVATE DEBT*

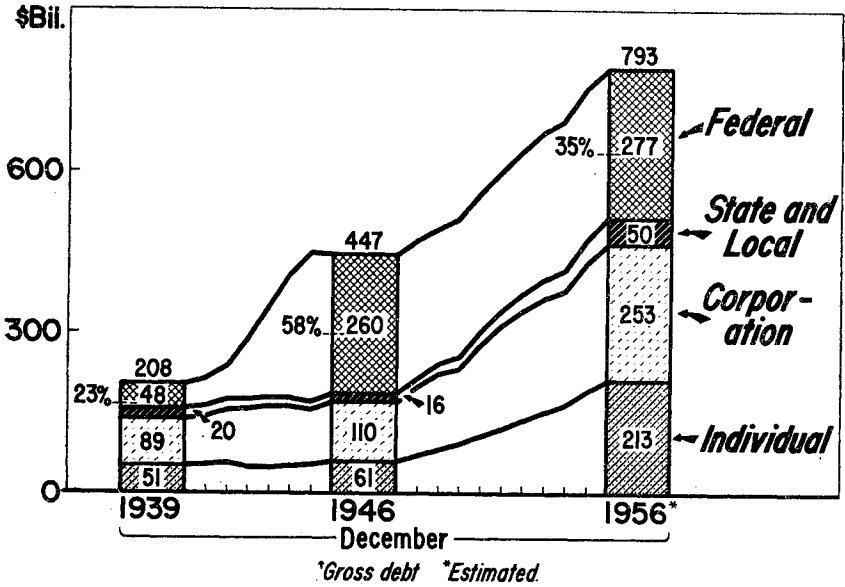


CHART 2

ANNUAL CHANGES IN PUBLIC AND PRIVATE DEBT

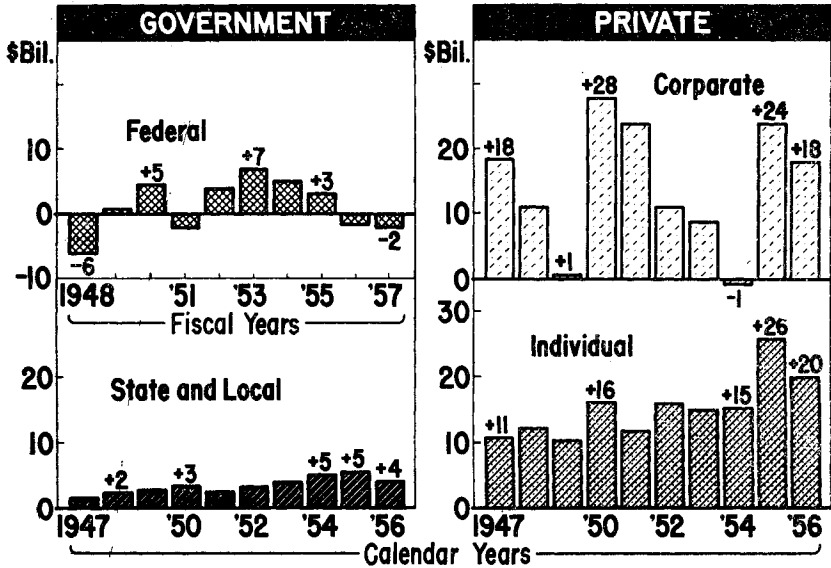


CHART 3

ANNUAL CHANGES IN PRIVATE DEBT

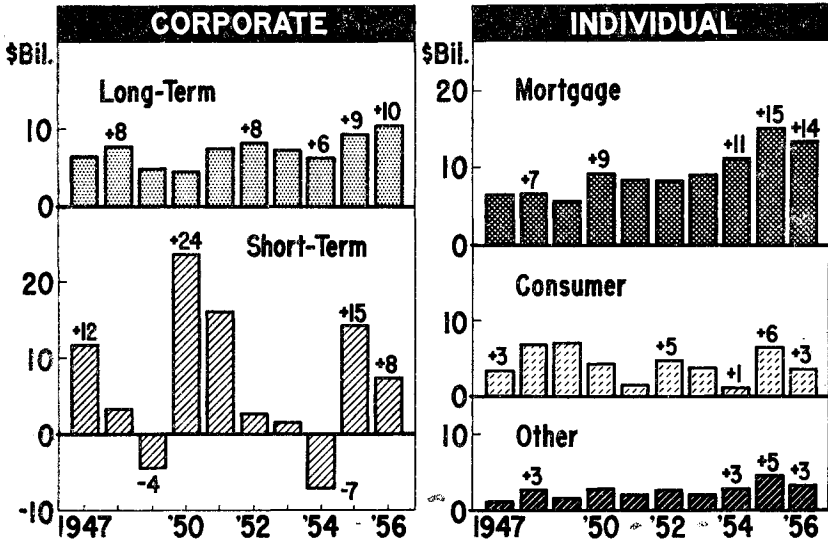


CHART 4

PERSONAL SAVING

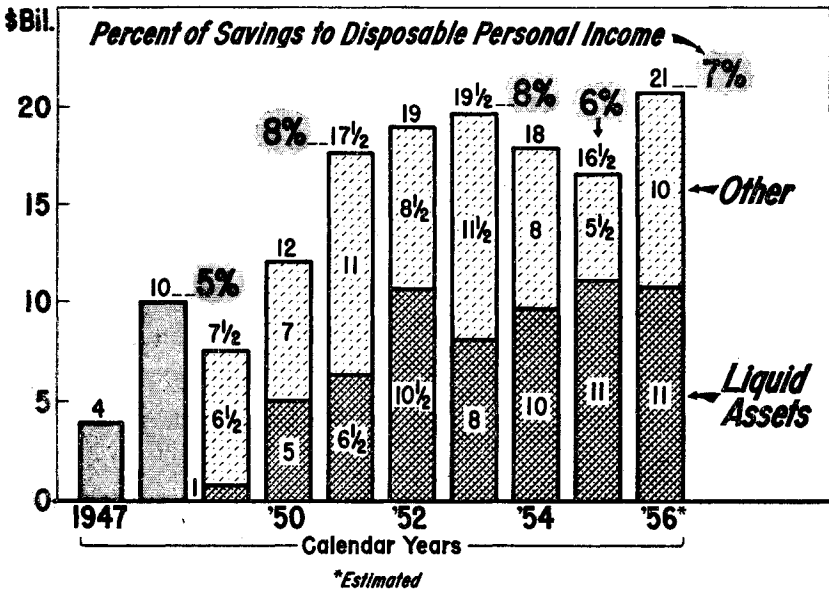


CHART 5

LIQUID ASSETS OF INDIVIDUALS

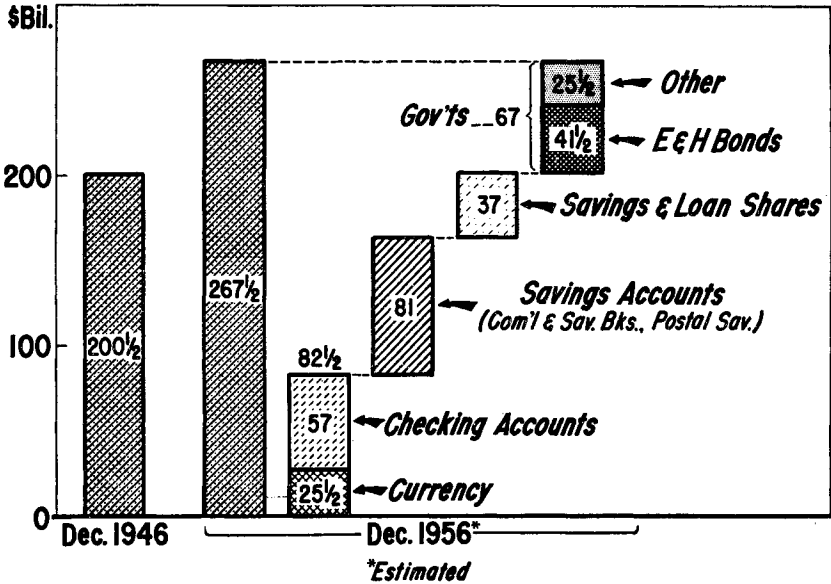
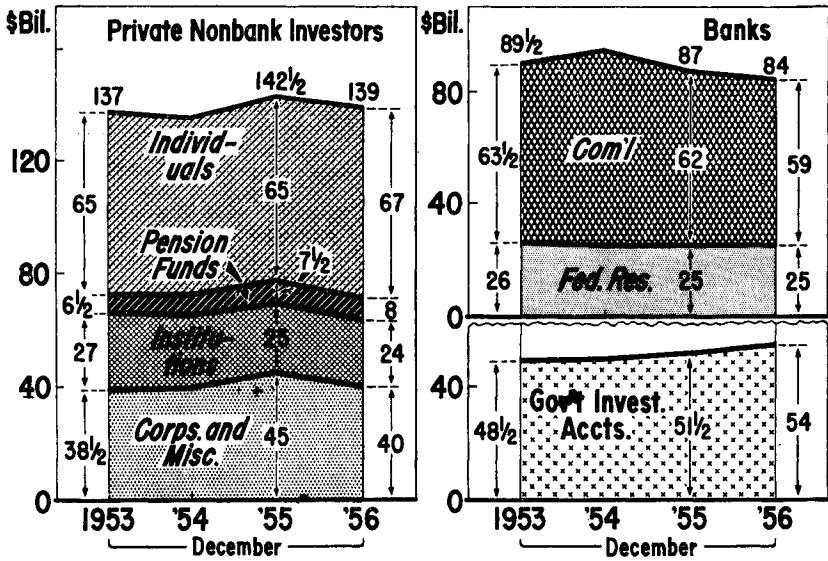


CHART 6

OWNERSHIP OF THE PUBLIC DEBT



Chairman PATMAN. Would you like to elaborate on that, Mr. Secretary?

Secretary HUMPHREY. I think not. If you have questions I am sure Mr. Burgess would be very glad to answer them.

Chairman PATMAN. Yes, sir. We have a limitation of time on the members. I will ask the staff to keep the time and advise me, too.

You have stated a number of times, Mr. Humphrey, that the States and local governments should do more in certain fields like school construction and school aid. I assume that is still your opinion?

Secretary HUMPHREY. It is.

Chairman PATMAN. And that the Federal Government should do less?

Secretary HUMPHREY. I personally think, Mr. Chairman, that the Federal Government's role in the school field is in the nature of an emergency effort.

Chairman PATMAN. How do you reconcile that view with the high-interest policy which makes it impossible for school districts to sell their bonds under the limitations imposed by the States? Since the bonds are tax exempt, the States have a limitation on the amount of interest that can be charged, and the high-interest policy now has almost stopped school construction in the States and school districts.

How do you expect the States and school districts to get the money if the high-interest policy stops them?

Secretary HUMPHREY. That would fall within the decision of the people of the State. They can pay any interest that they want to pay to get the buildings that they require.

Chairman PATMAN. Is it your recommendation that they take that ceiling off and raise the interest?

Secretary HUMPHREY. In cases where it is too low. If they want to get money in the market and they have an arbitrary prohibition which prevents them from getting it and they want to spend the money, I think they ought to revise their limit.

Chairman PATMAN. Does the Federal Government have a just complaint in that this money is tax exempt, and the more tax-exempt bonds that are put out and the more people who have their investments in tax-exempt bonds, the less revenue the Government will receive? Should not the Federal Government be interested in discouraging the payment of such a high interest rate by States and counties?

Secretary HUMPHREY. I don't think so. The amount of tax exemptions which are really attractive is limited by the people who are in the higher brackets. Otherwise, as you get into the lower brackets, the difference is not so great, and that means there is a distinct limitation in the market to which the tax exemptions particularly appeal.

Chairman PATMAN. Put up the first chart, please. With debts as large as they are, do you see anything alarming in the amount of debt in either category on that chart, Mr. Humphrey?

Secretary HUMPHREY. Mr. Chairman, I don't say "alarming," no; but I think our debts have gone up pretty fast and pretty high. Of course when we look at that chart we have, and compare 1939 with 1956, you have a great difference in the value of the dollar which you have to take into account here.

Chairman PATMAN. Mr. Humphrey, if you will pardon my interruption, we are talking about State and local debt. According to

your chart the State and local debt has increased twice as much the last 10 years as the Federal Government's has, \$17 billion to \$34 billion.

Secretary HUMPHREY. I think that is right, but the State and local debt is relatively small.

Chairman PATMAN. What I am really getting at is that, under our capitalistic system, we must have debt. There is no other way to expand in our country. Much as we believe in the capitalistic system and much as we complain about the debt and the amount and the size of the debt, we know we have to have debts in order for our country to expand. Isn't that right, Mr. Humphrey?

Secretary HUMPHREY. I don't know how much debt you need to have. It depends very largely of course upon how much money you take away from the people in taxes. If you took less money in taxes the people could save more. Therefore, they could invest more and have more available for equity investment and all sorts of investment and you might not have to go into so great a proportion of debt.

Chairman PATMAN. Let me make it just a little bit clearer if I can to carry my point. Do you believe it would be possible to have a capitalistic system and all of us be on pay-as-you-go basis, Federal Government, individuals, corporations, and everybody? In other words, could we have all of our debts paid and get on a pay-as-you-go basis and still have a capitalistic system?

Secretary HUMPHREY. I really don't know.

Chairman PATMAN. I have asked the Federal Reserve authorities about that frequently, and they tell me that you cannot, that you have to have debts.

Secretary HUMPHREY. I really don't know, sir, that you have to have them. I think it is desirable to have some. On the other hand, it is very undesirable to have too many.

Chairman PATMAN. Isn't it basic that under the capitalistic system money is based on debt? No debt, no money.

Secretary HUMPHREY. I hardly believe that.

Chairman PATMAN. The Federal Reserve authorities admit it. All the people I have interrogated over 20 years who are acquainted with our system admit that money is based on debt. No debt, no money. Therefore, in order for our capitalistic system to survive, we have to have debts and more debts.

Secretary Humphrey, mention was made by Mr. Burgess a while ago about the expansion for plant and equipment. Are you disturbed because in 1956, 67 percent of the money for corporate expansion came from retained earnings and depreciation?

Secretary HUMPHREY. No, I am not concerned, if that is the fact.

Chairman PATMAN. That is the fact. And it is 70 percent this year. That means that corporations are getting their expansion money out of the consumer in prices, and while Mr. Burgess mentioned involuntary savings, is this not an involuntary investment on the part of the consumers for which they get nothing in return? That is, when the corporations are getting their expansion money for plant and equipment by raising the prices and compelling the consumers to pay that much more so they can make the investment?

Secretary HUMPHREY. Mr. Patman, I don't think you can say that the consumers are getting nothing for it. That is the way that technological improvement is made. That is the way that our whole

system has been going ahead. It is the saving of that money and its reinvestment in tools that make the jobs that give the consumers the money to buy. If you didn't have a job your consumer would not get very much, and without the tools he won't have a job.

Chairman PATMAN. Shouldn't the consumer be allowed to voluntarily invest that money in stocks and bonds and get a return themselves rather than have it taken away from them in an involuntary adjustment by higher prices which they are forced to pay?

Secretary HUMPHREY. I don't know that that necessarily follows: I think that all of the progress that we make through technological improvement and through the higher productivity of people comes through investment which in turn makes prices cheaper and in turn makes goods better.

Chairman PATMAN. I will not use all my time. I yield to Senator Flanders.

Senator FLANDERS. Mr. Secretary, there are many points here and 10 minutes are short. I will make my questions short. If you will refer to the answer to question No. 3. What is the meaning of "fiscal easing"? I understand what monetary easing is. What is fiscal easing?

Secretary HUMPHREY. You are talking about what question, now?

Senator FLANDERS. No. 3. When you look at that what definition did you give in your mind to "fiscal easing"?

Secretary HUMPHREY. It means the various other activities of the Government other than those relating to the money. Our expenditure programs.

Senator FLANDERS. How would you ease monetary pressures fiscally?

Secretary HUMPHREY. Let me find where you are.

Senator FLANDERS. Question 3.

Secretary HUMPHREY. Fiscal policies in that context would relate tax policies, spending policies, and other activities of the Government.

Senator FLANDERS. To ease inflationary pressures, would you raise or lower taxes?

Secretary HUMPHREY. If you were in a very high period I think that the fiscal activity that you could indulge in that would be very effective in assisting to retard inflation would be a reduction in Government expenditures. As you reduce your Government expenditures, you make more men available for private jobs and more materials available for the public to buy. As more men come into the market, it eases the pressure on wages. As more material comes into the market, it eases the pressure on prices. As the pressure on prices and wages is relaxed, your inflationary pressure are relaxed. That is a fiscal policy that I think could be very usefully employed in times of very high activity.

Senator FLANDERS. In times of inflationary pressure you would reduce Government expenditures.

Secretary HUMPHREY. In periods of very high activity, I think so.

Senator FLANDERS. And in times of deflationary pressures you would correspondingly increase the Government's activity?

Secretary HUMPHREY. When you say correspondingly, you limit it somewhat. I think within your means you would. I think those expenditures which had been postponed in the higher periods of activity

might be carried forward in the latter periods of activity, so long as they were kept within reasonable bounds and could be financed and handled in such a way as not to shake confidence in the Government's activities.

In other words, they must be handled in such a way as to promote private confidence, because private expenditure, after all, is much greater than public expenditure, and if you shake confidence you retard private expenditure and you might much more than offset any increase in the public expenditure.

Senator FLANDERS. Don't they have inflationary pressures and we meet them by reducing Government expenditures? Of course that isn't a simple thing to do.

Secretary HUMPHREY. You are entirely right.

Senator FLANDERS. But if we were able to control inflationary pressures, would there be any effect on employment? Would not the reducing of Government expenditures to a very large extent show up in reduced employment?

Secretary HUMPHREY. Not necessarily if those employed directly or indirectly by the Government shifted over, and of course it would be your ambition to have them shift over into making goods for the public, because what you are seeking to do is to increase the goods available to the public and that is the thing that will help to level and hold the price so as to hold the cost of living more stable.

Senator FLANDERS. It is my impression that at the conclusion of the heavy expenditures resulting from the Korean war we did drop off Government defense expenditures at various times, seven, eight, nine billion dollars, and we had a recession.

Secretary HUMPHREY. You have a readjustment oftentimes. There were several things that conspired to effect that recession. Perhaps one of the things that did have some effect on it was the transition period, moving the men from Government employment into private employment. But it was the confidence that was generated by that move and by that readjustment and by the absorption of the excess of inventories that obtained at that time which has given us this terrific impetus which has carried us through the past 2 years. That is why we are in this position today.

Senator FLANDERS. In these various transitions and these various adjustments we are required by law to take note of the effect on employment.

Secretary HUMPHREY. That is correct. To the extent, Senator, that we can perform the necessary services and provide adequate security, it is highly desirable that as many people as possible be transferred from working for the Government, either directly or indirectly, into working for all the people.

Senator FLANDERS. I am very much concerned about the relationship between inflation and employment, deflation and employment. It has seemed to me at times—and I would like your judgment on this—that the avoiding of inflation under conditions of high employment is a very difficult thing indeed. Can the Government do anything about that?

Secretary HUMPHREY. It is very difficult to do it. You put your finger right on it. We ought to be able to do it. To accomplish this practically—in other words, to do practically what theoretically is

desirable—is a very difficult thing because the demands of the people, the demands all told are so great, the pressures are so great, that it is very hard to accomplish it. That is one of the things that I have talked so much about recently. I have felt that in times of great activity such as we have been in and great private activity such as we have been in, that is the time when we ought to make our most strenuous efforts to reduce our Government activity, and we have not been successful in doing that.

Senator FLANDERS. You do, then, look upon the reduction of Government activities during this period as a definite help to the control of inflation.

Senator HUMPHREY. I think it would make a very substantial contribution.

Senator FLANDERS. I think in this report somewhere the President seems to have thrown up his hands on this matter of controlling inflation during high production and suggested that employers and employees should use self-restraint. Do you expect them to?

Secretary HUMPHREY. I do to some extent; yes, sir. I think really, Senator, whether we have disastrous inflation in America depends very largely upon the courage and the self-restraint and the determination of the people themselves. I think it begins with the people themselves. I think that the Executive can exercise some leadership. I think the Congress can exercise some leadership. But I think actually it is the pressures of the people themselves that Congress finally responds to. If the people all want something, Congress responds.

I don't think the Executive alone or Congress alone can do much except to try to educate people and bring them into a position where they seek to do the right thing, where there is the proper self-restraint and where the right pressures prevail on both the Congress and the Executive.

Senator FLANDERS. I may say, Mr. Chairman, that I think the President was very wise in suggesting restraint on profits and prices and suggesting restraint on labor interests and wage negotiations, because a lack of restraint seems to me to make the situation impossible. We have other duties as citizens besides voting for the proper candidates. My 10 minutes are up. I am going to get back to expenditures later, I hope.

Chairman PATMAN. Senator Sparkman.

Senator SPARKMAN. Following up the question discussed with you by Senator Flanders about self-restraint of people themselves, when it comes to labor wages a great part of our labor—not a major part by any means, but a sizable proportion of our labor force—is working under contracts with escalator clauses in them; isn't that true?

Secretary HUMPHREY. That is true.

Senator SPARKMAN. There is no way of exercising restraint on that, is there? That is automatic?

Secretary HUMPHREY. To the extent the contracts have already been made. To the extent that they are amended or new contracts are coming up, there is an opportunity for some self-restraint.

Senator SPARKMAN. As a practical man you don't anticipate the amending of those to do away with the escalator clauses, do you?

Secretary HUMPHREY. No, I do not. I don't think we are in a period now where we are going to reduce wages or reduce commit-

ments. However, I do think that both labor leaders and businessmen in making their arrangements between themselves are moved by thinking not only of the day but thinking of the future of their business and of the future of their employment and their occupation.

I think there is a good deal of restraint exercised. I think there has been some, and I think there should be more and probably will be more. That includes both the employer and the employee, because the employee is interested in the continuation of his job. He knows if he gets too far out of line the competitive conditions will slacken him off. He wants his job to continue. The manufacturer is not in business just for 1 day. He is in business for a long period. He knows that if he gets his costs and wages so high that he prices himself out of the market, one of these days he will have a slack time and a bad time.

I think there are pressures on both labor and management in thinking of running their business adequately and well to have self-restraint. I think they exercise it within limits.

The conditions under which they are dealing at the time, of course, affect to a considerable extent the degree of self-restraint and the degree to which they think forward rather than for the moment.

Senator SPARKMAN. You say all of the people should exercise restraint. How would the housewife and the ordinary person who is not involved in this labor-management wage negotiation exercise restraint? By cutting down on their purchases?

Secretary HUMPHREY. Senator, it is the housewife of America who really holds the whole business in the palm of her hand.

Senator SPARKMAN. The purse strings.

Secretary HUMPHREY. Yes, sir. She is the one who spends the money. When she shuts off the money, the employer and everybody else is at her mercy. The great American consumer is the fellow who really controls this whole thing.

Senator SPARKMAN. That is the reason I am asking this question. In what way is that consumer going to exercise self-restraint?

Secretary HUMPHREY. By not going so far into debt that he gets himself away over his head.

Senator SPARKMAN. Not buy so many automobiles?

Secretary HUMPHREY. To keep himself within reasonable balance, to keep his own budget—his own household—in order. If every household in America was well run, we would not have too much trouble.

Senator SPARKMAN. I am thinking about the pressure at the other end. Suppose that housewife cuts down on the buying of automobiles. I will use that illustration; it could be any other thing. What would happen in Detroit?

Before you answer, what I am think of is, let us assume that this housewife is trying to resist the purchase of a new automobile. You realize that there is tremendous pressure emanating from Detroit and spreading out through every community in this country to sell more automobiles. As a matter of fact, when the automobile manufacturers speak of cutting down their production for the next year, the workers become afraid that they are going to lose their jobs.

Secretary HUMPHREY. We are all tied together, Senator, but let's just follow your thinking through for a moment.

Senator SPARKMAN. I am bringing that in because it seems to me it is a pretty difficult matter to exercise this self-restraint.

Secretary HUMPHREY. It is a difficult thing. That is why it is so desirable that it be indulged in early. I have said before, an ounce of prevention is worth a pound of cure, and we don't want to forget that. After this ball begins to roll, it is very difficult. It is much easier to try to handle it on the way up than it is to try to revive it on the way down. So self-restraint on the way up, self-restraint when you are at a high level, is much more effective and it is a much better and much more effective way of handling the thing than it is trying to stimulate it when you get down.

Senator SPARKMAN. I agree with you completely, but I notice from these charts and I read in newspaper accounts and statements that come out of the Government, by the way, boasting about the tremendous industrial expansion in this country. If those factories expand they are going to expect to produce new units. Of course they can't afford to produce those units unless they sell them. We talk about creating this psychology of self-restraint. I wonder if as a matter of fact the psychology which has been implied has been just the opposite. I read reports that come from some of our responsible Government officials, the Secretary of Commerce—I am not saying this in any critical way—and I think I have heard testimony by different ones before this committee and other committees of Congress that we are in a boom period, and that the boom continues to roll. We are boasting of the great boom that we are in. I am just wondering if that boom might not have some adverse effects on getting our people in this spirit of exercising the self-restraint that you talk about.

Secretary HUMPHREY. Every boom, Senator, carries in it the seeds of a corresponding deflation.

Senator SPARKMAN. Yes.

Secretary HUMPHREY. If that boom gets out of hand, if that boom gets too far, you will set up imbalances, which nothing but a deflationary period will correct.

Senator SPARKMAN. Don't we have imbalances now as a result of inflation?

Secretary HUMPHREY. We always have some imbalances and, as I said so many times to this committee, during the period in 1954, if we can only have those imbalances a little at a time and not have them all at once, if we can have an imbalance here and correct it and one there and correct it, and have—there is a word that I said so many times at that time—a rolling readjustment of these things, keeping these imbalances rolling and adjusting as we go, rather than have them all culminate at once. That is when you get into real difficulty.

Senator SPARKMAN. Mr. Burgess pointed out awhile ago that in 1956 we spent \$14 billion, I believe it was, for home mortgages as opposed to \$15 billion the year before. He said we were still building about a million units a year. It is true that last year we built about a million units. But there are a good many predictions this year that this may fall considerably below a million units. Another thing, too: the president of the National Association of Home Builders the other day out in Chicago, speaking to the home builders of the Nation, said in effect that the day of the house below \$15,000 is virtually gone. So when we measure this development by dollars we realize that we are getting into a rarified atmosphere.

Secretary HUMPHREY. Of course if that atmosphere becomes too rarified, the houses price themselves out of the market and then the price of the house will be such that they will just stop buying.

Senator SPARKMAN. Isn't that of this imbalance in home construction brought about as a result of the tremendous expansion of plant and new equipment? Is that absorbing a great deal of the savings that ordinarily would go into home building?

Secretary HUMPHREY. It is both; yes. It is the total demand.

Senator SPARKMAN. They go into the same field of construction; don't they?

Secretary HUMPHREY. That is right. It is the total demand on both men and materials and money. When you get that excessive demand on all three of those things you then begin to push your prices up.

Senator SPARKMAN. Mr. Secretary, there are a great many questions I want to ask you, but my time is almost up. I am not going into the problem of small business, but I hope you will be keeping that in the back of your head because I do want to ask you a good many questions on that before we get through.

Right now let me ask you about the E-bonds. It is shown on one of the charts that the people own about \$67 billion, I believe, in E- and H-bonds.

Secretary HUMPHREY. Total bonds.

Senator SPARKMAN. E and H, or E and H and other bonds?

Secretary HUMPHREY. Total Government bonds. The E- and H-bonds are about \$41 billion.

Senator SPARKMAN. Yes; about \$40 billion or \$41 billion. What is happening in the E bond field today? To what extent are the holdings being increased from time to time? Or are the redemptions running you a pretty close race?

Secretary HUMPHREY. Over a considerable period of time the sales of new bonds in dollars have not quite equaled the redemptions. In other words, the actual sale of new bonds has been a little below redemptions. But the total value of bonds outstanding has been increasing because of the fact that the interest was accumulating on those bonds. There has been little change in the last few months in the sale of bonds. There has been some change, but it is not a great change. While sales are declining below redemptions and it has continued for a long period of time that way, still we have the most total value of bonds outstanding today that we have ever had.

Senator SPARKMAN. I want to come back to that later. My time is up.

Chairman PATMAN. Dr. Talle.

Representative TALLE. Thank you, Mr. Chairman.

Dr. Burgess, in the chart which points out the growth of State and local debt, I believe some of that represents debt which the States have incurred because of the Federal Government's offers in matching propositions.

Dr. BURGESS. That is right; on roads, for example.

Representative TALLE. There has been considerable growth in that sort of thing. I believe at this time most State legislatures, if not all, are in session, and a good share of their time, I surmise, will be taken up with consideration of how they might find money to match what the Federal Government is offering.

Dr. BURGESS. Yes, although that matching program would account for a relatively small part of that \$4 billion increase in debt.

Representative TALLE. Whether that is a good thing or a bad thing, the credit or blame points to the Congress, and not to the Secretary of the Treasury. Some State legislators have complained to me about that, on this ground especially: They feel the Federal Government is by that device directing pretty much the activity of a State legislature.

Turning to housing, the mortgage debt is very high, is it not? Would you not say that over half of those mortgages were incurred in the ordinary conventional lending way?

Dr. BURGESS. Yes, at the present time the predominance of the mortgages being made are conventional mortgages, by savings and loan associations, life-insurance companies, and so forth. The Government-guaranteed mortgages are still a substantial amount.

Representative TALLE. I suspect that 600,000 houses could be financed through so-called conventional lending annually.

Dr. BURGESS. Just about, I would think. No FNMA, no FHA, no VA. FNMA of course is marginal. It is simply buying surplus mortgages.

Representative TALLE. It is my feeling that we are trying to accomplish too much in too short a time.

Dr. BURGESS. I think that is right.

Representative TALLE. Looking at this boom and relating it to housing—there are three things you need—men, materials, and money. The cost of men has gone up, the cost of materials has gone up, and we probably should expect the cost of money to go up a little too.

Dr. BURGESS. I think so.

Representative TALLE. At the top of a boom, all men may be employed and all materials may be used. Then the only way anybody could either start a new enterprise or expand the one he is engaged in would be to pay a higher price for men and for materials, and perhaps what he would produce would be no more than the reduction in the units produced by somebody else from whom he took the men and the materials. The net result would be higher prices and no increase in units produced. When we are on so high a plateau as we are at the present time, aren't we close to a situation like that?

Dr. BURGESS. I think so, sir.

Representative TALLE. That is all for the moment, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

Mr. Bolling.

Representative BOLLING. No questions.

Chairman PATMAN. Mr. Mills?

Representative MILLS. Go ahead.

Chairman PATMAN. Senator Goldwater.

Senator GOLDWATER. Mr. Humphrey, we have heard a lot the last several years about the plight of the small-business man. Do you agree that their dilemma is one of long growth which started back when deficit financing became the practice?

Secretary HUMPHREY. I think small business—I won't limit it to small business. I think any business has a lot of troubles and a lot of headaches. I never have seen a business and have never been in one that didn't keep you awake nights a good deal of the time, big or little.

Senator GOLDWATER. In trying to pin down what I believe to be the basic trouble of all business today, whether it is small or big, but particularly as applied to small business and those businesses that have started, say, in the last 5 or 6 years or since World War II, if we continue deficit spending at the Federal level or at any level of government, it requires more money. It, in turn, requires more taxes. We reach the point actually, do we not, that if we cannot provide the money out of the money market from the money in circulation, we find a decreasing value of money.

Secretary HUMPHREY. Of course, that is correct, and that is one of the great troubles today. One of the great troubles today with any business is that the depreciation which is available tax-free to the business to replace the wornout machinery and equipment and keep the business modern is not anywhere near enough to do the job because of the depreciation of the value of the money. If you bought a machine tool 20 years ago or 18 years ago and wanted today to replace that wornout machine tool with a new one, you are supposed to have received during that time in depreciation the amount of money that you paid for the tool. If you got it and if you had it all on hand, it would less than half buy the tool. In order to keep going you have to keep putting new money, additional money, either from earnings of the business or from additional investment in the business into the business just to keep the business going because of the depreciation of the value of the dollar.

Senator GOLDWATER. Then, chasing that snake around a little bit more, don't we see a great danger to businesses of all sizes, particularly to small business, in the constant necessity for the retention of a high tax rate?

Senator HUMPHREY. I believe, Senator, that our present tax rates are too high. I believe—I can't prove this, and only time will tell—but I firmly believe if we retain our present high tax rate, with no reductions in them, over a sufficiently long period of time, we will not be able to carry on the development which is required in this country to give employment to our people.

Senator GOLDWATER. I am very glad to hear you say that, because in my experience in business, particularly listening to my brother, who happens to be a banker along with his other evils, I hear time and again of small business which has started in the last 5 to 10 years, who do a good job, but they are not able to retain enough of their earnings and put it into surplus to purchase new equipment. When the time comes that expansion is necessary or replacement is necessary, they have to go to some other small business and say, let's you and me join hands, or they go out of business. I feel personally, and I am glad that you agree, that tax reduction is the only thing that can permanently help the business structure of this country and if we don't get to it pretty fast I think we are going to be in rather serious trouble.

I notice in your statement that you don't have any recommendations for general or structural revisions in the tax policy at this time, but your having said that you feel that tax reduction is a necessary thing for the continuance of our natural expansion tendency in a free enterprise system, don't you think it is incumbent upon the legislative branch and the executive branch to exert every effort to cut this present

budget to a budget which is realistic which will be within the ability of the American people to carry?

Secretary HUMPHREY. That is what I believe and that is what I have advocated.

Senator GOLDWATER. It is incumbent upon us as Congress people not to yield to the tendency to expend vast new sums of money in this country on domestic items, but to curtail new expenditures. My views are well known on this. I feel it is also necessary for us to take a good hard look at the giveaway of money to foreign countries in the guise of economic assistance.

Secretary HUMPHREY. I think every item of expenditures, Senator, has to be worked at and whittled away at. I think the only way that expenditures are kept in control is by overlastingly keeping at it and at every single one, with no exceptions at all.

Senator GOLDWATER. That is all I have, Mr. Chairman. I do want to compliment the Secretary on his courage in standing up for what every business man in this country knows are sound business practices, sound principles, which if not adhered to by the Federal Government will never permit us to get out of the hole.

Secretary HUMPHREY. That is correct.

Mr. Mills.

Representative MILLS. I have read most of what you have had to say since you have been Secretary of the Treasury. I have tried to understand what you meant by what you said. As indicated in the transcript of the record of the hearings before this committee on the opening day, I tried to give meaning to some of your recent statements concerning the proposed budget expenditures.

You have said this morning that you think it is necessary that we reduce taxes. Certainly in making that statement you reflect the desire of the people who write to me and I assume the people who write to other Members of Congress. You certainly reflect the desire of most of the Members of the Congress with whom I have discussed the subject.

The other day we had before us the Director of the Budget, Mr. Brundage, and I asked Mr. Brundage what the situation appeared to him to be as he began working on the budget for the fiscal year 1959.

He told us that he thought we would be fortunate if we could hold expenditures for the fiscal year 1959 within a level of between \$71 billion and \$72 billion. That, of course, is projecting his thinking quite a bit in advance, and no one would hold him to that figure.

If you mean by your statement that it is necessary for us to reduce taxes to provide for long-run economic growth in the United States, which I assume is what you mean, how can we accomplish that objective and still provide revenues for financing such staggering amounts as are contained in the budget this year and, according to Mr. Brundage, may be contained in the budget for 1959?

Secretary HUMPHREY. The only way you could, Mr. Mills, would be if your income increased sufficiently rapidly to do so. My fear is that that will not occur. Assuming the continuation of even the sort of times that we are in today and have enjoyed in the past short period, which have been very good times, I think we are going to have to reduce Government expenditures along with the increased income to have a sufficient amount of money to pay for a tax cut.

Representative MILLS. What disturbs me is that it appears that expenditures go up as fast as our gain in revenues from increased business activity, so that we can't take advantage of those increases in revenue for purposes of tax reduction or debt retirement. I am sure that disturbs you.

Secretary HUMPHREY. That is exactly what disturbs me.

Representative MILLS. I do not suggest this, but I have wondered whether the Congress might exercise more control over expenditures if Congress, now or sometime during this session, could take the position that in the long run economic interest, no more than a certain amount of revenue should be collected from the people in fiscal year 1959, and required through that procedure an evaluation of government expenditures on the basis of a smaller figure than now appears will come to you in receipts?

Secretary HUMPHREY. A number of people have advocated that. I think the NAM were the first ones to come out with that sort of proposal, the thought being that if we just cut off the receipts, we would have to trim the expenditures. I don't think it necessarily follows, and it runs the risk of running into substantial deficits which I think would be a very bad thing. I think we ought to have among us the self-restraint that we talked about a little while ago and we ought to get it so widespread, we in the executive department should talk about it, you in the Congress should talk about it, everybody should talk about it. Every housewife knows that when times are really good for her, if she doesn't lay aside a little nest egg, she won't have it when she needs it in an emergency.

Exactly the same thing applies to the housekeeping of the Government that applies to the housekeeping of the home. We don't need to get into any fancy economic theories. All we have to do is just do the kind of things that a prudent housewife would do and we would correct a lot of our difficulties.

Representative MILLS. I would agree with you that in all probability we get the cart before the horse if we try to determine a level of receipts before we actually know what level of expenditures Congress will finally appropriate. But the important thing for us to realize at this point, as I see it, and I think you agree, is that tax reduction can occur now, under the present inflationary pressures, only in proportion to reduction in Government expenditures.

Secretary HUMPHREY. Not wholly. Our income is going up, and I deplore with you that our expenses are going up as fast as our income. If we even held our expenses level, if we had been able to over a period of 3 years, we would have money for a tax reduction because of the increase in receipts. So a tax reduction, Mr. Mills, can very properly come from both sources, both increased receipts and reduction in expenditures. But I don't think either one is sufficient alone. I think you must have both of them, or else you can't get money enough ahead to make the tax reduction that you need.

Representative MILLS. Certainly even in a growing economy you can't have tax reduction if you allow your expenditures to rise to the exact level of your receipts.

Secretary HUMPHREY. You will never get it in the world except out of deficits, and that is the wrong thing to do.

Representative MILLS. Certainly it would be the wrong thing to do under conditions such as we have today.

Secretary HUMPHREY. There is no question about that.

Representative MILLS. There is not enough surplus projected in the budget of 1958 to provide for a tax reduction such as you and I would desire to occur.

Secretary HUMPHREY. That is exactly right.

Representative MILLS. Now, Mr. Secretary, let me ask you this: As I take it, the one thing this committee would be interested in learning from you is whether or not the present fiscal policies are adequate in your opinion to cope with present-day economic conditions.

Secretary HUMPHREY. I think the policies are adequate. I think the difficulty is getting them accomplished. As I have said before and as I just got through saying to you, Mr. Mills, I deplore the fact that we have not been able to have better control of our expenditures. That is a practical matter. The theory is that you ought to do it. The problem is how do you do it. We have worked at it as hard as I know how. The President worked at it as hard as any man I have ever seen. We have not got it done. I hope that the Congress assists in the matter, and I hope that in the last analysis, as I have said many times, the public will help.

Representative MILLS. In your opinion are the monetary policies at the present time adequate to cope with the situation?

Secretary HUMPHREY. They have been certainly applied in the right direction. Whether you have any question about the detail or not, I will pass that. The right direction of monetary policy has been pursued, and it is having effect in the right way. This economy, as I see it, is today very closely balanced. We are in a very close balance. There are certain things which are developing and certain things where there are little adjustments taking place. That is an excellent way to have it if it just keeps going in that sort of way. I think monetary policy has very definitely had an effect on restraint in certain fields, and I think that that restraint is very desirable because even with that restraint we still have pressure on our prices. Without that restraint I think we would have had pressure on our prices that would have been so great that we would have been in serious condition **by now.**

Representative MILLS. My 10 minutes are up, I believe, Mr. Secretary.

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. Mr. Burgess, in your presentation of the charts, particularly in regard to the investment dollar and your chart on personal savings, I thought there was something left out, and that is the amount of savings that are going into new equity capital. Don't you feel, particularly on the problem that we are discussing, the shortage of investment money, that the amount of personal savings which might be going into new equity capital is a significant factor?

Dr. BURGESS. That would be included in the chart on personal savings (chart 4) under the "other" item of \$10 billion.

Representative CURTIS. I thought the breakdown didn't show that. The following chart (chart 5) showing liquid assets of individuals shows the E- and H-bonds, savings and loans, savings, checking accounts and currency. Is your new equity at the top of that chart?

Dr. BURGESS. It is in addition to the liquid assets shown in that chart. We didn't count equity as liquid assets. We are a little arbitrary. One could of course call them liquid assets.

Representative CURTIS. In other words, that chart is not a complete breakdown of the personal savings?

Dr. BURGESS. They have lots of other savings, but this is the liquid assets. They also have equity in their homes which is part of the savings. This is the liquid assets.

Representative CURTIS. Is there any attempt made to compute the increased value of equity through corporate retained earnings? I don't imagine so.

Dr. BURGESS. No; we have not included that. That is a major factor, both for individuals and corporations.

Representative CURTIS. But that is not included in that?

Dr. BURGESS. No.

Representative CURTIS. That actually would be a form of savings, though.

Dr. BURGESS. That is right.

Representative CURTIS. And it is a pretty important factor in these times.

Dr. BURGESS. That is correct. Of course in this period when debt is increasing very rapidly, it would be very desirable to have even more of the financing of corporations and individuals done through equity. Let me illustrate that. One effect of a little tighter terms on mortgages is that it compels the individual to put more equity into his house. That is an advantage for him and for society.

Representative CURTIS. I might say I thoroughly agree with that, and I was a little disappointed that there was not some further recommendation in the President's economic report to carry out the principle that we thought we were putting in on the corporate dividend tax credit. This was an attempt at any rate to try to channel more savings and investments from bonds and bank lending into equity type investments.

There is one comment that I wanted to make. Mr. Patman remarked that the consumer was paying for the corporate expansion obtained through depreciation accounts and retained earnings. Senator Goldwater in talking about this, started to say "As the corporation expands," and then he said "or replacement" because actually the account for depreciation is set up simply to retain capital not for expansion and certainly it is a cost of doing business and something the consumer is always going to have to pay for.

I would add this thought: Due to inflation, corporations find that their depreciation accounts have insufficient funds in them in order just to replace the equipment that they had in the beginning. They have had to find additional capital outside of their depreciation account just to stay where they are, just to replace, let alone expand. Would that be your observation, Mr. Secretary?

Secretary HUMPHREY. That is absolutely accurate.

Representative CURTIS. So indeed the consumer, as I view it in this instance is paying for the effects of inflation and it is through this particular set of financial circumstances that he is in effect paying for this. All that is happening is that the corporation is replacing the assets that it has worn out in the production of goods.

I believe that is the only point that I wanted to try to emphasize at this time, Mr. Chairman. Thank you.

Senator SPARKMAN (presiding). Senator O'Mahoney.

Senator O'MAHONEY. Thank you, Mr. Chairman.

Mr. Secretary, it is always a pleasure to listen to you. You have a very great ability to state what you mean very simply so all can understand.

I don't want to place all of the responsibility for avoiding inflation and correcting the disparity of the national debt upon the housewife. I agree with you that there ought to be leadership in the executive branch, in the congressional branch, and in the leadership of business. Three or four days ago when Mr. Brundage was here, Congressman Curtis, Senator Flanders, and I were all in agreement that the Defense Department could save a lot of money if it would undertake to unify its procurement services. Can't we do something about that in the Government?

The Hoover Commission recommended unification. Congress passed the law. But the job has not been done.

Secretary HUMPHREY. Senator, I would hesitate to comment on the detailed performance of another department.

Senator O'MAHONEY. Naturally.

Secretary HUMPHREY. I really don't know, to tell you the truth.

Senator O'MAHONEY. The matter is so important, Mr. Secretary, that perhaps we ought to have some plain talk right out in public. Of course we could call an executive session and invite you there.

Secretary HUMPHREY. No, that isn't quite the point. It isn't that I wouldn't dare to say it if I knew. It is a question of really knowing what you are talking about, and I don't think that I can comment when I really don't know.

Senator O'MAHONEY. Let me put it this way, then: If it be the fact that the Defense Department has not pursued the unification policy provided by law and recommended by the Hoover Commission, is it your opinion that it ought to get about the job without any further delay?

Secretary HUMPHREY. I think, Senator, that any method of improving efficiency in any of these departments ought to be adopted. I think that if there are ways that can be pointed out that can increase efficiency and eliminate waste, it is a thing which ought to be done. I believe, more than that it is a job that must be done. Now, as you say, I didn't quite blame the housewife for lack of leadership. I said she had the power. I didn't absolve anyone from the responsibility of leadership in that. I think in our governmental departments it is the responsibility of every single department to single out within its own borders everything that it can do. Speaking for myself, I think we can do a little better job than we have done, and we ought to do it.

Senator O'MAHONEY. But you yourself this morning have urged upon us the importance of leadership. That means speaking up plainly and bluntly.

Secretary HUMPHREY. That is what I have tried to do.

Senator O'MAHONEY. Mr. Brundage brought before us his chart for the budget for 1958 including a column of expenditures for "protection." The use of the word "protection," as a matter of semantics,

has to do not only with military defense but also includes economic aid to foreign countries.

Secretary HUMPHREY. Atomic energy and various other things.

Senator O'MAHONEY. You observe that that is \$45.3 billion. The next item, "Civil benefits," is \$16.9 billion. The next item, "Interest on the national debt," which is \$7.4 billion.

The report, Economic Indicators, prepared for us by the Council of Economic Advisers, which this committee publishes every month as an indication of where the country is going, has an interesting chart on page 29. Do you have a copy of it before you?

Secretary HUMPHREY. Mr. Smith has it right here.

Senator O'MAHONEY. This chart shows that taxable Government bonds rose sharply about the middle of 1953. That was about the time that the Treasury Department issued the 30-year $3\frac{1}{4}$ -percent bonds. That was selling at a premium quite a while and then it began to drop. Commercial bonds, commercial rate of interest, also went at what was at that time a peak. And Treasury bills went at a peak. But all three of these items then began to decline in the second half of the year 1953 and slipped off to new lows in the middle of 1953.

Since that time they have all risen to an all-time peak.

Secretary HUMPHREY. No. They have risen to a peak on this chart, but not an alltime peak.

Senator O'MAHONEY. Do you know of a time when commercial paper, let us say in the last 25 years, was higher than it is here?

Secretary HUMPHREY. It sold for about twice this in 1929. As I recall it, it sold for about twice this in 1929.

Senator O'MAHONEY. That was just before the crash.

Secretary HUMPHREY. Yes.

Senator O'MAHONEY. Which curled our hair.

Secretary HUMPHREY. That was just before the hair-curling.

Senator O'MAHONEY. That year we had Treasury bills selling at about 3 percent. The latest bills that you have issued announced last week were—

Secretary HUMPHREY. A little over that.

Senator O'MAHONEY. Taking a much bigger interest rate.

Secretary HUMPHREY. A little over the 3.

Senator O'MAHONEY. It increases this expenditure for interest upon the national debt. The estimate that the Bureau of the Budget gave, \$7.4 billion, is \$200 million more than was guessed at last year.

Secretary HUMPHREY. That is right.

Senator O'MAHONEY. Do you think that the interest rate is increasing: This is a good representation of what we are up against in 1958?

Secretary HUMPHREY. Let me call your attention to this, Senator: These lines, as you have seen them on this chart, go up and down almost opposite to the demand for activity in business. In other words, when they are running up high, business is running high. When they run down low, business is running low. It simply means that as business increases it costs a little more. As business slackens off somewhat, the demand for money is less, and money is more plentiful and you can rent it cheaper. It isn't any different than renting an apartment. When there are a lot of apartments for rent you can rent them for a lot less than when there is only one apartment on the street that you can rent.

Senator O'MAHONEY. The cost of money to the Government in that period, which is obviously a period of increases, has been steadily rising in the last 3 or 4 years.

Secretary HUMPHREY. Business has been steadily rising.

Senator O'MAHONEY. Yes, of course.

Secretary HUMPHREY. As business demanded more money, the price of money went up. It is just like an apartment. The rent went up with it.

Senator O'MAHONEY. That leads me to the question I wanted to ask. If the business leaders of America are willing to pay this high rate of interest on the money they borrowed for the purpose of expanding their businesses, building new facilities and the like, is their judgment good or bad in your opinion?

Secretary HUMPHREY. I think that up to as far as we have gone in this area, their judgment is very good because I don't think these are unduly high interest rates yet. I think that 3 percent money is still pretty reasonably priced money. It has been much higher in times past. It is much higher in many other countries, I guess in practically every other country in the world. A similar rate in Great Britain is 5 or 5½ percent, almost twice as much. In Germany it might be more than twice as much. So I think that this money has been probably well spent. I hope so, while there has been a great rush for it and a great demand for it. Actually, you have to create savings to spend, and there are just two things that makes you save. One is that you get what you think is a fair price for your money so you would rather get that price than to spend the money. You will keep the money and if the price is decent, you will rent it out at that price. The other thing is that you have confidence that your money is not going to be depreciated if you save it. If you think your dollar is going to be depreciated you want to spend it and get rid of it. If you think you can save it and have it come back to you at a dollar's worth and you get a good fair rent for it, you will save the money. As you save money and money comes into the market and that stops the interest rate from rising.

Senator O'MAHONEY. That is all very well, Mr. Secretary, in normal times, but when we are spending \$43 billion all over the world for what we call "protection," we have distortion. Is it your advice to this committee that we should look around for opportunities to cut the budget?

Secretary HUMPHREY. That is my advice to you, yes, sir.

Senator O'MAHONEY. What do you think we ought to do about the interest upon the national debt which is running up about a billion dollars? Is that an expenditure which we ought to reduce?

Secretary HUMPHREY. If you are able to cut the budget it will reduce it, and the way to reduce it is to cut the budget. That will bring down that item.

Senator O'MAHONEY. Isn't it a matter of fact that the increase in interest rate upon the bonds which the Treasury offered last week was fixed by the Treasury? You offered them in exchange, did you not?

Secretary HUMPHREY. No, we don't fix any rates at all, Senator. We have a market fixing rates every day and it is just like going down to the fruit market. If they are bidding so much a dozen or per 100 for oranges, you will either bid that or the other fellow will

get the oranges. We are in a great, broad market and we can't sell money for less than the other fellow is willing to pay for it.

Senator O'MAHONEY. I wish you could convince me that it is like buying oranges.

Secretary HUMPHREY. Just the same.

Senator O'MAHONEY. It seems to me that it is a different thing. Here we have outstanding \$7,772 million of one type of United States bonds to the holders of those securities, not to the public, not to the market. No cash would be received. You offered these new securities and at a much higher rate. That doesn't sound to me like an open market or buying oranges.

Secretary HUMPHREY. It is exactly the same. If we didn't offer a sufficient rate, the securities are coming due, and the holders would simply take their money and go and buy some corporate bonds that were being offered. If I offer a bond at 3 and this fellow sits here and offers one at 4 and you have \$100 coming due, what are you going to do with your \$100? Are you going to buy mine at 3 or his at 4? It is just that simple.

Senator O'MAHONEY. You say therefore that the increased interest upon the national debt is due to the conditions which now exist through the expenditure of money by the Government?

Secretary HUMPHREY. It has a direct effect on it but the really basic cause is due to the demand for money. There isn't enough money to meet everybody's demands and therefore people bid for it.

Senator O'MAHONEY. Since my time is up I don't want to go into the question of the action of the Federal Reserve Board, which exercises tremendous influence on what the interest rate will be. I will have to drop the matter at that point and express the wish that sometime before you leave the table here today you will take out your scissors and go to some of these charts and point out exactly the places where you think the Budget Bureau should have recommended cuts and where instead increases have been recommended.

Secretary HUMPHREY. If I knew those, Senator, I would have done it long ago.

Senator O'MAHONEY. What is the job of the Bureau of the Budget and does it have no liaison with the Treasury Department?

Secretary HUMPHREY. It certainly has a liaison with the President and it has liaison with me and it has liaison with everybody else in the Government.

We have taken into consideration the ideas of the Congress, the ideas of the executive departments, and the ideas of the military as to what is required, and the demands that the public is making on us for expenditures for services to be rendered, and we have not found a place where we can reduce it below this amount. I think we ought to find some place and I am looking for it.

Senator O'MAHONEY. I think the Treasury Department is an admirable department to do it because on your shoulders, not on the shoulders of the housewife, lies the responsibility of financing the extraordinary expenditures we are compelled to make because of the foreign policy that we are carrying on, a foreign policy which in its general aspects I support.

Secretary HUMPHREY. You see, Senator, my job is to do the financing. My job is not the conduct of foreign policy.

Senator O'MAHONEY. But I think you can suggest to us where the cuts can be made.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you.

Mr. Kilburn.

Representative KILBURN. This has been a very instructive morning to me.

Mr. Burgess, I don't understand exactly how you get your statistics. I should think it would be very difficult. For example, when an individual pays more money for insurance premiums, I presume only the cash value would show up as a "liquid asset," would it not?

Dr. BURGESS. These are very difficult to put together. They are partly estimates. They are derived from figures collected by the Department of Commerce, the SEC, the Federal Reserve Board. We put them together as best we could, recognizing there is a margin for error on them.

Representative KILBURN. Mr. Humphrey, carrying on the questions Senator O'Mahoney asked, isn't the high interest rate simply the law of supply and demand applying to credit?

Secretary HUMPHREY. Yes.

Representative KILBURN. The so-called tight money policy doesn't make the rates high. It is the law of supply and demand. The policy follows that law. Isn't that right?

Secretary HUMPHREY. The law of supply and demand operates on the amount of money that is available. That of course is what is reflected in the market.

Representative KILBURN. There is one other question on which I would like to ask your advice. Since money rates have gone up, it seems to me the tendency of Congress has been to have the Government lend the money direct, just as is proposed with the veterans loans. Private capital won't make the loan, so the Government makes the loan. It operates to some extent as the small-business loans do. This may be all right if it doesn't go too far but a great many Government agencies are now in the business of lending money. Don't you think that that tendency, if continued much more, would be inflationary?

Secretary HUMPHREY. I am sure it would. And the pressure is not only in the lending area. It is everywhere. Wherever there is anything that some group of people either don't like or where it bears on them heavily, they come to Washington to get it fixed. That is a pressure. If the Federal Government is going to give way to all these pressures, there will be no way that we can control our expenditures. Not only that, but I think it is an extremely dangerous thing to let people living in a free country believe that they are free of the obligations of freedom. I think there is no way that the Government can let people have all the benefits of freedom and then the Government absorb all of the obligations. I think the people who enjoy the freedom have to absorb part of the obligations themselves and that the Government can't just absolve them from it. I think the feeling which exists quite generally, that no matter what you do as an individual, if you get into trouble the Government will take care of you, is all wrong. I think carried to the final conclusion, it will simply prove that the Government can't do it, and then we will be in a lot of trouble. I think that there is an individual obligation

that individual citizens must assume and carry through and comply with if they are to enjoy the freedom that we have in this country.

Representative KILBURN. Thank you; that is all.

Senator O'MAHONEY. May I make a comment at this point, Mr. Chairman?

Chairman PATMAN. Certainly.

Senator O'MAHONEY. The words of the Secretary sounded so much like Grover Cleveland that I can't refrain from quoting his famous sentence:

It is the business of the people to support the Government, not of the Government to support the people.

Secretary HUMPHREY. That is very correct; and I am very honored to be classed with Grover Cleveland in that regard.

Chairman PATMAN. Mr. Secretary, you stated, and I think correctly, that the available money and the demand for that money that is available determines the interest rate. But the amount of money is determined by the Federal Reserve System, is it not, Mr. Humphrey?

Secretary HUMPHREY. Within limits, the amount available can be affected by Federal Reserve action.

Chairman PATMAN. Within limits. It is almost unlimited, isn't it?

Secretary HUMPHREY. No; I wouldn't say so.

Chairman PATMAN. Through their Open Market Committee.

Secretary HUMPHREY. But within limits they do control the amount available, and that is why I answered the question as I did.

Chairman PATMAN. Couldn't the Federal Reserve System, for instance, the Open Market Committee, put \$50 million more in circulation tomorrow if they wanted to? I am not advocating it. I am just stating the possibility to minimize your phrase "within limitations."

Secretary HUMPHREY. Senator, if you are just suggesting an absurdity to illustrate a point—

Chairman PATMAN. That is right. They could do it. They have the power to do it.

Secretary HUMPHREY. Theoretically, I think it could be done; but practically it could not happen.

Chairman PATMAN. I know, but they have the power to. That is the point I make. In other words, they determine the availability of money. Therefore, they determine interest rate by restricting the availability of money.

Secretary HUMPHREY. I would have to amend what you say by this: I think they influence the availability of money. When it comes to the word "determine" I think you are going pretty far.

Chairman PATMAN. Let us see just a little bit further. The Open Market Committee has unlimited power to buy Government obligations and certain other obligations by using the Government's credit. That is correct; isn't it?

Secretary HUMPHREY. That is correct.

Chairman PATMAN. The Federal Reserve's Open Market Committee could buy an unlimited amount of bonds and pay for them with Federal Reserve notes if it wanted to, just exactly as they bought and paid for \$25 billion worth which Mr. Burgess called our attention to a while ago.

Secretary HUMPHREY. I don't think they could practically do it; no.

Chairman PATMAN. I don't see how you could say that because the law is very plain, Mr. Humphrey, but I shall not pursue the matter further because it is not that important.

I want to ask you about these investment funds and pension funds. How many of them are there? You have the national service life insurance, you have the old-age and survivors insurance funds, and which other major ones are there?

Secretary HUMPHREY. I will have to have that checked. We have social security.

Chairman PATMAN. Will you put them in the record at this point.

Secretary HUMPHREY. Yes; I have quite a list of them here.

(The information referred to follows:)

PRINCIPAL TRUST FUNDS THAT INVEST IN PUBLIC DEBT OBLIGATIONS

Civil service retirement fund
Federal oil-age and survivors insurance trust fund
Foreign Service retirement fund
Government life insurance fund
Highway trust fund
National service life insurance fund
Railroad retirement account
Unemployment trust fund
Veterans special term insurance fund

Chairman PATMAN. I will ask you about those two, which will bring out the point I have here. When so much is paid in to the national service life insurance in premiums, you accept that money and you give the national service life insurance fund what is tantamount to a Government bond drawing 3 percent interest, do you not?

Secretary HUMPHREY. Yes.

Chairman PATMAN. Do you actually have those bonds printed and delivered to that fund or do you just do it in a bookkeeping transaction?

Senator HUMPHREY. They are not bonds. They are notes that are——

Chairman PATMAN. They are IOU's?

Secretary HUMPHREY. They are public-debt obligations.

Chairman PATMAN. Do you do the same thing on social security?

Secretary HUMPHREY. We do the same thing with all of them.

Chairman PATMAN. You place that Government obligation in a lockbox, we will say, for each particular fund. Why couldn't you use those funds now under existing law to buy Government-guaranteed home-loan mortgages?

Secretary HUMPHREY. I think we could by some method.

Chairman PATMAN. The law permits it, does it not?

Secretary HUMPHREY. I think so.

Chairman PATMAN. All right, why should you not consider using part of the national service life insurance——

Secretary HUMPHREY. Wait a minute. They tell me I am wrong. What is this? [Conferring.]

Mr. Heffelfinger says I can't.

Chairman PATMAN. You cannot under existing law, but laws can be changed and that is what we are trying to do, Mr. Humphrey. Then

there would be no sacrificing the interest of the veterans in that fund if the Congress were to authorize you to take a billion dollars of the national service life insurance fund and invest it in Government guaranteed home mortgages which provide for 4½ percent, would there, Mr. Humphrey?

Secretary HUMPHREY. We would have to get that much more money out of the market some other place, so I don't see that it would make much difference.

Chairman PATMAN. I know, but almost every week you are projecting your program for the future, a year in the future, and usually borrow about \$78 billion during the year. One billion would not affect it too much, would it?

Secretary HUMPHREY. Oh, yes. A billion dollars is getting to be an awful lot of money.

Chairman PATMAN. I know, but \$78 billion is a lot, too.

Secretary HUMPHREY. I think it could be done if you change the law to make it available. But then we would have to borrow that same amount some other place. I don't see that you would gain anything by it.

Chairman PATMAN. Of course, we would gain something because that fund would get 50 percent more in returns. As it is now it is getting only 3 percent. That way it would get 4½ percent, 50 percent more.

Secretary HUMPHREY. We would pay money right out to buy mortgages and then have to borrow right away, so what is the difference? You are just chasing yourself around a ring.

Chairman PATMAN. No. The veterans pay it when they pay their installments on their homes. They pay it back.

Secretary HUMPHREY. Over a long enough period, but currently it comes out of us.

Chairman PATMAN. But they pay it because they are good pay. The records show that.

I do want you to put an answer in the record, Mr. Humphrey. I won't press you for an answer here now. I get mail all the time asking "Why doesn't the Government pay its debts as an individual pays his debts? It should be on a cash basis." I would like you to answer that in the record as to what effect that would have on the capitalistic system if we all in some way could or should go on a pay-as-you-go basis. If your answer is that it will destroy the capitalistic system, which I assume it will be, then what will be the alternative? In other words, how much debt should we have and how much debt is dangerous, and do we have to have debt, if so how much, and so forth. Will you put an answer in the record on that?

Secretary HUMPHREY. You are going to give me plenty of time to work that out?

Chairman PATMAN. Yes. I want to ask Mr. Burgess some questions but I shall not do it right now because my time has almost expired.

Senator Sparkman.

Senator SPARKMAN. You can get some help from Alexander Hamilton's first report of the Treasury, can't you?

Secretary HUMPHREY. I hope so.

There is no doubt that it is perfectly proper to incur debt at times within the limits of the ability of the debtor to repay the loan. The

amount of debt which can properly be carried without tending to imbalance the whole economic system cannot be accurately estimated. I do not think anyone can set up an arbitrary figure in this connection. But in prosperous times such as these I am firmly convinced that our Government should not only be living within its income but should be making some payments down on its debt from time to time. In that way we can best promote the sound long-term growth of our country and the fiscal integrity of Government.

Senator SPARKMAN. Mr. Secretary, I want to ask you a couple of very quick questions.

You said something a while ago in answer to Senator O'Mahoney about the competitive position of different securities that a person with money would buy. I agree with you fully. What is happening in the E-bond market and the H-bond market? Is it going to dry up because of the present low rate?

Secretary HUMPHREY. Senator, we are giving a very great deal of attention to that, and we have to make a decision with respect to it. We are slow in making that decision because we have about 40 million people who own those bonds. When you make a decision which affects the pocketbooks of 40 million people it is a great responsibility and you have to be awfully sure you are doing what is right. Any change we make will affect 40 million people who already have purchased bonds and held them for some period of time.

I am not prepared today to give you the answer. All I can say is that I am sorry we have not been able to answer it yet, but we are pursuing every angle of it, trying to be sure that when we make the decision we will not have forgotten anything in trying to do what is fair and right.

Senator SPARKMAN. I recognize the fact that it is a complicated situation and I think all of those who have been buying in the past serve to complicate it more when you consider that a person who so invested his dollars 10 years ago has lost not only the accrued interest but some of the principal. Now when he cashes it out he is going to have to pay income tax on the supposed interest that is added to it. It seems to me that he is in a very rough place. It seems to me that it might very well be a threat to the existence of this source of income to the Government, a source which I think certainly ought to be maintained.

Secretary HUMPHREY. As you know, I am very, very strong for the E-bond. I think it is one of the greatest things there is. I think the fact that we have that many people interested in it is a great thing for this country.

Senator SPARKMAN. It is a fine testimonial to their patriotism and at the same time it adds strength to our economy.

Senator HUMPHREY. Not to belabor the point at all, but this is the finest security in the world, to start with—

Senator SPARKMAN. To start with.

Secretary HUMPHREY. Right now it is the finest security in the world. There is no security as good as it is. There is no security that you can go up and lay on the counter any time you are ready and get your dollars back for it. There is no depreciation in it, no market fluctuation. This is designed for people who don't want to follow the newspapers, who don't want to try to beat an eighth or sixteenth or a point or two points in the market. They want to get their money

and they want a fair rate of interest and they want their money now when they need it. This bond furnishes all of those things. So this bond has some very excellent provisions in it. It is a very excellent instrument. In fact, it is the finest instrument there is to serve its purpose.

Whether there are some minor things that should be readjusted or not, I am not sure.

Senator SPARKMAN. Did you read the article by John Fisher in the Editor's Easy Chair columns in the January 1957 issue of Harper's magazine on World's Finest Investments?

Secretary HUMPHREY. I did, and I would like to answer it all the way through because I think it is a lot of bunk.

Senator SPARKMAN. I will say this, Mr. Secretary, just as a practical matter. If you can answer it, then I think it ought to be answered because a lot of people have read that article and are thinking of it very seriously.

Secretary HUMPHREY. You see, it is the same old thing. When a man bites a dog it gets a lot of publicity, and to charge that one of the finest credit instruments in the world, which has ever been known, is no good, of course that makes news. It was so charged and it did go all over. It got a lot of publicity—much more, I think, than it deserved.

Senator SPARKMAN. I want to say just a word about this trimming of the budget.

Senator O'MAHOONEY. Senator, would you let me ask a question at this point?

Senator SPARKMAN. All right, sir.

Senator O'MAHOONEY. I wanted to tell you, Mr. Secretary, of a letter which I received only a short time ago from an old gentleman who bought a thousand dollar Government bond 10 years ago. Now both he and his wife are beyond the age of working, and they are not in an unusual position. He wrote to me about the fact that he can't sell that bond on the market except at a substantial loss because the price of Government bonds had gone down. It is not like an E-bond or an H-bond which are redeemable at par at any time. Would there be any possibility in the consideration which you are making of arranging for some sort of exchange to persons who might be in this category who do hold a marketable bond in exchange for E-bonds or H-bonds which would repay them at par value, just as for the notes the Treasury exchanges a new note with higher interest to the banks and the big corporations which are carrying huge sums? I have no recommendation myself, and I am carefully not making any recommendation.

Secretary HUMPHREY. Of course, Senator, just as soon as his bond comes due he can take the cash and buy E-bonds. He bought that bond because he wanted some special things that that bond had.

Senator O'MAHOONEY. That is true.

Secretary HUMPHREY. He wanted it instead of an E-bond. He could have bought an E-bond. You have to take the bitter with the sweet. If you want something special that you get in another bond, instead of an E-bond, you may have to wait until it is due before you get your money.

Senator O'MAHOONEY. I thought perhaps you might have said "We will take it under consideration, Senator."

Secretary HUMPHREY. There is no use fooling anybody.

Senator O'MAHONEY. Thank you.

Senator SPARKMAN. Of course when the Government retires this bond it retires it at full value; doesn't it?

Secretary HUMPHREY. That is correct. That man will get his money and he can turn around and buy E-bonds with it at that time.

Senator SPARKMAN. In the meantime if he has to sell it to keep body and soul together and he loses and the purchaser makes the profit.

Secretary HUMPHREY. Then he ought to have bought E-bonds in the first place even though, as you just indicated, perhaps there are some other things that are more attractive elsewhere.

Senator SPARKMAN. Now I want to get to the budget. I agree with the recommendation that you have made and with the statement that the President made in his press conference that Congress ought to cut it. I am very much in sympathy with the questions which have been propounded here as to why the various Government departments acting through the Budget Bureau did not cut it before it came here. However, I do want to make this point, and I think it is a point that a great many overlook.

Over the last 10, 12, or 15 years Congress, without exception, has always appropriated less money than the President's budget request called for.

Secretary HUMPHREY. Not in specific items. In the total, but not in specific items.

Senator SPARKMAN. Oh, no, of course not. Congress uses its discretion as to where it should be cut.

Mr. Chairman, I think it would be well to insert this table in the record at this point, showing the actual budgets. The table that I have shows it from the 79th Congress through the 84th Congress. The cuts range all the way from a tremendous amount to the relatively small amount of \$84 million.

Chairman PATMAN. Without objection, it will be inserted.
(The table referred to follows:)

Comparison of estimates and appropriations by sessions of Congress (Fiscal years 1946-57)

Congress, session	Estimates	Appropriations	Reduction
84th Cong., 2d sess.....	\$73,298,859,629	\$73,041,364,417	-\$257,495,212
84th Cong., 1st sess.....	66,023,089,195	63,947,281,321	-2,075,807,874
83d Cong., 2d sess.....	60,770,315,686	58,160,445,563	-2,609,870,123
83d Cong., 1st sess.....	77,190,083,599	65,156,254,797	-12,033,828,802
82d Cong., 2d sess.....	94,608,763,252	85,999,646,411	-8,609,116,841
82d Cong., 1st sess.....	105,837,897,537	101,117,786,897	-4,720,110,640
81st Cong., 2d sess (after Nov. 27, 1950).....	19,926,529,938	19,841,684,745	-84,845,193
81st Cong., 2d sess (to Nov. 27, 1950).....	63,090,906,227	61,203,355,096	-1,887,549,531
81st Cong., 1st sess.....	48,313,575,167	46,497,456,898	-1,816,118,269
80th Cong., 2d sess.....	44,446,109,713	41,675,480,957	-2,770,628,756
80th Cong., 1st sess.....	39,349,643,652	35,982,887,708	-3,366,755,944
79th Cong., 2d sess.....	37,315,954,247	35,734,209,165	-1,581,745,082
79th Cong., 1st sess.....	71,175,840,878	69,780,137,110	-1,395,703,768

Source: "Estimates, Appropriations, etc." 1946-55, table VIIIA, "Grand total, regular annual, deficiency, supplemental, and miscellaneous acts and permanent appropriations."

Note.—Foregoing figures pertain only to "Appropriations" in appropriation bills and "Appropriations" pursuant to permanent law, and therefore does not include other forms of obligational authority such as contract authority and authority to expend from public debt receipts, some of which are enacted in other than appropriation bills.

Senator SPARKMAN. Mr. Secretary, we probably won't get very far before my time runs out, but I want to have you tell me what we can hope for in the way of tax relief to small business.

Secretary HUMPHREY. If it is left to me, I will recommend against any tax relief which depletes our revenues.

Senator SPARKMAN. By any amount?

Secretary HUMPHREY. By any substantial amount. Congressman Mills has some suggestions which he spent a great deal of time working on and we worked with him with respect to many of them. There are some things that have relatively little effect which I think undoubtedly should be adopted. But by and large anything that depletes our revenues by a substantial amount, I am opposed to.

Senator SPARKMAN. I am not going to ask you what you mean by "substantial amount." I see where you answered that once before, that you would not cut your throat for \$50 million but for \$51 million you might.

Secretary HUMPHREY. We are getting on very dangerous ground.

Senator SPARKMAN. Mr. Secretary, when you speak of depleting the revenue do you mean for this 1 year or would you be willing to look at it on a long-range basis?

Secretary HUMPHREY. I am talking about right now.

Senator SPARKMAN. Back in August the Cabinet Committee which the President appointed—I am sorry that you were not one of the members of that Committee; I notice several Cabinet members were—recommended a very fine tax relief program. I would not agree with it in all of its details, but in its summation I certainly would. They recommend a program which they said would cost between \$600 million and \$700 million and indicated that they thought that that much would be absorbed and later the President endorsed this program.

Are we to understand now that it is the stand of the administration to withdraw from the endorsement of that recommendation?

Secretary HUMPHREY. I think, Senator, you will find that the President's endorsement was always coupled with the assumption that a tax reduction would be a proper step at the time it was done. I can say this with respect to those recommendations: They were very carefully considered. A number of them are unquestionably good thing to do if you can afford to do them. But my position is that there are lots of good things you ought to do, lots of good things. In fact, our taxes are so high that there is scarcely anybody in the United States who can't come in and make a pretty good showing of hardship on him to pay the tax he has to pay.

Senator SPARKMAN. You will admit, though, that the plight of small business is particularly acute, would you not? The tax on small business is particularly heavy.

Secretary HUMPHREY. It is heavy; yes. It is also heavy on a lot of other people.

Senator SPARKMAN. Mr. Secretary, the Wall Street Journal on October 22, 1956, had quite an article on this program. It is headed "Eisenhower Planning Special Program of Tax Aid, Other Relief to Small Business for Next Congress."

I don't have time to read the whole article, but I see down here, a question was asked of the President and it says:

In reply, Mr. Eisenhower said he is "moving ahead" with legislative proposals which, among other things, would—

Cut to 20 percent from the present 30 percent the Federal tax on a corporation's first \$25,000 of income.

And then do other things which I shall not go into in detail. Then there is this paragraph which I think bears out certain statements which you have made.

While he did not specifically state that he would ask Congress to cut the tax rate on a corporation's first \$25,000 of income, Mr. Eisenhower said the administration has been moving ahead with recommendations of the Cabinet Committee, and added elsewhere in his message that these "excellent recommendations" requiring new legislation "must await the next session of the Congress."

My 10 minutes are up, but I think I may have enough time to say that we are in that next session of Congress.

Secretary HUMPHREY. Of course, as I said before, I have never seen any place where the President recommended this except in connection with something that could afford to be done. When we can afford to reduce some taxes, those are items that can well be considered.

Senator SPARKMAN. Of course, the Cabinet Committee in its recommendation which the President did endorse called for these things. I remember the newspaper stories at the time, and I have the report here, which happened at a significant time in this Nation's life. It indicated that it would cost between \$600 million and \$700 million, and following that the President endorsed those recommendations.

My time is up.

Mr. Chairman, I should like to put into the record the progress report by the Cabinet Committee on Small Business, and then I would like to insert the Wall Street Journal article.

Chairman PATMAN. Without objection, they may be inserted in the record.

(The documents referred to follow :)

[The Wall Street Journal, October 22, 1956]

EISENHOWER PLANNING SPECIAL PROGRAM OF TAX AID, OTHER RELIEF FOR SMALL BUSINESS FOR NEXT CONGRESS

PRESIDENT SAYS OTHER STEPS NOT NEEDING LEGISLATION WILL BE TAKEN BEFORE THEN

(By a Wall Street Journal staff reporter)

WASHINGTON.—President Eisenhower disclosed he is drawing up a special program for small business—topped by tax relief—to present to Congress next year.

He also reviewed his administration's favors to small-business men since 1953 and outlined still other steps he is taking to help them before Congress returns next January.

The President's statement of plans for small-business men took the form of a telegram to an upstate New York group called Small Businessmen for Ike. They complained that, while the administration has a good record for small concerns, the Democrats are misrepresenting it in their campaign oratory.

In reply, Mr. Eisenhower said he is "moving ahead" with legislative proposals which, among other things, would:

Cut to 20 percent from the present 30 percent, the Federal tax on a corporation's first \$25,000 of income.

Boost to \$500,000 from the present \$300,000 the ceiling on securities issues exempt from full registration with the Securities and Exchange Commission.

Enable the Department of Justice to scrutinize more closely proposed mergers that might jeopardize the competitive position of little companies.

Extend the life of the Small Business Administration beyond its expiration date of next June 30.

NONLEGISLATIVE STEPS TAKEN

Noting that these proposals were made last summer by the Cabinet Committee on Small Business, Mr. Eisenhower said he has "already put into operation" the Cabinet Committee proposals that don't require new legislation.

Specifically, the Chief Executive said he has:

Called for a "comprehensive review" of Government procurement policies aimed at increasing small-business share of Uncle Sam's purchases, urging big prime contractors to subcontract to little concerns and insuring that a small concern's need for "progress payments" on partly completed Government work won't handicap its chances of getting contracts.

Asked the Commerce Department and SBA to draw up, early next year, programs to keep small business abreast of advances in technology and methods of distribution.

Called on the Budget Bureau to lessen the burden of paperwork on small businesses by simplifying wage reporting for social-security and income-tax withholding and streamlining other statistical reports.

Mr. Eisenhower's statement was in reply to a telegram from Fred Herman, who said his group was "concerned over the misrepresentations of your program in the present campaign."

Democrats have charged the Republican administration is "dominated by big business" and that a growing number of mergers between corporations, coupled with what they call the administration's tight-money policies, are driving many small concerns out of business.

Mr. Eisenhower answered that the record of his 3½ years in office "shows more accomplished, and more under way, for small business than ever before."

"Small business is sharing in the prosperity of the American economy," the President said. "Profits of small manufacturing concerns rose in 1955 and again in 1956." Elsewhere in his telegram the Chief Executive, in reply to Democratic statements that business failures have increased, declared:

There is a "larger number of independent business firms, in relation to the size of the Nation's work force, than there were in 1929 or in 1939," and that "the number is growing rapidly."

Turning to the administration's past activities, Mr. Eisenhower said it created the Small Business Administration, "the first independent peacetime agency to devote itself exclusively to matters of interest to small business."

PRESIDENT CITES "POSITIVE STEPS"

Moreover, he said, it established last spring a Cabinet Committee on Small Business for "developing policies and getting prompt action" on problems involving more than one agency of the Government. Members of this group include the Secretaries of Defense, Commerce, and Labor, the heads of the Office of Defense Mobilization, the Housing and Home Finance Agency, and the Small Business Administration. The group is headed by Dr. Arthur F. Burns, Chairman of the President's Council of Economic Advisers.

In addition to these moves, the President said, the administration has aided small concerns through such "positive steps" as:

Allowing the excess-profits tax to die at the end of 1953 and sponsoring the 1954 general tax revision which included provisions designed to benefit small business.

Getting the Government out of some 234 activities that competed with private enterprise, thereby creating new opportunities for small concerns.

Boosting small concerns' share of prime Government contracts to 22.2 percent of the total in the 3 years ended last June 30, up from 19.4 percent during the period from 1951 to 1953.

Extending to other big buying agencies of the Government the program under which the Defense Department sets aside certain contracts for exclusive award to small concerns.

Setting up a new division in the Federal Trade Commission to handle complaints from little companies of unfair competition from larger concerns.

Approving, through the SBA, over 8,000 business and disaster loans worth nearly a quarter of a billion dollars.

Furnishing, through the SBA and the Commerce Department, advice on management problems and information on Government contract opportunities.

While he did not specifically state that he would ask Congress to cut the tax rate on a corporation's first \$25,000 of income, Mr. Eisenhower said the administration has "been moving ahead with the recommendations" of the Cabinet Committee, and added elsewhere in his message that these "excellent recommendations" requiring new legislation "must await the next session of the Congress."

OTHER TAX STEPS OUTLINED

Mr. Eisenhower noted that the tax recommendations included, in addition to the proposal for slicing the corporate-tax rate, several other proposals which would:

Permit accelerated writeoff, for tax purposes, of a small company's purchases of used property.

Give an estate consisting largely of investments in closely held business concerns an option to pay death taxes over a period up to 10 years, in order to avoid financial disruption of small enterprises.

Give a small corporation with a small number of stockholders an option to be taxed as a partnership. This latter proposal, Mr. Eisenhower explained, is designed to enable the owners of a small business to avoid being taxed twice on earnings received from his business.

PROGRESS REPORT BY THE CABINET COMMITTEE ON SMALL BUSINESS, AUGUST 7, 1956

THE WHITE HOUSE,
Washington, August 9, 1956.

DEAR MR. CHAIRMAN: I was particularly pleased to receive and read the Progress Report of the Cabinet Committee on Small Business which you and your colleagues have been working on for many weeks.

This Administration is engaged in a continuing effort to ensure that the American economy is based on a strong, broad foundation of healthy free enterprises—small and large. The first Progress Report of the Cabinet Committee on Small Business is a further forward step in this effort.

The scope of the Report's analysis and recommendations demonstrates that no constructive potential avenue of improvement—either legislative or executive—is being overlooked in our search to widen the opportunities for small businesses in America.

We must continue to strive to eliminate obstacles hindering the growth of small businesses. I also firmly believe that uneconomic or sweeping nostrums have no place in this Administration's program; such measures usually help no one and eventually injure all. I am glad to see that the Committee emphasizes the importance of maintaining competition and of continued vigilance against any outcropping of monopoly; also that the Committee's report recognizes the need of preserving and increasing efficiency in business, and that it has focused on positive measures to help small businesses get started and grow.

I want to assure you that I shall give the recommendations of the Committee the prompt and favorable consideration they deserve—both in preparing for executive action and in drawing up the Administration's legislative program for the new Congress. I shall ask the departments principally concerned to advise me further.

I wish to thank you and your Cabinet colleagues for this forward-looking and useful progress report, and I urge the Committee to continue its studies of small-business problems and to keep its findings current in order that no opportunity will be neglected to strengthen this vital segment of the American economy.

Sincerely,

DWIGHT D. EISENHOWER.

DR. ARTHUR F. BURNS, *Chairman,*
Council of Economic Advisers,
Washington, D. C.

WASHINGTON, D. C., August 7, 1956.

DEAR MR. PRESIDENT: We herewith present a progress report of the Cabinet Committee on Small Business, in conformity with your request for a report on or about August 1.

Respectfully,

C. E. WILSON,
Secretary of Defense.
SINCLAIR WEEKS,
Secretary of Commerce.
JAMES P. MITCHELL,
Secretary of Labor.
ARTHUR S. FLEMMING,
Director of the Office of Defense Mobilization.
ALBERT W. COLE,
Administrator of the Housing and Home Finance Agency.
WENDELL B. BARNES,
Administrator of the Small Business Administration.
ARTHUR F. BURNS,
Chairman of the Council of Economic Advisers;
Chairman of the Cabinet Committee on Small Business.

PROGRESS REPORT BY THE CABINET COMMITTEE ON SMALL BUSINESS

Since its appointment on May 31, 1956, the Cabinet Committee on Small Business has been engaged in investigating the economic condition of small business enterprises, in reviewing Federal policies and programs that affect small business, in sifting hundreds of suggestions for governmental action received by the Committee, and in formulating a constructive program, both legislative and administrative, for expanding the opportunities of small businesses to prosper and grow. On the basis of the study and investigation carried on to date, the Committee submits its first progress report.

THE PROBLEMS OF SMALL BUSINESS

The Committee finds that the fortunes of small businesses have ordinarily varied with the fortunes of the economy at large. When production, employment, and the flow of incomes have risen, as has been the case in recent years, the majority of smaller enterprises have shared in the economic expansion. On the other hand, when business activity has been dull, many small businesses have suffered a setback. The most important contribution that the Federal Government can make to the economic health of small businesses is, therefore, to pursue monetary, fiscal, and housekeeping policies that foster sustained expansion of aggregate economic activity and that avoid the illusions of well-being that are sometimes produced by price inflation.

In formulating governmental policies, it is also necessary to recognize certain basic changes that have occurred in the economic environment of smaller businesses during the past generation. Problems of organization, of survival, and of growth, which have always complicated the life of new and small businesses, have become more difficult. The following facts, in particular, should be kept in mind:

(a) In the past quarter century an enormous increase has occurred in the burden of Federal taxation. The impact of this development has been especially severe on small businesses. Such concerns have little or no access to public markets for capital. If they are to grow, they must have the wherewithal to expand plant, equipment, and markets. But the heavy burden of taxes nowadays sharply reduces the ability of small enterprises to plough profits back into their businesses.

(b) The Federal Government has become by far the largest single purchaser of the goods and services produced by our private economy. A substantial part of the buying by the Government necessarily consists of intricate and expensive military items which cannot be efficiently produced by small firms, except for parts or components on a subcontracting basis.

(c) The pace of technological change has been accelerating in recent years. Large and well-financed firms have become accustomed to undertaking costly research and development programs, which enable them to set the pace or to

meet the pace of industrial innovation and investment. Small business enterprises cannot normally do this.

(d) The scope of advertising has greatly increased with the diffusion of rising family incomes and the growth of the radio, television, and other mass media of communication. These developments have favored concerns with nationally known brand names, and have complicated the marketing problems of small enterprises.

(e) The progress of mechanization in industry, the increasing investment by consumers in durable goods, the expansion of home ownership, and the growth of suburban life have opposed the tendencies just described, by opening up new opportunities for small businesses—particularly in construction, retailing, repair work, and in various service occupations. They have not, however, stemmed the difficulties faced by small manufacturing establishments.

FEDERAL POLICIES AND PROGRAMS

Recognizing these changes in the economic environment of small business, the Federal Government has acted on many fronts. Our tax laws contain provisions that are helpful to the smaller firm in carrying the risks of enterprise. Government agencies make or insure loans to sound businesses that are otherwise unable to obtain credit. The Securities and Exchange Commission provides a simplified method for registering small public issues of securities. The Department of Commerce and the Small Business Administration offer services of special value to the little concern. They supply scientific information, arrange free use of Government-owned patents, aid in developing new products, counsel on how to expand markets, advise on efficient methods of management, and keep firms informed about Federal procurement and surplus disposal plans. The Department of Defense and other procurement agencies assure small businesses a good share of Government contracts. The Department of Justice strikes down unlawful barriers to markets and preserves competitive opportunities by enforcing the antitrust laws.

Since 1952 Federal aids to small business have been very extensive. The Small Business Administration was established July 30, 1953, to strengthen Federal programs in this area and to make loans solely to smaller firms. Up to June 30, 1956, SBA approved 3,560 loans aggregating nearly \$166 million. The procuring agencies of the Government, in cooperation with SBA, have adopted policies designed (a) to assure small firms an equitable opportunity to participate in all Government contracts, (b) to set aside a larger amount of Government business exclusively for small firms, and (c) to help small concerns to get defense subcontracts. Changes made in Federal taxation during 1954 have been helpful to all businesses, but especially to the small enterprise. The excess profits tax was permitted to expire. Individual income taxes were reduced. A new Internal Revenue Code was adopted which—among other reforms—enlarged depreciation allowances, reduced double taxation of dividends, extended the period of loss carryback, and permitted the treatment of research and development outlays as a current expense. The annual amount of defense work a business may do with the Government, without being subject to the uncertainties of contract renegotiation, was raised this year from \$500,000 to \$1,000,000, while firms with contracts to supply standard commercial items have been exempted from renegotiation altogether. In recent years, also, the Department of Justice has greatly intensified the effort to curb outcroppings of monopoly.

COMMITTEE RECOMMENDATIONS

Although much has been done, the importance of maintaining a vigorous system of free and competitive enterprise requires further constructive steps to aid smaller businesses.

A sound program must be mindful of the Government's responsibility to raise the taxes needed to pay its own bills and to secure full value for every dollar spent. It must avoid arbitrary restrictions on large concerns that have come to the top through honest competition. It must scrupulously avoid subsidies of inefficiency. The proper way of aiding small businesses is to improve their opportunities to thrive, to survive periods of stress, and in time to become larger. The recommendations that follow embody these precepts.

Taxation

With regard to Federal taxes the Committee recognizes the recent improvement in the budgetary outlook and, in the event that the budgetary outlook remains favorable, recommends:

1. *That the taxes imposed on business corporations be modified by reducing the tax rate from 30 percent to 20 percent on incomes up to \$25,000.*

At present the tax rate is 30 percent of the first \$25,000 of the income of a corporation and 52 percent of the income in excess of \$25,000. The Committee's proposal would reduce by one-third the tax on the first \$25,000 of corporate income, but would leave unchanged the tax on income in excess of this figure. Thus, the benefits from tax reduction would be concentrated progressively upon corporations with the smallest net incomes.

While taxes on all corporate businesses should in time be lowered, the present proposal would substantially reduce the taxes on small corporations which constitute the great majority. It would help the smaller firms to retain earnings for financing expansion, or would give them some advantage in pricing. It would generally encourage the formation of new businesses.

2. *That businesses be given the right to utilize, for purchases of used property not exceeding \$50,000 in any one year, the formulas of accelerated depreciation that were made available to purchasers of new property by the Internal Revenue Code of 1954.*

This measure would benefit small and new businesses, whether or not they are incorporated. Because of the limitations of its capital, a small business must often begin operations by buying an old building, used machinery, or used display equipment. Under the Internal Revenue Code of 1954, only new property is eligible for the prescribed methods of accelerated depreciation. An extension of the privilege of accelerated depreciation deductions to limited purchases of used property would improve the financial position and outlook of smaller businesses.

3. *That corporations with, say, ten or fewer stockholders be given the option of being taxed as if they were partnerships.*

Many small businesses avoid the corporate form of organization, despite the advantages of limited liability and continuity of legal existence, because the corporate income tax may prove an added burden. The present proposal would make decisions whether or not to incorporate turn on factors other than taxes, since the law already gives certain partnerships the option of being taxed as corporations.

This measure was originally proposed by the Administration in 1954. It would particularly benefit small firms having stockholders with very modest incomes.

4. *That the taxpayer be given the option of paying the estate tax over a period of up to ten years in cases where the estate consists largely of investments in closely held business concerns.*

At present the need to pay a heavy estate tax at times leads to the disruption of the management, control, and operations of a small business. This is a contributing cause of numerous mergers. Although the law permits the Commissioner of Internal Revenue to defer the payment of the estate tax up to 10 years, this provision of the law applies only to cases of hardship. It does not give the taxpayer who may claim hardship any assurance that his claim will be recognized. Nor is relief available when assets can be sold at a fair price, even though the sale leads to the merger or dissolution of a company.

To remove these difficulties the taxpayer should be given the option of paying the estate tax forthwith or in installments over a maximum period of 10 years, whenever an estate consists largely of investments in closely held business concerns. In the event that the taxpayer elects the latter option, he should be charged a moderate rate of interest as at present in hardship cases. Careful consideration should be given to the merits of limiting the installment option to an estate tax of some specified maximum amount.

Procurement

To supplement the commendable programs that have already been undertaken to expand the participation of small business in Federal procurement, the Committee recommends:

5. *That the President arrange for a comprehensive review of procurement policies and procedures of all departments and agencies, including the legislation pertaining thereto, with a view to facilitating and extending the participation of small businesses in work on Government contracts.*

Variations in procurement procedures from one agency to another, or from one division to another of the same agency, are often confusing to small-business men. Not all of these variations are necessary.

The aim of the proposed survey should be to eliminate needless inconsistencies in the procedures of various departments and agencies, to simplify present procurement procedures and to remove any inequities which may be involved in them. A codification and especially a simplification of procurement policies and procedures, carried out with an eye to the needs and capabilities of smaller businesses, would facilitate their participation in Government procurement.

6. *That the President direct departments and agencies engaged in extensive procurement to adopt procedures which would insure that a need for advance or progress payments by a bidder will not be treated as a handicap in awarding a contract, and which would facilitate and accelerate the making of such progress payments as may be requested by small suppliers under Government contracts.*

Small businesses are more likely than large firms to lack the funds needed to carry out Government contracts. However, contracting officers at times regard the need for advance or progress payments as a disability on the part of a bidder, despite existing rules to the contrary. It would serve to clarify current rules and procedures and materially aid small businesses in obtaining Government work, if the procurement agencies would indicate explicitly in their invitations for bids that a need for advance or progress payments by a bidder will not be treated as a handicap, provided he is otherwise qualified to carry out the contract.

In cases where a contract specifies progress payments the Government should make these payments more promptly to the prime contractors. They in turn should be urged to make similar payments promptly to their sub-contractors.

7. *That the Renegotiation Board clarify the fact that, although a contractor who subcontracts work may not reasonably expect to be allowed as large a profit thereon as if he had done the work himself, the practice of subcontracting—especially the extent to which subcontracts are placed with small businesses—is encouraged by giving it favorable consideration in determining allowable profits.*

Existing law and regulations recognize that subcontracting to small firms ordinarily involves technical and other assistance and may entail additional risks by the prime contractor, and that these factors warrant consideration in the profits allowed to him. It is desirable to dispel the supposition of many businessmen that allowable profits on a Government contract will be prejudiced to the extent that they subcontract the work. Clarification of present policies and procedures of the Renegotiation Board will assist small businesses to obtain more Government business through subcontracts.

Financing and technical aids

With respect to financing and technical aids to small businesses the Committee recommends:

8. *That the life of the Small Business Administration, which is now scheduled to expire in mid-1957, be extended at the earliest opportunity.*

This measure would help small businesses by lessening the doubts of some banks regarding participation in SBA loans running beyond June 30, 1957, by enabling SBA to keep its personnel or to recruit better personnel, and by indicating to the public that the Federal Government regards the welfare of small businesses as a matter of continuing concern.

9. *That the maximum amount of an issue of corporate securities which the Securities and Exchange Commission may exempt from registration be increased from \$300,000 to \$500,000.*

The Commission is now authorized to accept a simple notification statement in lieu of the full registration statement on issues of securities that do not exceed \$300,000 in amount. This limit has been in effect since 1945, and should be raised in recognition of the substantial increase in the price level that has occurred in the intervening years.

As a rule, the notification statement substantially reduces the legal, engineering, and accounting costs that are involved in filing a registration statement. By raising to \$500,000 the amount of an issue of securities that is exempted from registration, more small- and medium-sized firms would find it practical to utilize the public markets for capital. In order to prevent the proposed change from reducing protection to investors, the Commission should limit the exemption privilege to seasoned businesses and should withhold it from issuers of so-called penny stocks.

10. *That the President call a Conference on technical research, development, and distribution, for the benefit of small business.*

The broad purpose of the Conference would be to formulate a program under which small firms can avail themselves of up-to-date technological and managerial knowledge in this era of rapid scientific progress. The conferees should include outstanding businessmen, heads of technological institutions, heads of engineering and business administration schools, and directors of economic and business research agencies. One of the Conference's tasks would be to assess research and development aids currently available to small businesses through Government departments, State and private universities, and other private agencies. Another task would be to recommend measures for extending such aids to small firms over the whole range of management, including product selection and development, manufacturing processes, market measurement, sales promotion, cost control, etc. It would be desirable to hold the Conference early in 1957.

Competition

The vitality of the American economy has depended in the past, and may be expected to depend in the future, upon the continuous infusion of new firms, new entrepreneurs, and new ideas.

In the interest of maintaining and extending free competitive enterprise, the Committee recommends:

11. *That legislation be enacted to enable closer Federal scrutiny of mergers.*

Some mergers serve the public interest, as when two weak firms are joined in an enterprise that can offer vigorous competition. Other mergers, however, place obstacles in the path of effective competition. For this reason, continuous and close scrutiny by the Federal Government is desirable.

The Economic Report of the President, transmitted to the Congress on January 24, 1956, contained several important recommendations with regard to proposed mergers, which require legislative action. They are as follows: "First, all firms of significant size that are engaging in interstate commerce and plan to merge should be required to give advance notice of the proposed merger to the antitrust agencies, and to supply the information needed to assess its probable impact on competition. Second, Federal regulation should be extended to all mergers of banking institutions. Combined with the requirement for advance notice, this extension of the law would give the Government an opportunity to prevent mergers that are likely to result in undue restraint of banking competition. Third * * * the Clayton Act should be amended to make explicit the Federal Government's authority to take action in merger transactions in which either party is engaged in interstate commerce." Another helpful measure would be to empower the Federal Trade Commission to seek an injunction before filing a formal complaint, when it seems likely that a proposed merger would result in a substantial impairment of competition.

12. *That procedural changes be made in the antitrust laws to facilitate their enforcement.*

Two recommendations in the Economic Report of the President, cited above, are particularly urged: first, that the Clayton Act be amended so as to make the cease-and-desist orders of the Federal Trade Commission final when issued, unless appealed to the courts; second, that when civil rather than criminal proceedings are contemplated, the Attorney General be empowered to issue a civil investigative demand, compelling the production of relevant documents before the filing of a complaint, and without having to invoke grand jury proceedings.

Paperwork

With regard to the burdens of paperwork the Committee recommends:

13. *That wage reporting by employers for purposes of social-security records and income-tax withholding be simplified.*

At present an employer must file five reports a year with the Internal Revenue Service on the earnings of his employees. Four are quarterly statements that are used in the administration of the social-security system. Still another is used in the administration of the individual income tax. Since the latter report would suffice to meet the needs of both the Old Age and Survivors Insurance System and of the Internal Revenue Service, the quarterly reports should be eliminated.

This proposal has previously been advanced by the Internal Revenue Service, the Social Security Administration, the Hoover Commission, and the President's Budget Message. Its adoption would produce substantial savings for employers, most of whom are small-business men. This reform would also reduce the paperwork of the Government, and it would facilitate better accounting for taxable incomes.

The full advantage of a shift to annual wage reporting will be obtained only when parallel changes are made to simplify employer reports for unemployment insurance purposes. Of course, such technical changes should be carried out without modifying the standards of benefits under unemployment insurance.

14. *That the Office of Statistical Standards of the Bureau of the Budget undertake a comprehensive review of the reports and statistics required of small businesses.*

There are grounds for believing that some of the paperwork required of small businesses, apart from that noted above, may be superfluous, while information of great potential usefulness is not now being gathered. It would therefore be desirable to review all forms that small businesses are now required to fill out by governmental agencies. This should be done from the viewpoint of the need for such forms and the possibility of simplifying them. The importance of improving statistics on the economic position of small businesses should also be kept in mind. Such information is vital to a proper appraisal of small-business problems. Existing statistics on the employment provided by small firms and their profits are especially inadequate. There is also a need for detailed information on governmental procurement from firms classified according to size.

IMPACT ON FEDERAL BUDGET

Apart from the tax proposals, the adoption of the recommendations presented in this Report would have very little impact on the Federal Budget.

The loss of revenue entailed by the tax proposals is estimated at about \$600 million in the first year, at about \$740 million in the second year, and at somewhat reduced figures in later years. It is doubtful, however, whether there need be any loss to the Treasury in the long run. For, in the first place, some of the tax proposals involve merely a deferral of taxes and, in the second place, the proposed measures would tend to enlarge the national income which is the ultimate source of all tax revenues.

FUTURE ACTIVITIES OF THE COMMITTEE

The preceding recommendations express the Committee's conclusions concerning the legislative and administrative actions that are needed to enable small businesses to improve their competitive positions and their chances of survival and growth in our evolving economy.

The Committee is continuing to investigate the economic problems of small business and to examine additional proposals for action by the Government. Among other suggestions, the Committee is studying a proposal to help small concerns attract capital by allowing investors to deduct from their ordinary incomes a limited amount of losses, in the event that losses are sustained from investments in small businesses.

While much remains to be learned, the Committee has reached some firm conclusions. The evidence varies for different types of business, but it does not reveal any decline in the overall economic significance of small business in the American economy. Nor has there been any diminution in the importance of the small entrepreneur in the maintenance of our democracy. The four million small business enterprises are serving as a dynamic influence in our system of free and competitive enterprise. They are making a vital contribution to the success of our economy. The adoption of the Committee's recommendations can be expected to enlarge this contribution.

APPENDIX

The President's letter of May 31, 1956, to Chairman Arthur F. Burns, establishing the Cabinet Committee on Small Business:

DEAR MR. CHAIRMAN: The important contributions made by small business concerns to the progressive spirit and vitality of the American economy have re-

peatedly been stressed in my Economic Reports to the Congress and on various other occasions. Such enterprises, of which there are some four million currently in operation, serve continuously as a dynamic influence in our enterprise system. It is often through them that new products and new processes are first brought into use. Equally important, it is in small concerns that many men and women find an opportunity to demonstrate their ability to serve constructively in the business world. For these and related reasons, government policies that make it easier for new businesses to be established and that foster the growth of small concerns enhance the welfare of the whole economy.

The Federal Government has a number of programs now in operation that are significantly helpful to small businesses.

The Department of Commerce helps constantly in the solution of management problems for small businesses through its Office of Technical Services, Office of Area Development, Business and Defense Services Administration, and Office of Business Economics.

Financial assistance is available to small concerns through the Small Business Administration.

Jointly with the Department of Defense and with other Federal departments and agencies, the Small Business Administration assists small concerns in obtaining government procurement contracts.

Many small construction companies and related businesses benefit from the home financing programs administered by the Housing and Home Finance Agency.

The Office of Defense Mobilization seeks to strengthen the production potential of small firms in our defense programs.

Through its enforcement of the antitrust laws, the Department of Justice helps maintain the competitive environment that is essential to the Nation's economic welfare.

These and other programs and policies of the Federal Government facilitate the establishment of new concerns and foster the growth of small businesses. Yet the conditions of our modern economy are such that many small concerns confront substantial hindrances to their growth. It is my wish that the Federal Government keep fully abreast of developments that affect small businesses. Its programs and policies aimed at assisting small businesses should be carefully reviewed at this time with the object of strengthening them where necessary, and of making recommendations for steps that will provide such enterprises with additional constructive assistance.

To this end I am establishing a Cabinet Committee on Small Business of which I would like you to serve as Chairman. By copies of this letter I am designating the Secretaries of Defense, Commerce, Labor, the Director of the Office of Defense Mobilization, the Administrator of the Small Business Administration, and the Administrator of the Housing and Home Finance Agency as Members. Other department and agency heads will participate on an *ad hoc* basis as may be deemed desirable. The Committee is to have the continuing assignment of making specific recommendations to me for administrative actions, and where necessary for additional legislation, to strengthen the economic position of small businesses and to foster their sound development.

Sincerely,

DWIGHT D. EISENHOWER.

Dr. ARTHUR F. BURNS, *Chairman,*
Council of Economic Advisers,
Washington, D. C.

Chairman PATMAN. Senator Flanders.

Senator FLANDERS. Mr. Secretary, I found on my desk this morning a copy of a letter to you from a mutual friend, Mr. Harry Zinsmeister, of Duluth and Minneapolis. I don't know how long it takes letters to get to your desk. Mine comes quickly. Yours may have arrived some time in the middle of the week or later. His letter was on the subject of the budget, about which many of us have had something to say. It led me to think that I would concentrate, when I get around to concentrating, on this matter of the budget and I have just now arrived at concentrating. You have made it quite clear that your responsibility for the budget is limited, I think.

Senator HUMPHREY. Yes.

Senator FLANDERS. You have made that quite clear. The responsibility of the Congress for the budget is unlimited but quite impractical.

Secretary HUMPHREY. It is not only unlimited, Mr. Senator, it is a constitutional obligation.

Senator FLANDERS. Yes; it is. That leads me to put an idea that has been I think in many of our minds in concrete form. I would like to ask you if you would favor a statutory ceiling on Government spending comparable to the debt ceiling limitation, qualified to the extent that the ceiling could be broken at times of economic emergency and the ceiling would provide for nominal yearly increase.

Secretary HUMPHREY. I doubt if I would advocate that, Senator, for this reason: It is your constitutional obligation now to provide such money as you think the country ought to have to spend, and the Executive cannot spend a single dime that you don't authorize.

Senator FLANDERS. But that sum is made up of a practically infinite number of items, beyond the range of investigation of any individual Congressman or Senator. It is an impossible task, with Government in its present state of complication, to carry out the responsibility which the Constitution puts on us unless in my judgment something of this sort is done.

Secretary HUMPHREY. It is beyond, as you say, the capacity of a single man, but it is not beyond the capacity of the Congress. The Appropriations Committees of the Congress can and do study in minute detail each of these budgets. So far as the Treasury is concerned, our Appropriation Committee knows as much about what we spend as I do. They are thoroughly informed. Most of them have been on the committee for a good many years. They travel around and see all the places. They know exactly what we are doing.

The fault lies, I think, in our system of not having those things coordinated. Each Appropriation Committee passes on its budget and then they make a recommendation. We never know what the total budget is to be until the last dog is hung. Nearly two years ago the Treasury presented a revised system to be adopted that would hold all of these appropriations in a temporary state until the entire budget was brought together, together with the estimated income, and the whole thing then would be approved and adopted by the Congress.

We presented that to a number of the Senators and Congressmen on the Appropriations Committees and made a good deal of progress with it. It was approved by both the chairman of the Appropriations Committee and of the Finance Committee of the Senate and by several members of the Appropriations Committee in the House. Some way or other it got into a pocket that we never have been able to get it out of, and it has rested there for a year and a half or nearly 2 years.

Senator FLANDERS. Is it being introduced again under administration auspices?

Secretary HUMPHREY. We have not done it again because it is in Representative Cannon's committee. We have hoped and thought that we could get it out of there.

Senator FLANDERS. It is in his committee. It is still in the Congress at the moment.

Secretary HUMPHREY. Yes. The program has been there for a year and a half or more.

Senator FLANDERS. But that is not this Congress. The time you introduce reforms is at the beginning of the first session of a new

Congress. It should be reintroduced for this Congress. Technically, it is not in Mr. Cannon's committee.

Secretary HUMPHREY. I see.

Senator FLANDERS. Unless it has been reintroduced.

Secretary HUMPHREY. Maybe we ought to get it introduced again.

Senator FLANDERS. Mr. Secretary, I would have been so happy, just me, not the Treasury Department or the country or anybody else, but just me, if the administration had said preparatory to bringing in this budget, "How would you spend the same amount of money in fiscal year 1958 that you had for fiscal 1957?" Put the question like that. It seems to me that that lies within the jurisdiction of the administration instead of adding things up and seeing what you have got. That is what this suggestion I was proposing here would do, only if the administration does not do that, I think Congress should.

Secretary HUMPHREY. Senator, you don't need any law to do that. The Congress can do that any minute. All you have to do is just to say those are the appropriations and how are you fellows going to spend it. You can do that any minute.

Senator FLANDERS. That is the purpose of this statutory—

Secretary HUMPHREY. You don't need it. You have the power right now.

Senator FLANDERS. No. The Budget comes to us with some tens of thousands of items.

Secretary HUMPHREY. But each Appropriations Committee can just say, "We will approve the same amount you had last year or the year before, or any other amount they decide and that will be it and we can't spend another cent."

Senator O'MAHONEY. Mr. Chairman, may I make a comment?

Chairman PATMAN. Certainly, if the Senator will yield.

Senator FLANDERS. In just a moment.

On this matter of the restraint of the people and the restraint of manufacturers and businessmen and the restraint of organized labor, I wonder if you would feel that you could state as a principle that the long-range self-interest is difficult to distinguish from virtue.

Secretary HUMPHREY. I think that is right.

Senator FLANDERS. I have meditated long enough on that subject, and I have come to that conclusion.

Secretary HUMPHREY. I never thought of it before, but I believe that is right.

Secretary FLANDERS. We will have that enacted into law.

I yield.

Chairman PATMAN. Senator O'Mahoney.

Senator O'MAHONEY. I wanted to call to the attention of Senator FLANDERS the fact that the Legislative Reorganization Act which was approved on August 2, 1946, section 138 (a) contains this provision:

The Committee on Ways and Means and the Committee on Appropriations of the House of Representatives and the Committee on Finance and the Committee on Appropriations of the Senate, or duly authorized subcommittees thereof, are authorized and directed to meet jointly at the beginning of each regular session of Congress and, after study and consultation giving due consideration to the budget recommendations of the President, report to their respective houses a legislative budget for the ensuing fiscal year, including the estimated overall Federal receipts and expenditures for such year. Such report shall contain a recommendation for the maximum amount to be appropriated for expenditure in such year, which shall include such an amount to be reserved for deficiencies

as may be deemed necessary by such committees. If the estimated receipts exceed the estimated expenditures, such report shall contain a recommendation for a reduction in the public debt. Such report shall be made by February 15.

That is subsection (a) of section 138 of the Legislative Reorganization Act. It has been honored in the breach and not in the observance.

Senator HUMPHREY. That is correct.

Senator FLANDERS. Mr. Secretary, if the administration is for that procedure, can't you see to it that the measure you mentioned is again introduced, because other bills of this sort do not have the force behind them that an administration bill has.

Secretary HUMPHREY. Just to take a minute on that, Senator O'Mahoney, that is still advisory. February 15, or whatever that date was, is still only an advisory thing. The real time you want is in June or sometime before these things all become law. After this advisory step is taken which is, I admit, a very desirable step, then you go ahead and enact into law piecemeal a lot of appropriations and you never know what the total appropriations are until you finally enact the last one and add them up.

Senator O'MAHONEY. Of course, during all the time since that law was passed we have been on the brink at one time or another of conflict, if not actually involved, and there has been a great deal of deficit financing, but the budget which has been submitted to Congress this year does contain estimates for fiscal 1957 and 1958 which will exceed expenditures. That, under this theory, should be accompanied by an actual retirement of debt.

Secretary HUMPHREY. That is right. That is what we did last year. We did have a surplus and we did retire some debt. That is why we are not involved in the debt ceiling yet.

Chairman PATMAN. Dr. Talle.

Representative TALLE. I want to say to you, Mr. Secretary, what I have said on many occasions during the years you have been Secretary of the Treasury of the United States that yours is the most difficult financial assignment ever given to anybody. Virtue is its own reward, the proverb says, but I am sure the vast majority of the American people are grateful to you and to Dr. Burgess and to all who work with you for performing extremely difficult duties so well.

The hour is late, but I want to put in a plug for the E-bonds. We talked about savings at the outset. The habit of saving is not easy to establish, but the E-bond has been a wonderful device for cultivating the habit of saving. I think it is good to start with the low denomination of \$18.75 and then move upward to higher figures. As has been said, it is cash at any time that cash is wanted. It is offered in convenient denominations. More could be said for it, of course.

I deplore what I have read in some newspapers and elsewhere that some people don't believe it is a good investment. I believe firmly in it. I think the most damaging thing, aside from the fact that it might encourage people not to buy and therefore shift debt from individuals to banks where the money supply would be multiplied, aside from that, this hammering away at the E-bonds does damage to the habit of saving. We are on the right road in savings. Parents buy them and give them to their children. Children have learned to save. It is an excellent habit. I do hope that those who are inclined to find fault with the E-bond will think twice before they proceed

further with that because it does damage to a great virtue, the habit of saving.

That is all, Mr. Chairman.

Chairman PATMAN. At this time we recognize Mr. Curtis of Missouri.

Representative CURTIS. Thank you, Mr. Chairman.

I might call the attention of Senator Flanders to the hearings before the House Committee on Appropriations on the budget for 1958. Mr. Humphrey testified on this question about a subcommittee of the House Appropriations Committee. If this testimony is accurate, and I am sure it is, Mr. Secretary, you have again recommended to the House that they pursue these recommendations which you made to review appropriation methods. I thought it was a good recommendation. I regret to see that the chairman of the committee, Mr. Cannon, didn't indicate whether he was going to go ahead. He asked if you would appear and you said you would be glad to. I thought you would be interested in that.

Senator FLANDERS. Might I make the inquiry whether this is one of the measures which should originate in the House?

Representative CURTIS. It should, in my judgment. Of course, I am just another person observing this appropriation area.

Chairman PATMAN. I would want to consult the Parliamentarian about it, Senator Flanders. I don't know.

Secretary HUMPHREY. Mr. Chairman, the recommendation was not presented in the usual manner. It came out in the testimony. It was to the whole 50 members of the entire Appropriations Committee.

Representative CURTIS. I happen to agree quite strongly with your statement on page 44 of these hearings where, after being, as I would call it, badgered by some of the members, you said:

You gentlemen sound to me as though you do not perform any function; that you just sit here and report to some fellows and rubber stamp it. I do not believe that.

It has been my observation that there are many things that the Congress can do on a budget that the executive department cannot do. One area that I would like to suggest is better use of the Government Accounting Office, which is an arm of the Congress, not of the executive department.

One other area where our Appropriations Committee could function is to establish better liaison with our expenditures committee, which is called Government Operations now. There is practically no liaison there.

That leads to the point which Senator O'Mahoney was making, that very few of the requirements of the unification of the armed services are being followed. It has been brought to the attention of the Executive, it has been brought to the attention of the Congress and the people, and still the law is not being followed.

Judging by the Hoover Commission recommendations, if the law were followed we would be saving 2 or 3 billion at least out of this budget and not impair in the slightest our military defense. In fact, it probably would improve our defense because we would have generals and admirals devoting their time to airplanes and guided missiles and not underwear and a few things of that nature. Inasmuch as that did come up I want to emphasize it.

Again in this same report on page 80, one of the members of the Appropriations Committee pointed out that for years he has been advocating a permanent staff on the committee so that the committee could go into those things.

So I myself am in complete accord with you, sir, that your Department and the Bureau of the Budget at this particular point probably have done about as well as could be done. I think it behooves the congressional committees and Members of Congress to get to work and use the facilities they have and think up a few more facilities to get this budget in line.

I would like to ask you a question. Of what significance do you think the relationship or ratio of our Federal debt to our gross national product might be? I have roughed out these figures which I think are about right. In 1939 we had \$48 billion Federal debt, \$91 billion gross national product, which is ratio of about 1.8, or 53 percent.

In 1946 it was \$260 billion Federal debt and our gross national product was 209, which made it 124 percent.

In 1956, \$277 billion national debt, with a gross national product of \$412 billion, 67 percent.

Another interesting figure is the total debt. The ratio has not varied too much over these 3 years: \$208 billion total debt in 1939, with a \$91 billion gross national product, 217 percent; 1946, \$447 billion total debt in ratio to a \$209 billion national product, which is 214 percent; then in 1956 a total debt of \$793 billion in relation to \$412 billion gross national product, 192 percent.

That figure of total debt to gross national product has not varied so much, but certainly the Federal debt in ratio to gross national debt has.

Do you think there is any real significance in those comparisons, and do you think that in considering how much Federal debt we can carry, the gross national product is a basic fact?

Secretary HUMPHREY. I really don't know, Mr. Curtis. We have this debt. There isn't much we can do about it except to pay down a little on it as the time comes along. I hope that we would not increase it. I advocated as much as I know how not to increase it. Obviously the greater our turnover is in relation to our debt, the lighter the debt burden becomes, but just what straw will break the camel's back or how difficult it is I have no way of measuring.

Representative CURTIS. Thank you. That is all.

Chairman PATMAN. It seems that we are just about to conclude here. I will not detain the witness much longer. I do want to ask Dr. Burgess 2 or 3 questions. If these are questions that he prefers to answer later, that will be all right.

I assume, Mr. Secretary, it will be all right for any member of the committee to submit questions to you before the record is closed and you will answer them for us.

Secretary HUMPHREY. I would be very glad to.

Chairman PATMAN. Mr. Burgess, you made a speech on December 15, 1956, in which you stated:

In this country we are now going through one of the critical struggles to maintain sound money as significant perhaps as the gold and silver arguments of the middle nineties or the discussions 20 years later which resulted in the establishment of the Federal Reserve System. This is a time when maintaining sound

money inevitably hurts some people, and that means cries of distress and political pressures on the people or institution responsible for Government monetary policy.

Then in a speech you made, I believe, about 18 months before, you stated :

We are, in fact, in the Treasury today following policies which are closely parallel to those inaugurated by Alexander Hamilton 165 years ago.

Then you stated :

We have worked unceasingly to carry out Hamilton's policies of an effective central banking system as a core of a sound financial mechanism. Our principal objective has been to relieve our Federal Reserve System from political pressure and make sure that its activities are devoted solely to serving the welfare of the people.

Keeping those four quotes in mind, I would like to ask you these questions :

Why is this as critical a struggle as the 1890's? Are conditions today similar to those of the 1890's, Mr. Burgess?

Dr. BURGESS. Not at all. This is a period of great prosperity. When a country is very prosperous and doing well, there is danger of forgetting the dangers of overexpansion. The reason this seems to me a critical period is that this is one of the times when we are so prosperous and expanding so rapidly that some restraint was desirable. The Federal Reserve has had to apply policies of restraint. The problem of the public understanding of those policies is enormously important. Otherwise, you will have an overriding policy or suppression of their freedom.

Chairman PATMAN. One other question: Are the people who inevitably get hurt the same group today as in the nineties, and who are they?

Dr. BURGESS. In the nineties the people who felt they were hurt were the farmers. I don't think the farmers have been particularly hurt this time by monetary policy. Their troubles arise from other sources. The two groups now who have felt the pinch and shortage of money particularly have been in the field of housing and in the field of State and municipal financing, which is rather a different group. Small business also feels the pinch of tight money.

Chairman PATMAN. Why do you say that the Fed, or the Federal Reserve System or Federal Reserve Board should be free from political pressure? In that connection, I wish you would define what you mean by political pressure.

Dr. BURGESS. That is rather hard to define. From time to time laws are introduced which would tend to make it very difficult for the Federal Reserve to administer its powers, not necessarily changes in the Reserve System itself, but other laws which would offset what they did. Of course, they feel also public pressure when they are called to account and are criticized severely. They need defenders. They are human beings. They need appreciation as well as depreciation.

Chairman PATMAN. Do you mean to say that they don't have defenders? They are pretty successful.

Dr. BURGESS. They have done pretty well. I think one encouraging thing is that the people have shown an increasing understanding of the function of the central banking system in this country.

Chairman PATMAN. The Federal has the complete support of the Treasury, hasn't it, Mr. Humphrey?

Secretary HUMPHREY. Yes.

Chairman PATMAN. Although you disagreed with them a year ago, you are in line with them right now, aren't you, Mr. Secretary?

Secretary HUMPHREY. You don't have to agree on every detail of everything and still you can be in favor of what they are doing.

Chairman PATMAN. Concerning political pressure, Mr. Burgess, you recognize that in Congress there are people on either side of questions, and although the Federal Reserve System is an agency of Congress, you would have it insulated from Congress, from any pressure from Congress?

Dr. BURGESS. No. I think the law which provides that they have to report currently to the Congress is very sound. They ought to listen to everybody. They ought to have freedom of speech about their policies. Those all are good.

Chairman PATMAN. In this case the Constitution places the money and credit problem in the hands of Congress. Congress has delegated that to the Federal Reserve System and, of course, the Board of Governors of the Federal Reserve Board is the one that we deal with. Don't you think that the Federal Reserve Board should be at all times reporting to Congress what they are doing, because Congress is directly responsible for the actions of the Board of Governors?

Dr. BURGESS. Exactly. That is exactly the right relationship.

Chairman PATMAN. And the Open Market Committee, too.

Dr. BURGESS. Yes. They ought to be reporting to Congress as part of the system, probably through the Board of Governors or any other agency desired.

Chairman PATMAN. Are there any other questions, gentlemen?

Representative TALLE. Mr. Chairman, I don't have a question but I would like to pay tributes to the National Director, who has done such a good job in connection with the sales of E-bonds, the State directors, the county directors, and all who have worked with him. I repeat again that it is a wonderful means for promoting the habit of saving and I hope nobody does anything to harm it.

Chairman PATMAN. I share your views, Dr. Talle. We have had a lot of testimony by experts before this committee recently that the average saver doesn't consider the amount of return. He considers only the fact that he can get his capital back from his investment whenever he wants it. That is more important to him than the amount of interest.

I agree with Dr. Talle it is a fine system. People get into a good habit of investing so much each week or month in E-bonds. They are not looking at the interest rates particularly. They are looking at getting their capital back if they want to, and at a method of savings. As Dr. Burgess says, it is the voluntary way instead of the involuntary way of installment buying.

I think people generally look upon it with great favor. I certainly don't want to do anything or anybody else to do anything that would reflect on the system or detract from it. I share the views of Dr. Talle in that respect.

Secretary HUMPHREY. There is just one thing, Mr. Chairman. I personally don't believe that the buyers of E-bonds are interested in eighths and sixteenths. I don't think they think of that. On the other hand, they want to feel generally that they are fairly treated. That is what we want. We want to sell them a good article and we

want to have them feel that it is a good article and that is why we are spending so much time to try to get the right answer.

Senator O'MAHONEY. Mr. Chairman, may I address another question to the Secretary?

Would you be willing to add to what you have just now said, for the purpose of defending against an attack which is being made upon the validity of the E-bond and its strength, that one of its great virtues is that it is completely insulated both by Congress and by the attitude of the Department of the Treasury against the daily fluctuations of the market?

Secretary HUMPHREY. That is correct. We want that understood that way.

Senator O'MAHONEY. It would be a terrible mistake if the E-bond were to be converted into some bond that would not carry the obligation of the United States to repay dollar for dollar?

Secretary HUMPHREY. We have lots of other securities that people who want to buy something that fluctuates can invest in if they wish. The E-bond is a very special thing and we want to preserve that.

Chairman PATMAN. Any other questions, gentlemen?

Representative TALLE. Mr. Chairman, I do want to add a word about interest. I don't underestimate the importance of interest rates. I look at it this way, that saving is postponement of consumption. Each of us would rather have something right now than in the future because the future is uncertain. If we wait for that future day we want a little more on that future day than we can have today. It is postponement of consumption. For the irksomeness that lies in postponing consumption a price must be paid, and therefore interest can certainly be defended. I do hold that the rate does not have to be high to encourage people to save.

Secretary HUMPHREY. It must be fair.

Mr. TALLE. That is right.

Chairman PATMAN. I believe it should be fair. The people who are really mistreated, if any one is mistreated now, is the person Senator O'Mahoney referred to, who bought bonds in good faith during the war or after the war, during emergency, during drives, who were led to believe they could always get their money, 100 cents on the dollar, and now by the reason of the stress and misfortune they are compelled to sell those bonds and get only about 90 cents to the dollar. I think it is more important to be thinking about them right now than increasing interest in other categories. That is my personal feeling about it. I know that you want to treat the E-bond holders fairly and I am all for that, too.

Mr. Secretary, we want to thank you very much, and Dr. Burgess and the staff, for giving us the benefit of the information which you have. It has helped us greatly in carrying out our work and we appreciate it more than we can tell you.

Secretary HUMPHREY. Thank you very much indeed.

Chairman PATMAN. Tomorrow morning we will have Mr. William Martin, Jr., Chairman of the Federal Reserve Board, in this room at 10 o'clock.

The committee stands in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12:55 p. m., the committee was recessed, to reconvene at 10 a. m., Tuesday, February 5, 1957.)

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 5, 1957

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

The committee met at 10 a. m., pursuant to recess, in room P-63, the Capitol, Hon. Wright Patman presiding.

Present: Representatives Patman (presiding), Bolling, Mills, Talle, Curtis, and Kilburn; Senators Flanders and Watkins.

Also present: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Chairman PATMAN. The committee will please come to order.

We continue our hearings this morning with Mr. William McChesney Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System, as our witness.

As the committee knows, the Subcommittee on the Economic Stabilization of the Joint Economic Committee held hearings on monetary policy in June and December 1956. The December hearings included a brief session with the Open Market Committee. Copies of these hearings have been provided to members of the committee and the public.

This morning we will examine what monetary policies should be pursued in the year ahead.

In our letter of invitation we set forth questions that this committee wishes you to address yourself to, Mr. Martin. We are very glad to have you, and you may proceed in your own way.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH A. YOUNG, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS

Mr. MARTIN. Thank you, Mr. Chairman.

On behalf of the Board of Governors, I wish to say again that we are always glad to have an opportunity to appear here. We welcome inquiry into what monetary and credit policy can do, and cannot do, to aid in achieving the goal of sustained economic growth and widespread prosperity.

The national economy continues to operate at the highest levels in history. Gross national product reached the unprecedented rate of \$424 billion by the last quarter of 1956. National income reached more than \$352 billion, personal incomes more than \$333 billion, and civilian employment about 65 million. These figures mark new highs.

The year 1956 opened with the economy generally operating at near-capacity levels. A sharp rise in business expenditures for new plant and equipment, combined with increased spending by consumers and by State and local governments, more than offset decreased spending for automobiles and new home construction, thus imposing further heavy demands upon productive resources. Wage rates as well as prices for goods and services moved upward. The year ended as it began, with the economic climate dominated by inflationary pressures.

In this environment of intensive utilization of national resources, the aim of monetary policy has been to restrain inflationary tendencies, while providing at the same time for orderly economic growth. Over the year, the Federal Reserve System sought to prevent too rapid expansion of bank credit and the money supply by restricting the availability of bank reserves. To have permitted more rapid expansion of bank credit and the money supply would have intensified inflationary pressures already present in the economy. It would not have produced more goods. Rather, it would have increased prices further. Without relative stability of the currency, continued high utilization of resources would have been in jeopardy.

Commercial bank loans and investments in the aggregate rose only moderately during 1956. Banks expanded their loans substantially but to a large extent they obtained the necessary funds by reducing their investments in government securities. As a result, while there was little further growth in the supply of money, there was a more active use of existing money, as indicated by an 8 percent rise in demand deposit turnover.

The great bulk of all loanable funds is provided by savings of businesses and individuals. Although the volume of savings was somewhat higher in 1956 than in 1955, the growth was not enough to keep pace with the rapidly increasing demands. Interest rates on borrowed funds rose sharply over the year, particularly on long-term borrowing.

Interest rate changes, as well as other price movements, reflect supply-demand relationships. Rising rates, like rises in other prices, indicate that demand is exceeding supply. They discourage some borrowing on the one hand and encourage increased saving on the other. Thus they perform the vital function of balancing supply and demand. Current interest rates are a signal that the economy is straining its resources by trying to accomplish more at one time than resources permit.

Economic realities cannot be eliminated or circumvented by government fiat. Even the Congress with its enormous powers to redirect the available resources of the country must operate within the aggregate of resources available. In other words, under conditions of heavy utilization of resources generally, an increase in the resources made available to any one sector of the community would have to be taken from other sectors either by taxation, or by some form of direct rationing, or by the processes of the market. They cannot be made available by attempts to ease credit. That is the road to inflation. In 1956, fully half of the increase in gross national product represented a markup in prices. Had commercial banks been enabled to generate sufficient new money to satisfy all the demands for funds that were pressing on the market, the result perhaps would have been

a smaller rise in interest rates, but at the expense of a sharper rise in prices of goods and services.

In the final analysis, investment must be financed out of saving from current income. This economic principle cannot be vitiated by any form of monetary manipulation. Under our institutions there is no practicable way of balancing savings and investment without flexible interest rates.

Monetary policy must be administered with regard to changing situations in the financial markets. During 1956, within its general policy of restraint, System operations met seasonal changes in the reserve needs of members banks and also cushioned disturbing movements in financial markets, including those arising from necessary Treasury financing. From time to time during the course of the year the degree of restraint was adjusted to variations in the financial climate and in business activity.

Notwithstanding the combined influence of restraint on credit expansion and the realization of a substantial cash surplus in the Federal budget, prices of goods and services moved upward in 1956. Increases of 4½ percent in wholesale prices and 3 percent in the consumer price index are indicative of the vigor of demands. Such increases cannot be accepted complacently.

In a growing, competitive economy such as ours, production and prices for individual commodities fluctuate over a considerable range in response to changes in supply and demand without creating serious overall instability. These adjustments are necessary to economic progress. They are part of the process of developing and maintaining high-level employment, economic growth, free markets, and overall stability in the price level. Even though many components may be unstable, the total economy can still experience an upward trend in production and employment with a horizontal trend in average prices.

In recent years, large shifts in the flow of funds through the economy have originated in such important areas as the Federal budget, agriculture, business investment, consumer outlays for durable goods and housing, and State and local governments. Declines in some sectors have released resources that have made possible increases in others. Such rolling adjustments not only are inescapable in a dynamic and unregimented economy, but the ability to adjust to changes with resiliency and flexibility, and with a minimum of Government interference, is one of the great virtues of a private enterprise system.

We know from experience, however, that the pathway of economic growth cannot be free of turns and dips. Experience tells us that important shifts in demands in major economic sectors can be so powerful as to have an excessively stimulative or depressive impact on the whole economy. Where the effects of such shifts become cumulative, they can develop into serious booms and depressions. Monetary and credit measures, by being adapted promptly to shifts in total demand relative to the supply of available resources, play an essential role in moderating these cumulative forces and in promoting orderly growth and financial stability.

Considerable attention has been focused of late on the impact of monetary and credit policy on various sectors of the economy. Higher interest rates as a mechanism for allocating the available supply of funds among different credit seekers have been sharply criticized.

It is frequently contended that monetary policy is depriving communities of such vital needs as schools, housing, and roads. Similarly, small business is said to be injured.

These are debatable matters to say the least. School and road construction, home building, and small-business activity are actually at high levels. In some of these sectors, many borrowers have been prevented from competing in the market for savings by statutory or regulatory limitations on the maximum interest rates they are allowed to pay. As a result, borrowers thus affected have borne a disproportionate brunt of general credit restraint. The cause of this disproportion, however, lies in the interest rate limitations that have kept some borrowers out of the market and not in the effort to restrain inflation. All of these sectors would suffer infinitely more from further inflationary bites out of the purchasing power of the dollar than they would from temporarily foregoing some of their borrowing—however, worthy the purpose—if their plans and programs cannot be financed out of savings or, in the case of schools and roads, for example, out of taxes.

It is important to recognize that the problem of monetary stability is to keep the use of credit in line with resources available for production of goods and services. To accomplish this, some demands must temporarily go unsatisfied. Naturally, these deferments are of great concern to all of us, but unlimited supplies of easy money would only complicate and worsen the situation.

It has been suggested that the Government should take action to enable certain meritorious programs to move forward relatively unhampered by the effects of monetary restraint. These proposals present very difficult questions of public policy, which can be decided only by the Congress. Programs designed to make funds more readily available to some users should be accompanied by action reducing still further their availability to others, for example, in some cases, by increased taxation. Otherwise, the effect will be to intensify inflationary pressures and imperil price and monetary stability.

The problem is not insoluble. The correction of economic imbalances takes time, but corrective forces have been and still are operating. Our Nation unquestionably has the resources to provide for a continuously rising level of physical well-being, educational attainment, and cultural development. Our resources are steadily growing and so is our ability to use them intelligently. What cannot be accomplished today may become readily attainable in the not too distant future.

Mr. Chairman, that constitutes my preliminary statement. We have done a lot of work in response to the specific questions which you directed to us which we think are highly important. The essence of the Board position in general is in the answer to the fifth question, which I would like to highlight. I will not read the rest of them unless you wish me to.

Chairman PATMAN. We will insert them in the record.

(The document referred to follows:)

SUPPLEMENTAL QUESTIONS ADDRESSED TO THE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND ANSWERS SUPPLIED BY CHAIRMAN MARTIN

1. What information do you have about the impact of so-called general credit controls upon small business as compared with big business? Upon State and local governments as compared with nongovernmental credit users? Manifestly, the effects of credit restraint are felt by more small businesses, numerically, than by large ones. This does not necessarily mean that the impact of general credit restraints falls disproportionately on small businesses. There are over 4¼ million business enterprises in this country. Most of these would be considered small business under any standard of measurement, and only about one in a thousand would be classed as big business.

The major difference between small and large businesses is not in their direct access to some source of credit but, rather, in their access to alternate sources of credit. Unlike most small businesses, most large businesses generally have direct contact with and access to a number of banks as well as to other sources of outside financing. Consequently, at a time when overall credit demands are greater than can be fully met without inflationary impact, a greater number of small businesses than large ones find it difficult to secure their customary credit accommodation.

The Federal Reserve System cannot allocate credit among groups of borrowers. With demands for goods and services exceeding capacity to produce, monetary policy over the past year has been directed toward keeping expansion of the total credit supply within limits set by the willingness of the community to save. The market place has determined the allocation of the available supply of savings.

With aggregate demands for materials and credit so large, it is obvious that available productive capacity and savings could not accommodate all credit-worthy applicants to the full extent of their desires. All of us know of legitimate, useful projects that have had to be deferred or reduced in scale, because either the physical or financial resources could not be obtained.

We know of no figures that permit a precise measure of the relative impact of credit restraints, in particular, on different groups of borrowers. We have, however, assembled a considerable body of information that may help to illuminate this troublesome question.

A survey of business loans made in October 1955 shows that one-fifth of the total dollar volume of the business loans held by member banks on that date were loans to firms with assets of less than \$250,000, and more than one-third were loans to firms with assets of less than \$1 million. Most commercial banks are small enterprises themselves; nearly 85 percent of our 14,000 commercial banks have deposits of under \$10 million and, necessarily, most of the lending of these smaller banks is to small businesses. In October 1955, about nine-tenths of the number and four-fifths of the dollar volume of business loans held by small banks were loans to firms with assets of less than \$250,000, and these loans accounted for about one-fifth of the dollar volume of all commercial bank loans to such small businesses. With the close and direct contact with customers that smaller banks enjoy, and with so large a stake in the financial position of their small customers, it is evident that most commercial banks have a strong incentive to maintain the volume of bank credit flowing to smaller businesses.

Even at large banks, lending to small business represents a significant share of their loan volume. In October 1955, banks with deposits of \$100 million or more accounted for about two-fifths of all bank loans to small business. At these larger banks, small-business loans represented three-quarters of the number and one-tenth of the dollar volume of their business loan portfolios. Lending to small firms is profitable business, and most large banks are anxious to obtain this type of business.

Information on the structure of bank loans to business since late 1955 is less comprehensive. We do receive reports from large banks in major financial centers on the size distribution of new business loans of over \$1,000 made in a 2-week period of each quarter. These figures indicate that from mid-1955 to mid-1956 the number and dollar volume of new short-term business loans made increased to record levels. Increases were recorded in all loan-size categories; with the sharpest rise in loans of \$200,000 and over. The average size of new loan increased about 30 percent over this period.

The rise in average size of business loan extended by large commercial banks reflected primarily the shift in patterns of industrial demand that occurred last year. When the bulk of the loan demand on commercial banks is from industries where larger business units predominate, such as public utilities, machinery, or metals manufacturing, the average size is larger than when most of the loan demand arises primarily from the needs of retail merchants or service industries. This past year there has been increased emphasis on borrowing to meet financial needs in industries characterized by large producing units.

From June to December of 1956, the volume of new loans made declined about one-eighth from the peaks reached in June. The decline was of about equal proportion for both small and large loans, and there was very little change in the average size of loan.

With interest costs rising generally, both large and small borrowers have had to pay more for their loans. Since mid-1955, the average interest paid at large banks on short-term business loans of \$200,000 or more rose by 87 basis points, to 4.20 percent, while costs on loans of from \$1,000 to \$100,000 went up 58 basis points, to 4.94 percent.

Loan applications to the Small Business Administration rose from about 3,000 in 1955 to almost 6,000 in 1956. Loan approvals increased more rapidly, rising from 1,148 loans, amounting to about \$55 million in 1955, to 2,890 loans, amounting to about \$122 million. These figures are not large relative to the size of the small-business population or to the usual volume of lending to small businesses by commercial banks.

An increasing share of the loan funds supplied by SBA last year was for longer-term purposes, such as purchase of plant and equipment or consolidation of obligations, rather than for working capital. The proportion of SBA loans carrying final maturities of less than 3 years is small. Most maturities are longer than are customary in commercial bank business loans.

Reports on manufacturing corporations, compiled quarterly by the Federal Trade Commission, indicate that both the return on shareholders' equity and profits per dollar of sales increased substantially for small businesses from the third quarter of 1955 to the third quarter of 1956 (the latest data now available). Over this period, return on equity, after taxes, rose from 10.4 percent to 15.3 percent for small companies, as compared with a decline from 12.3 to 11.0 for the total. Profits per dollar of sales rose from 2.2 to 3.0 percent for small companies, compared with a decline for all manufacturing corporations over the period.

These reports also indicate that the liquidity position of small corporations deteriorated much less last year than that of large companies. The ratio of cash balances and Government security holdings to total current liabilities for small companies declined from 37 to 34 percent over the period, while for all manufacturing corporations, the decline was from 71 to 55 percent.

Statistics published by Dun & Bradstreet, Inc., on business failures indicate that the number of failures where the liability involved was less than \$25,000 rose by one-seventh, as compared with an increase of one-fourth in the number of firms failing with liabilities of \$100,000 or more. The dollar amount of debts involved in failures of small firms also rose less than did the debts of larger firms failing last year.

State and local governments

State and local governments spent about \$10.7 billion last year for construction of schools, highways, and other community facilities. This was about 10 percent more than was spent for these purposes in 1955. Bond issues for new money floated by State and local governments during the year amounted to about \$5.4 billion, about one-tenth less than was floated in 1955. All of the reduction in flotations was in issues to finance toll highway construction and in bond issues to fund short-term debt incurred for public housing projects. Financing of school construction continued at the record level of the previous year, and financing of sanitation and other community facilities increased sharply.

The decline in toll road financing reflected reconsideration of many highway projects contemplated earlier. The financial difficulties experienced with some recently completed roads (financed for the most part at lower interest costs), rising materials, labor, and credit costs, and uncertainties about developments in the new Federal highway program led to the deferral of several projects.

Construction outlays for public housing continued at close to 1955 levels, but an increasing share was financed through short-term debt. Instead of funding the notes issued by local housing authorities on completion of construc-

tion, these notes were "rolled over" and fewer long-term housing bonds were issued in 1956.

Deferral of long-term financing last year reflected the rapid rise in costs of all types of long-term borrowing. Yields on high-grade corporate bonds outstanding rose 63 basis points, and yields on new issues rose almost 100 points. In addition, repayment terms on corporate issues became substantially more restrictive last year, with longer "no call" provisions and higher call prices required of borrowers.

Yields on high-grade State and local bonds outstanding rose 75 basis points over the year, but these bonds still offered investors returns about three-quarters of a percentage point less than comparable quality corporate securities. This was close to the average differential that existed in 1955. For investors subject to high corporate or personal income-tax rates, the exemption from Federal income taxation of interest received on State and local government obligations provides an offset to the lower rate of return. This feature is not one of prime importance to investors subject to lower tax rates, however, particularly for institutional investors such as life insurance companies, pension funds, and mutual savings banks, which receive a large share of the community's long-term savings. As the volume of State and local long-term borrowing increases beyond the supply of investment funds attracted by the tax-exemption feature, it becomes increasingly necessary for these governments to compete for funds on a straight return basis.

In part, the stability of the differential between yields on corporate and municipal bonds reflects the acumen of the officers managing the finances of State and local governments. Because the planning and financing of large-scale construction projects is usually undertaken long before construction actually begins, finance officers are often able to time the flotation of bonds to take advantage of temporary ebbs and flows of funds into and out of security markets. On several occasions in 1956, the volume of security issues floated was greater than the supply of investment funds could accommodate, and security dealers' inventories of unsold securities increased rapidly. As these situations of temporary congestion developed, finance officers postponed some offerings.

A survey made last year indicated that about 120 issues, aggregating \$175 million, were not sold on previously announced flotation dates during the third quarter of 1956. The Board's staff has followed the subsequent history of these issues; they found that 41 of the issues were sold later in that same quarter and 28 were sold in the fourth quarter of the year. By year end, three-fifths of the number and two-fifths of the dollar volume of the postponed issues had been sold. The pattern of issues postponed in the fourth quarter of 1956 (estimated as 135 issues, valued at \$240 million) has been similar, with about 40 percent sold to date.

For some borrowers, postponement has meant higher costs, for others it has proven advantageous. For example, the State of Michigan offered a highway bond issue in early December, with a maximum interest ceiling of 3.5 percent. No bids were received. The issue was reoffered in reduced amount in mid-January, and successfully marketed at 3.37 percent.

It appears that, for the most part, State and local governments last year were able to finance a very large and rising volume of expenditures and that the rise in interest costs of bond financing was a reflection of supply and demand factors. There were some cases, however, where borrowers were unwilling to pay current market rates, and withdrew their issues, and others where borrowers were prohibited by statutory limitations from paying rates which the market demanded.

2. Are present statutory provisions governing reserve requirements satisfactory and desirable?

The present system of reserve requirements is not altogether equitable in its impact on individual member banks. It has not seriously impeded, however, the effectiveness of monetary and credit policy in influencing the aggregate volume of bank credit. The problem of devising a more equitable and effective structure of reserve requirements has been under intensive study for many years, within the System, by the banking community, and by other students of monetary affairs, and many alternatives have been proposed and analyzed. It is one of the problems to be considered in any overall review of the existing financial organization.

3. Is the breadth of direct control (now limited to member banks) sufficient for the workings of general monetary controls, or should the direct influence of central bank operations be extended to cover other financial

intermediaries, such as insurance companies, savings and loan associations, installment credit institutions, nonmember banks, etc.?

Our experience of recent years indicates clearly that the actions of the System under its present authority are potent forces affecting financial developments in the economy. This is true both when stimulation of additional spending to achieve full utilization of resources is needed or when the problem is to achieve restraint on spending in order to avoid inflation.

Although the direct discipline imposed by the System through control over reserve requirements, the volume of reserves, and discount rates applies only to member banks, its ramifications are felt by nonmember banks, other financial institutions, and the financial markets generally. Federal Reserve member banks, with loans and investments of nearly \$140 billion, account for more than four-fifths of the assets of all commercial banks of the Nation. Control over the rate at which new credit and money are created by this preponderant part of the banking system gives the Federal Reserve System a substantial influence on the total flow of loan funds, which include those of individuals, savings institutions, businesses, and government. It also has a marked influence on liquidity conditions in the economy. The operations of other financial institutions, particularly their ability and willingness to sell United States Government and other securities in order to advance new credit to borrowers, are substantially affected by changes in credit conditions brought about in part by Federal Reserve policies.

As we have pointed out in the past, the fact that reserve requirements of nonmember banks are defined differently, and in many cases are much lower than those of member banks, creates some inequities and problems. These differences in reserve requirements may discourage some banks from seeking or maintaining member bank status. This situation is not new and no simple and practical way of making reserve requirements of nonmember banks consistent with those of member banks has been devised without an extension of Federal banking authority. The problems arising out of the situation are in some ways less pressing now than they were earlier in the postwar period, when the discrepancy between reserve requirements of member and nonmember banks was greater than it is now.

A policy of extending to nonbanking institutions a system of monetary controls analogous to that now applied to member banks by the Federal Reserve, however, would represent a basic and far-reaching departure from the principles that have in the past governed banking legislation and Federal Reserve policies. Commercial banks have special functions that are not presently shared by nonbank financial institutions. Before extending monetary controls over these institutions a careful study should be given to the far-reaching implications of such a departure.

4. Is there any acceptable way of restraining the demand for loans without raising interest rates?

We are not in favor of interest rates any higher than required by the underlying economic realities, but we do not believe that there is any practicable way of preventing them from increasing during those periods in which desired borrowings tend to outrun the flow of savings.

In order to keep interest rates below the level at which the amount of loan funds supplied is equal to the amount demanded, it is necessary to select some classes of potential borrowers and prevent them from borrowing, by law or regulation. Essentially, the problem is one of rationing, and involves many of the same sorts of difficulties and problems that have attended such programs in other areas. In a peacetime economy, there is no acceptable way of administratively determining who is to be permitted to borrow and who is to be forbidden.

Selective credit controls affecting the demand for credit have been used in certain areas where special considerations and conditions made them desirable and workable and are now in use in one area, applying to stock-market credit. The earlier controls over borrowing to buy houses and consumer durable goods were similar in nature. In each of these cases, however, there were special reasons for attempting to control the particular type of credit involved and some rough guides as to what would be reasonable objectives of control. Further, control of this kind was made possible by the special character of the borrowing; namely, that it was related to specific collateral and could be regulated (though imperfectly) by setting minimum downpayments and maximum margins and maturities.

Any attempt to extend similar controls to other types of borrowing, however, would be balked by much greater administrative difficulties and by the problem

of selecting the borrowers to be excluded from the market in a way that is equitable and makes economic sense. Who can say which business borrowers are to be permitted to have credit, and how much, and for what purpose? Which State and local governments are to be able to borrow? Who is to be permitted access to personal loans? An attempt to develop any system of general administrative rationing of credit in an effort to hold down the interest rates paid by those who were permitted to borrow would run into three kinds of difficulties: (1) it would create inequities, (2) it would require placing great power in the hands of the administrators, and (3) it would tend to undermine the flexible and progressive character of our economy. This would make it almost certain that any broad system of administrative rationing of all types of credit across the board would not be effective under peacetime conditions but, rather, would become a force for inflation.

Even from the narrow point of view of its effect upon the level of interest rates, such a policy would be self-defeating. The greatest possible threat to the maintenance of reasonably low interest rates is inflation, and acceptance by the public of the idea that continuing depreciation of the dollar is to be expected. The reason for this is simple. If borrowers expect to repay their debts with dollars that are worth less than those borrowed, they are willing to pay high interest rates. If lenders expect to be repaid in dollars of reduced purchasing power, they will lend only at interest rates that are correspondingly high. Such behavior has been illustrated in the extremely high levels reached by interest rates in countries undergoing inflation. Continued inflation, even if not of extreme proportions, must tend to cause high interest rates.

5. Have you any general suggestions for revision of the present institutional arrangements in the field of money and banking, which would facilitate the use of general credit controls for economic stabilization?

We are not convinced that our present institutional arrangements are altogether satisfactory; nor do we believe that Federal Reserve operations in the past have been entirely successful. Therefore, we will welcome a comprehensive study of our financial institutions and practices by a congressional committee or by a monetary commission and will cooperate in every possible way with such a group. Meanwhile, we do not wish to propose suggestions for broad changes in institutional arrangements or techniques of control in the area of money and banking.

Mr. MARTIN. In the fifth question you say:

Have you any general suggestions for revision of the present institutional arrangements in the field of money and banking, which would facilitate the use of general credit controls for economic stabilization?

I want to state here that the Board of Governors of the System has no complacency or smugness with respect either to its current operations or to the difficulties of the problems confronting us. Our answer to that question I think is important in relation to all the other questions and to the basic problem. We answer it this way:

We are not convinced that our present institutional arrangements are altogether satisfactory; nor do we believe the Federal Reserve operations in the past have been entirely successful. Therefore, we will welcome a comprehensive study of our financial institutions and practices by a congressional committee or by a monetary commission and will cooperate in every possible way with such a group. Meanwhile, we do not wish to propose suggestions for broad changes in institutional arrangements or techniques of control in the area of money and banking.

Chairman PATMAN. I would like to turn to page 2 of your statement, Mr. Martin. You say:

To have permitted more rapid expansion of the bank credit and the money supply would have intensified inflationary pressures already present in the economy. It would not have produced more goods. Rather, it would have increased prices further.

In other places you have mentioned the probable inequalities and injustices that were evident by reason of the high interest policy. I believe you admit in your statement and in the answers to the ques-

tions that the large concerns have an advantage in this policy, that they have connections with the banks and are in a position to get funds, whereas the smaller concerns are not in a position to get funds. Am I correct in that or not?

Mr. MARTIN. I don't think you are quite correct in that, Mr. Patman. What I have tried to say here is an elaboration of what I said in December, that we cannot clearly outline this problem. There are 4¼ million business enterprises. There are bound to be more small businesses affected than large businesses. We have also pointed out that of the 14,000 banks in the country, most of them are small banks. What we have really suggested here is that this is a question concerning which one should not jump to conclusions. Rather, it is a problem calling for further inquiry and study. I myself are not fully convinced that there is any significant discriminatory effect.

Chairman PATMAN. You admit, Mr. Martin, that someone must ration anything that is scarce, and you state that credit is scarce. Who rations that credit?

Mr. MARTIN. That rationing is done by the process of the market.

Chairman PATMAN. Let us state specifically, Is it the bankers or not?

Mr. MARTIN. It is through the banking system that the reserves the country—

Chairman PATMAN. But the truth is that the bankers are the ones that are rationing the credit, is it not?

Mr. MARTIN. The bankers are rationing credit against the force of demand. There was a time when the banks were loaded with money and nobody wanted it. Other financial institutions, are much larger sources of funds than banks and they are also rationing credit against the demand.

Chairman PATMAN. We are not talking about that time. We are talking about this time, when money is scarce. Someone must ration that money and credit. Obviously, the bankers must do it. Don't you think if you are going to have rationing, that the public should be represented in some way so that the smaller concerns will have a fair chance and the people who want to build schools will have a fair opportunity to get money to finance school construction?

Mr. MARTIN. I am unprepared to say that they don't have a fair opportunity at the present time.

Chairman PATMAN. You mention in your statement that the interest rates were increasing. Are you in favor of increasing the interest rates on these school construction funds for local communities and States?

Mr. MARTIN. I am in favor of as low interest rates as it is possible for us to have without producing inflationary pressures, but I don't want the prices of labor and materials in those schools or whatever buildings are being put up to increase in such a way that it costs all of us a part of the purchasing power of our dollar.

Chairman PATMAN. That is a very convincing argument, Mr. Martin, but whenever you analyze and evaluate the situation, the conclusion which you must come to is that the big fellows are getting the credit they want and they are getting the materials they want and the labor they want under this system because money and credit are rationed. In many cases they are directors and officers of the banks

that would make the loans. You say you should not let the little fellows come in because that would cause inflation.

Mr. MARTIN. No, I am saying that the little fellows are not discriminated against exclusively. There are many big fellows who want credit here, too. What I am trying to highlight is that in 1956 roughly half of the increase in that gross national product came from a markup in prices. The whole community loses by that, big and little.

Chairman PATMAN. We are acquainted with that. But your system would just let the big fellows continue to have everything they want for plant and equipment, and the little fellows would not have any opportunity at all.

Mr. MARTIN. No. Small businesses did a lot of financing last year, Mr. Patman.

Chairman PATMAN. But they are paying usurious interest.

Mr. MARTIN. Everybody is paying higher interest rates.

Chairman PATMAN. I know, but you are breaking every usury law in the Nation. You are compelling people to ride roughshod over all the State laws against usury.

Mr. MARTIN. You have information that I don't have if that is a fact.

Chairman PATMAN. I don't see how you can keep from having it because it is certainly true.

You state here on page 4 that investment must be financed out of the savings from current income. Don't you know, Mr. Martin, that this year, 1957, out of the \$40 billion that will be expended for plant and equipment, 70 percent of that money will be in the nature of costless capital from the concerns using it, that is, it is obtained through raising prices to provide for more retained earnings and depreciation. How do you expect small businesses to compete with big concerns that secure so much of their capital for expansion in that way?

Mr. MARTIN. Small businesses are able to retain earnings also. If they can finance in such a way that is fully within their prerogatives.

Chairman PATMAN. Is that your answer to my question? How do you expect small concerns to survive when they are in competition with costless capital? Small concerns cannot fix prices. They cannot engage in manipulating prices. They are not that powerful. But big concerns are. They are getting so much of their capital from the consumers in the form of involuntary investments from the consumers. This contradicts your statement on page 4 which says that investments must be financed out of savings from current income. They are not financed from savings from current income because the consumers are compelled to pay higher prices in order to give the large concerns more investment capital which comes from retained earnings. That consumer, if he were allowed to keep the money that he is paying in extra prices and invest himself in these concerns would get some return on it. He would get the dividends or if he bought bonds he would get interest on the bonds. But as it is, he is compelled to pay it in to the big companies in the form of increased prices. The large companies will use his money and invest in capital expenditures like plant and equipment and returns from that money will come to the concern and stockholders, not to the fellow who involuntarily turned it over. Can't you see in that an evil in our economy, Mr. Martin?

Mr. MARTIN. The working of the market process is the only way that I can see that that can be worked out. I don't see how you

or I can sit by and determine what these corporations, big or little, should do, unless we are prepared to take over their management.

Chairman PATMAN. I will go on to another point, then, since we have limited our time. In talking about inflation, how significant would a 1-point increase at the consumer price level be?

Mr. MARTIN. One point in the consumer price level?

Chairman PATMAN. Would that be very inflationary?

Mr. MARTIN. One point in the consumer price level, Mr. Young tells me, would cost consumers \$2.5 billion.

Chairman PATMAN. All right, 5 points would be how much?

Mr. MARTIN. Five times that much.

Chairman PATMAN. That would be about \$12.5 billion. With the spiral which takes place, that would be almost ruinous; wouldn't it?

Mr. MARTIN. It is certainly something that we don't want to contemplate.

Chairman PATMAN. I want to tell you an interesting fact. The other day when we had before us Mr. Clague from the Bureau of Labor Statistics and Mr. Wells from Agriculture, I asked them to compile for me a statement which would show how much the price level would have increased if farm prices had increased comparable to industrial prices. The statement they prepared is as follows:

REPORT SUBMITTED BY COMMISSIONER EWAN CLAGUE FOR HIMSELF AND MR. WELLS
IN RESPONSE TO QUESTION BY CHAIRMAN PATMAN ON THE EFFECT OF AGRICULTURAL PRICE MOVEMENTS ON THE CONSUMER PRICE INDEX

There are some questions of interpretation involved in making such an estimate. "Industrial prices" may have various meanings. We have, therefore, computed the hypothetical change in the Consumer Price Index in three different ways as follows:

Assuming that the change in food prices during the period was the same as the change in all commodities, except food, included in the Consumer Price Index, the index in December 1956 would have been 118.7, instead of 118, as officially reported by the Bureau.

Second, we have used the changes in prices received by manufacturers, that is, our wholesale price index for all commodities, except farm products and food. This index increased by 6.3 percent during the period in question. Applying this percentage to the food component of the consumer price index we estimate that the index of December 1956 would have been 119.6 as against the actual index of 118. This calculation assumes that the margins between prices received by farmers and those paid by consumers would not have widened as they actually did.

A third estimate is based on the data supplied by Mr. Wells, who has provided another measure of the change in the food component, based on the estimates made by the Department of Agriculture of the change in value to the farmer of their farm food market basket. The farm food value figure for February 1951 was increased by the change in our wholesale price index for all commodities, less farm products and foods. To this figure was added the gross margin estimate for December 1956 as estimated by the Department of Agriculture. This yielded a theoretical current retail value for the farm food market basket. That figure is 14.6 percent higher than the current actual cost to the consumer of that market basket. Applying that 14.6-percent increase to the food component of the consumer price index produces an index of 122.7 in December 1956, or 4 percent higher than the actual index of 118.

Chairman PATMAN. They say if such an increase had occurred, the consumer price index would have increased five points, which, according to your estimate, would have been on the basis of \$12.5 million a year. Of course, actually the consumer price level has been maintained practically on an even keel because as industrial prices went up, farm prices went down, permitting the overall price level

to remain practically unchanged. I have it from these experts then that if the price level had gone up on farm products as it did on industrial prices, it would have been five points higher. That would have been very inflationary, would it not?

Mr. MARTIN. You are pointing up the demand-supply relationships that we previously brought out, and that is one of the reasons we were so concerned when the stability of the price level in late 1955 was maintained only by a decline in farm prices, which offset the rise in industrial prices. That came about from demand-supply relationships. We take no credit for the stability in prices so achieved.

Chairman PATMAN. You should take credit for the farmers' part because high interest is ruining the farmers, Mr. Martin. It is ruining them. Of course it has helped the entire economy because farm prices went down and kept the consumer price index level, but I think the cost to the Nation was tremendous and unjustified.

Mr. MARTIN. The supply-demand relationships for farm output and the farmers' problems have been unfortunate.

Chairman PATMAN. I know, but that doesn't help the farmer much.

Chairman PATMAN. Senator Flanders my time is up.

Senator FLANDERS. Mr. Martin, I will first make a short speech in the form of a question.

Would there be any better way of attaining our chairman's purpose of having expansion financed by new funds from present and would-be stockholders, instead of by retained earnings, than to do away with the double taxation of dividends by not taxing companies on the funds that they distribute in dividends? That is my speech in the form of a question.

Mr. MARTIN. I hadn't thought of it in its tax relationship, but anything which encourages equity capital financing I think is helpful.

Senator FLANDERS. That is my question, Mr. Patman. I hope that if you are interested in that subject you will consider relieving, when we can, business companies of taxes on the profits which they distribute.

Next, Mr. Martin—

Chairman PATMAN. Will the gentleman yield briefly?

I have a bill in on that, Senator.

Senator FLANDERS. May I congratulate you.

Chairman PATMAN. Thank you, sir. I still say it doesn't answer the question. It doesn't justify the large concerns, by reason of size, which take from the consumers more in prices than they should take and thereby confiscate that much investment capital for themselves.

Senator FLANDERS. Sir, I am glad to your your statement on my time.

Chairman PATMAN. Thank you, sir.

Senator FLANDERS. Mr. Martin, is it a simple thing at the same time to have large employment and keep prices under control and avoid inflation? Is that a simple thing to do?

Mr. MARTIN. That is a difficult thing to do.

Senator FLANDERS. Can it be done entirely by the processes which are in your charge?

Mr. MARTIN. I am by no means certain that it can, Senator. That is what I intended to imply in my earlier comment on the general point, because we have here not only money and credit policy when we are concerned with that, but we have the problem of debt management

and fiscal policy, which also have a direct impact. Money and credit policy is only one of the factors which are important. We have never claimed too much for money and credit policy. On the other hand, we think that it is essential to have a money and credit policy which is directed toward leaning against the wind, whichever way it is blowing, so as to give the maximum assistance to these stabilizing forces.

Money and credit policy alone will not do it, but without money and credit policy you will have rampant inflation.

Senator FLANDERS. So you feel a considerable measure of responsibility but do not feel and can't feel completely responsible for controlling inflation under conditions of high employment.

Mr. MARTIN. No; I don't think we should.

Senator FLANDERS. Another question leading into this is the question of consumer credit which Congress at times puts in your care and at other times takes out of your hands.

Have you not just concluded at the President's request an extended study of consumer credit?

Mr. MARTIN. It has not been concluded, Senator. We are in process of concluding a report, as you suggest, which we hope will be available about the middle of March. We are working actively on the study at the present time, putting in nights and weekends trying to complete it.

Senator FLANDERS. Are you prepared to say at this time whether, either as a result of your past experience or of these as yet uncompleted studies, you feel that you should have some control over consumer credit?

Mr. MARTIN. I am not prepared to comment on that until this report is available, Senator.

Senator FLANDERS. Would you be prepared on March 15, to come to some conclusion?

Mr. MARTIN. I won't make a commitment on behalf of the Board as to a date, but I can assure you that the Board is going to do its very best to reach some conclusions as well as to present its study materials.

Senator FLANDERS. Thank you. That is all, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

Mr. Bolling?

Representative BOLLING. Mr. Martin, what segments of the economy are to a substantial degree insulated from the operation of policies which come within the purview of your Board? In other words, what segments of the economy are less affected by the actions of credit restraints in which the Federal Reserve System is involved?

Mr. MARTIN. I think the housing field, for one, is a case where we have had a sheltered operation for some time which has worked in reverse recently. This has happened because the rates which were originally set on FHA and VA loans were at that time fully compatible with the market, but since then they have become incompatible. Recently, FHA and VA mortgage loans have not been able to compete for savings in the market because the limitation on the interest rates they can carry, which started out as a shelter, has become a handicap. I would say that, at all times you can question whether the impact is as great on some areas as others.

We have tried to emphasize here that our influence is immediately on member banks and only indirectly on nonmember banks or other

financial institutions. The bulk of the economy's loanable funds comes from savings of individuals which are channeled through mutual savings banks, savings and loan institutions, insurance companies, and public and private welfare funds and flow into the market from these sources. We don't affect these institutions directly. I am not sure that we should. We affect them indirectly in that if there is an inadequacy of savings and we don't permit the banks to have reserves, then the deficiency in savings is not made up by expansion of bank credit and money through the banking system. In my judgment, if this happened, it would not only endanger the solvency of the banking system but could do nothing but add to inflationary pressures.

Representative BOLLING. What other area besides housing?

Mr. MARTIN. Another area that we previously regulated is the installment credit area. We have no control at the present time over the terms of installment credit. The individual entrepreneur can do pretty much what he wants in that area provided he can get access to overall credit.

Representative BOLLING. What I am trying to get at—I am not at all clear in my own mind—is that it seems to me that what we have done in the past in Congress is to quite literally insulate more than housing from the full effect of monetary and credit restraints. I am not suggesting for a moment that I think it is a bad thing. For example, the activities of the Small Business Administration, whether adequate or inadequate, have had, I don't know whether it is a completely insulating effect, but a modifying effect. Certainly the activities of some of the agencies operating in the farm credit field have had an insulating effect. Would that be accurate?

Mr. MARTIN. I think that is quite accurate, surely.

Representative BOLLING. Are there some others besides these three?

Mr. MARTIN. I think those are the principal areas. The farmer, housing, and installment credit I would say are the three.

Representative BOLLING. So in effect, either deliberately or not deliberately, we have arrived at a system where we have a general approach that when hardship is caused to a particular segment we tend to insulate it, thus making the general approach more difficult of implementation and less likely to total success.

Mr. MARTIN. The area of its impact is limited.

Representative BOLLING. Is it possible to quantify this and say what is the total area of potential impact, what are the quantifications of the areas insulated, what is the backwash, in effect, on the area which is not insulated?

Mr. MARTIN. No; I don't think it is possible to quantify it. I think money and credit policy permeates the operation of the whole credit market, and it is degrees that you are talking about. I don't think you can quantify that.

Representative BOLLING. The reason I ask these questions as you may remember is because I have taken a peculiar position with regard to certain aspects of credit for quite a long time. I think I am the only person on one committee of the Congress who has voted for continuation of regulation W. This grows out of my concern for the necessity of developing what would seem to me a more flexible instrument. As I have been thinking about it over the years it occurs to me that the instrument has turned out to be more flexible than I

had at first realized. I am not at all clear in my own mind yet that it is sufficiently flexible when we move from the purely economic into a slightly different field which is certainly a legitimate field for the Congress to consider, and that is the decisions involved as to allocation.

I am profoundly disturbed by the fact that although we have a very large level of school construction today, one of the reasons Congress is being urged to pass a school construction bill, and quite properly so, grows out of the fact that this particular area is not much insulated against general restraints. It seems to me that we have a situation where we press down the balloon here and it pops up there. Our answer appears to be to have a compensating Federal subsidy. I just wonder whether in the long range this is the only way we can meet this set of problems.

Mr. MARTIN. Let's look at it this way, from the overall point of view. You have only a given pool of credit. If you want to give more credit to a specific sector of the economy without having price instability created, then by taxation or by some other means you will have to make credit less available to other areas of the economy. We cannot, just by credit, increase the size of the pool. There is only so much at a given time. The time element works to increase it. At times, I have used the simile of the river. You are trying to have a flow of money and credit through the economy that will not overflow either side of the river and flood the fields of business and commerce. You cannot have an increase in the flow until the riverbed is sufficiently large to retain it.

We don't want too little credit flowing at any time in that riverbed, but the problem we are facing now in terms of priorities, you see, is that there is too much demand for the ample flow of credit that is there; hence, we have the question of some borrowers being excluded from access to the stream.

Representative BOLLING. I see that very well, Mr. Martin, but the thing that disturbs me is that the argument which is usually made for general credit approaches is that it is impersonal. Yet it seems to me that if one follows through the thought that you suggest with regard to taxation then we get very personal. The solution of restraining expansion in this area by heavier taxation requires a very selective set of decisions. It seems to me that we come back around to this business of sort of individual type administrative decision.

Mr. MARTIN. It is impersonal until the Congress decides that in terms of the greatest good for the community a decision to alter the course of the market is desirable.

Representative BOLLING. That is all, Mr. Chairman.

Chairman PATMAN. Dr. Talle.

Representative TALLE. Thank you, Mr. Chairman.

I thought today's chuckle in the Washington Post was a good one. It said the only reason why a lot of people don't buy a yoke of oxen is that nobody has offered them a yoke of oxen for a dollar down and a dollar a week. I think there is some truth in that. It certainly points up an interesting aspect of human behavior in the market place.

My learned friend Senator Flanders, who sits to my left, good scholar that he is, remembers the proverb from the Romans which says, "De gustibus non disputandum," which, simply translated, means that there must be no argument about tastes.

Don't you think, Mr. Martin, our principal trouble is that we are trying to do too many big things in a short time?

Mr. MARTIN. I agree.

Representative TALLE. The customary business cycle curve that you find in textbooks—I think the mathematician calls it a sine curve—depicts four phases. You have the rising curve, the crest, the dip down, and then the valley of despair. If we could cut the crest off and fill up the valley, we would move more nearly along a horizontal line, and business could be conducted with a little less worry, I believe.

Looking at our present situation, aren't we pretty close to the top of that curve? We are moving at such a rapid rate.

Mr. MARTIN. We have had intense utilization of resources through most of 1956 and that is certainly true at the start of 1957.

Representative TALLE. Picking up your point about 1956, I think you are entirely right. We have come as close to full employment as any nation could hope for; don't you think?

Mr. MARTIN. We certainly have a high level of employment.

Representative TALLE. For a good many years there have been periods of great scarcity of such materials as cement. A few days ago a subcommittee of the Senate conducted a hearing on steel. These are two materials which are used so much in construction. It seems to me that we have full employment and we have pretty full utilization of materials. The third item you need for construction is money. If the cost of the other two have gone up, it would seem only reasonable that the cost of money necessarily would have to go up, keeping in mind the functions that are performed by money in our economy.

Since we are at that point, if a certain entrepreneur wants to expand his production he would have to entice labor and materials from other entrepreneurs; wouldn't he?

Mr. MARTIN. That is correct.

Representative TALLE. The same would be true if a new person came into the picture. He would have to entice labor and materials from other entrepreneurs. The only way in which he could do that would be to pay more. As others are obliged to cut down, this new person would produce some units, but with no increase in total production. If there were no new person in the picture, the other producers would simply produce the units they had produced before but at a higher price. So there is no gain insofar as units of production are concerned. The only thing which has happened is that the consumer pays more per unit.

Therefore, it seems that we should take stock, because the time to be careful is before you get up to the crest of the sine curve and tumble down. The exercise of restraint at the proper time can prevent severe deflation as well as severe inflation.

I agree with your statement, Mr. Martin. I think it is very well done, very well presented. I congratulate you on good performance in your important post.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Mills.

Representative MILLS. Mr. Martin, we are constantly told by witnesses before this committee that if we have a proper fiscal policy and a proper monetary policy we can minimize inflationary pressures which may exist at a given time. Do you agree with that?

Mr. MARTIN. I certainly agree that it would minimize them; yes, sir.

Representative MILLS. I think I understand who it is that formulates fiscal policy. The administration, the President, the Congress determine pretty well what fiscal policies are to be at a given time by the appropriation of funds, the expenditure of money, the collecting of revenues for governmental purposes. When we are in balance and have a surplus in inflationary times we say that is good fiscal policy; do we not?

Mr. MARTIN. We do.

Representative MILLS. I have been somewhat perplexed, however, as to who it is in the Government who formulates monetary policy. Can you enlighten me as to who does determine monetary policy?

Mr. MARTIN. I think that is the primary responsibility and purpose of the Federal Reserve System.

Representative MILLS. The Federal Reserve Board has that as its primary function?

Mr. MARTIN. That is right.

Representative MILLS. Does the Federal Reserve, as a matter of fact, formulate and carry out monetary policy? I am asking these questions for the record.

Mr. MARTIN. Yes; it does so.

Mr. MILLS. You say in your statement on page 4:

Notwithstanding the combined influence of restraint on credit expansion and the realization of a substantial cash surplus in the Federal budget, prices of goods and service moved upward in 1956.

Does that mean that we did not have either proper fiscal policy in 1956 or adequate monetary policy in 1956?

Mr. MARTIN. I think we probably were a little bit deficient in both.

Representative MILLS. What were the reasons for the deficiency in monetary policy? I think I understand the reasons for deficiency in fiscal policy.

Mr. MARTIN. Human judgment. We sit as a board and put our best attention to these problems. We have a deliberative body of seven members of the Board. Then, we have the Federal Open Market Committee, the membership of which consists of the members of the Board and 5 of the 12 presidents of the Reserve banks. We are constantly reviewing the economic situation and trying to arrive at a concensus with regard to Federal Reserve policy. We are a fallible group. Sometimes we are not accurate and precise in our judgments as we should be, but we do the best we can.

Representative MILLS. Would your judgment have been influenced in 1956 by such statements as those made by the former Chairman of the President's Council of Economic Advisers, Dr. Arthur F. Burns, before the National Federation of Financial Analysts in Boston, in which, speaking on the subject, Some Observations on the Problems of Inflation, he stressed the relative stability of prices in recent years and played down the danger that the rapid rise in wholesale prices then evident might find a way through to the retail level? Would that have had some bearing on the judgment of the Federal Reserve with respect to what monetary policy to follow in 1956?

Mr. MARTIN. Not only his views but the views of every other qualified observer; they are always considered and discussed by our Board and carefully assessed.

Representative MILLS. The President in his Economic Report, apparently is referring to our recent experience when he makes this statement:

In the face of a continuous upward pressure on costs and prices, moderate restraints would not be sufficient.

Would you characterize the restraints and monetary policy which were in effect in 1956 as being moderate?

Mr. MARTIN. Yes; I would say they were moderate.

Representative MILLS. I know you don't want to speak with respect to the future and I will not ask you any questions with respect to the future. Then part of the increase in prices which occurred in 1956 may well have resulted from miscalculations and faulty judgment with respect to the establishment of monetary policy in 1956?

Mr. MARTIN. That may have been one of the factors, always stressing the point that that is only one of the factors in the picture. That may have been one of the factors.

Representative MILLS. I am not being critical because I might very well have done the same thing you did in your position had I had all the information you had at the time.

Mr. MARTIN. I am not trying to duck the question, either. I am just trying to qualify it.

Representative MILLS. I know there is a lot of guesswork involved in the establishment of monetary policy. I realize that. I want to emphasize that point this morning. It is not always foolproof and cannot always accomplish the results that are indicated when we look back at what was needed, isn't that true?

Mr. MARTIN. That is certainly correct.

Representative MILLS. Then can we conclude that it is not safe to rely on monetary policy in the future as a controlling influence in minimizing inflationary pressures?

Mr. MARTIN. As the only control in minimizing inflationary pressures it definitely is not safe to count on monetary policy, but it is an indispensable element in the picture. Unless there is an effective money and credit policy directed to preserving the purchasing power of the dollar, you will be in continuous trouble.

Representative MILLS. I am certain that you are aware of the speech which was made last night by a distinguished American, former President of the United States, Mr. Herbert Hoover, in which he referred to the future dangers involved in present or increasing inflationary trends. As a self-confessed experiencer of hair-curling, I think we should not treat lightly the things that he said. If we do not have the ability through monetary policy to control these situations, then are you suggesting that we strengthen fiscal policy to do more in the way of control of the pressure?

Mr. MARTIN. I am suggesting that it requires all of our efforts to face up to the problem. I did not read Mr. Hoover's address and I saw only a leadline on it in the paper, but I have said before this committee and I reiterate that we can have depressions and recessions and that there are certain guiding principles that we have to deal with. If we think the Government is powerful enough to elimi-

nate these weaknesses in human nature and conduct, then I believe we are fooling ourselves. I think what we must do here is to recognize what our objectives and purposes are.

Not to make a speech on this, but the goals of the Employment Act of 1946, which all of us are for, in my judgment can only be attained under the postwar conditions of growing population and more complex technology, by resisting inflation. The problem has not been to create jobs. The problem has been to sustain jobs. To sustain jobs, we must keep a moderation in the economy so that we will not have excesses. If we permit excesses, then when an inevitable correction comes, there will be 2 people unemployed whereas there would be only 1 person unemployed if we had maintained moderation and had not had a preceding inflation.

Representative MILLS. Let me approach this in this way: You say that we miscalculated in 1956—

Mr. MARTIN. No, no. We didn't entirely miscalculate. We are talking about a degree.

Representative MILLS. I understand. To a degree we miscalculated.

Mr. MARTIN. We were not perfect in 1956.

Representative MILLS. I say I am not criticizing.

Mr. MARTIN. I understand.

Representative MILLS. Now we have had the opportunity to see what transpired in 1956 and we now know more about what we should have done in 1956. If we had it to go through again would you think that there should be stronger restraints in monetary policy?

Mr. MARTIN. If we had the whole period to go through again, I think I would be inclined toward having a little bit more restriction in monetary policy from the latter part of 1954 to date. If we had been more restrictive, we would have had more influence, not that monetary and credit policy is the only thing, but it would have been a more stabilizing influence on the economy.

Representative MILLS. Yet the President said in his economic report following the language I just read:

Yet stronger restraints would bear with undue severity on sectors of the economy having little if any responsibility for the movement toward a higher cost-price level and would court the risk of being excessively restrictive for the economy generally.

Mr. MARTIN. I am not going to quarrel with that statement, Mr. Mills, but I want to reiterate my earlier position, which is that one of the reasons why I think a basic restudy of this subject is required, is that I am not at all certain that that is correct.

Representative MILLS. The matter about which I have been primarily concerned—and I want to come back to this in just a moment—is the subject you direct yourself to on page 5, the second sentence on that page:

Even though many components may be unstable, the total economy can still experience an upward trend in production and employment with a horizontal trend in average prices.

Do you mean to say it is possible for us to have maximum growth in employment and have a horizontal trend in average prices all at the same time?

Mr. MARTIN. It is my conviction that prosperity and stability go hand in hand, stability and prices.

Representative MILLS. Just tell me, now, do you mean to say that we can have maximum growth in employment and a horizontal trend in average prices at the same time?

Mr. MARTIN. A relatively horizontal trend, yes, not a precise horizontal level.

Representative MILLS. Fairly stable prices?

Mr. MARTIN. That is right. Yes, sir; I believe that.

Representative MILLS. So the two, then, are not inconsistent; is that correct? You can have this maximum increase in employment and have stable prices.

Mr. MARTIN. That is my conviction.

Representative MILLS. We want this maximum increase in employment. Are we, then, willing to incur the sacrifices which are involved in assuring stability in prices? That is the big problem; isn't it?

Mr. MARTIN. That is the big problem.

Representative MILLS. We do have to make some sacrifices in order to have both.

Mr. MARTIN. We do indeed.

Representative MILLS. It is that point that you discuss when you say that people themselves must assume responsibilities or the President suggests that the people themselves must assume some responsibilities. It has to do with that point, do you think?

Mr. MARTIN. Everybody has to play a part in it.

Representative MILLS. What can we in the Congress do to bring about greater understanding of these necessities and what progress could we have in Congress which would result in recognition of these responsibilities to a greater extent for the accomplishment of this goal?

Mr. MARTIN. I would not presume to go into all of the programs of the Congress, but I would say that any emphasis which is put on the desirability of maintaining stability and the fact that prices have to be paid for certain things is of great value. Let us take this matter of debt. In the last few years we have had a glorification of debt which I think is a mistake. Debt has a legitimate place to play in the economy. Short-term liquidating debt is all right, but we have gotten the idea, which has been increasingly spread about, that you are doing a service to everybody if you go in debt and the deeper you get in debt the better off you are. We are everywhere carrying debt, including installment debt, to the extreme. We advertise that it is a wonderful thing to take a trip to Europe and pay later. I am not saying it is wrong. I don't know. But I say let us try to keep to basic principles, because if we don't, we know that at some time these deviations from basic principles will come back to plague us.

Representative MILLS. Just this one final question on this point. I am sorry to go over my time but this is what I was leading up to. Do we make your job easier or more difficult as you labor to try to minimize inflationary trends by appropriating 71 to 73 billion dollars?

Mr. MARTIN. You make our job more difficult.

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. Mr. Martin, first I want to add my personal tribute to your statement and also to the job you have been doing in your capacity as head of the Federal Reserve System. I am per-

fectly willing to go along with that as one who is in politics, and I have in the past.

There is one aspect of your statement, though, and of the policy in the past which is not quite clear to me. I hope I can bring it out.

First of all, I distinguish in my own mind a very definite difference between the consumer dollar and the investment dollar. You recognize such a distinction—a dollar which is used for consumption as opposed to a dollar which would go into investment.

Mr. MARTIN. Yes, I do.

Representative CURTIS. Is our so-called tight money situation in the consumer dollar area or in the investment dollar area or is it in both?

Mr. MARTIN. It is in the investment dollar area primarily. It is the desire to increase plant and equipment expenditures in some instances through bank credit or through borrowing which cannot be covered by savings.

Representative CURTIS. That has been my interpretation and what I have heard. Actually we don't have much of a tightness in the consumer credit field but it is in the investment area. This is where it seems to me to be a little inconsistent. If the tightness is in the investment area for plant and equipment, essentially enlarging our plant and equipment is going to increase our productivity, which in turn is the basic way of combating inflationary trends; is it not?

Mr. MARTIN. Yes, and it is all a matter of time, Mr. Curtis. The part that I am trying to emphasize here is that if we don't go too fast on this, the savings are accumulating. We had an increase in savings in 1956, but not sufficient to provide as rapidly as people wanted the plant and equipment expansion.

Representative CURTIS. I have posed this question to other witnesses. It is not completely the job of increasing our plant and equipment so much as it is replacing it with reserve funds based upon the preinflationary dollar and replacing it with the inflated dollar.

Mr. MARTIN. That is correct.

Representative CURTIS. So there is an added need for capital just to replace?

Mr. MARTIN. There is no doubt of that.

Representative CURTIS. In certain areas where we have created this need for additional plant and equipment through congressional action—for instance, the big highway program, our encouragement to home building, the upper Colorado project where cement and other building materials are in great demand—it would seem that we do need to increase our productive plant in these areas.

This is the question: There is no way that the Federal Reserve can allocate as between types of investment; is that a correct statement?

Mr. MARTIN. No, we can't allocate as between types of investment, and the very problem which you are raising is one of the reasons why we have made our errors, if we have made them, on the side of ease.

Representative CURTIS. Because you would hope that possibly it might go into this kind of—

Mr. MARTIN. Exactly. We have not at any time wanted a credit-worthy borrower to be denied credit because of stringency.

Representative CURTIS. One of the witnesses before our committee when I posed this line of questioning said he thought instead of the Government trying to allocate, the best thing that could happen

would be to pay off on the Federal debt because that would immediately release investment type money to be used in these other areas. Would you tend to agree with that?

Mr. MARTIN. A further budget surplus would have been equally helpful to us last year.

Representative CURTIS. In other words, that is investment money which could be used to take care of these demands in the private enterprise field?

Mr. MARTIN. That is right.

Representative CURTIS. One other line of questioning: What would you say the effect of the monetary policy during the last 2 years has been on the composition of corporate security offerings?

For instance, how did the rising yield on corporate bonds affect the choice as between equity and debt financing?

Mr. MARTIN. It is difficult to say, but there has been an increase in stock issues almost steadily over the period.

Representative CURTIS. It is an interesting thing that with the yields increasing on bonds and borrowing, equity issues should increase.

Mr. MARTIN. That is for new financing.

Representative CURTIS. That is right, for new financing. How do you explain that?

Mr. MARTIN. There was of course, a tendency for people to do debt financing when they could do it on a cheaper basis than equity financing.

Representative CURTIS. In other words, what I think you are suggesting, and what I have seen at any rate, is that some corporations, particularly small ones, instead of financing through equity, which would be the normal way, got it through the banks. That is one place where they are having their difficulties because the banks now are cutting out that kind of financing.

Mr. MARTIN. That is a matter which has disturbed us. In some instances, there was imprudence on the part of our corporate treasuries with respect to their financing and they too often resorted to short-term bank credit for what were long-term purposes.

Representative CURTIS. This is just a remark of my own. I remember that back in 1954 we, through a change in our tax structure, the corporate dividend tax credit, tried to channel more funds and investment capital into equity kind of financing. Incidentally, in my judgment had we been completely successful we would have increased the capital take of the Federal Government. There has been no further development along those lines in our tax structure to encourage equity financing. I said I was going to make that statement, but I would appreciate any comment that you would like to make on that.

Mr. MARTIN. I think an increase in equity financing would be helpful.

Representative CURTIS. Thank you, Mr. Martin.

That is all, Mr. Chairman.

Chairman PATMAN. Mr. Kilburn.

Representative KILBURN. Mr. Martin, it is always a pleasure to hear you testify. This is one of the best statements that I have seen and I agree with it.

A couple of things have been brought up. In the first place, in your policy on tight money don't you try to follow the law of supply and demand on credit?

Mr. MARTIN. We do indeed.

Representative KILBURN. So your policy doesn't make tight credit. Tight credit has been made by the law of supply and demand.

Mr. MARTIN. That is correct.

Representative KILBURN. Several things have been said about rationing credit. There has been some suggestion that of a sinister influence at work here, that the banks lend to their friends and turn down people whom they don't like. Do you not think that a bank makes a loan which has the greatest advantage to it, and many considerations are involved such as compensating balances, the risk involved, the credit standing, and even the history of the company. If the company has been an old concern and the bank considering the loan is their regular bank and they need some money, the bank will take care of them instead of taking on a new customer. Isn't that right?

Mr. MARTIN. If they don't operate within that framework, they will be in trouble before too long.

Representative KILBURN. Another thing. The small banks of the country don't own the big corporations. They don't make bank loans to big corporations. They take care of their own immediate vicinity and their own customers. Isn't that right?

Mr. MARTIN. That is right, and I developed that in this answer, Mr. Kilburn. When you get a chance to read it I think you will see that.

Representative KILBURN. So the small banks of the country by and large take care of small business and the big banks take care of big business. I know of cases where big New York banks come up and solicit customers of the little banks in my hometown trying to make some little loans.

So I doubt if there is anything to this statement that the banks ration credit. They give credit where they can get the best deal with their own customers. Isn't that about correct?

Mr. MARTIN. That is the way they should, yes, sir.

Representative KILBURN. There is one other question I would like to ask you. If a big corporation wants a long-term loan to build an additional plant or for some other purpose, they sell their own bonds to the public. That money doesn't come out of the banks. It comes from the public, who use their savings to supply the money. But a little fellow who wants to build an addition to his plant which will cost \$50,000 can't go out and sell bonds. He has to depend on his bank. So my guess would be that the banks have gone farther in supplying needed money to small business than the banks have gone in supplying needed money to big business. Would you comment on that?

Mr. MARTIN. I am uncertain, Mr. Kilburn. That is one of the things we are trying to collect all the data on. I think a very good case could be made in that direction. I do think there are some instances where banks have not always been as wise as they should be. That is because of the human element in administrative processes. I don't think we should draw blanket conclusions, but I certainly am

unprepared to accept the thesis that the little man has been discriminated against willfully or in general.

Representative KILBURN. On the question of retained earnings, there has been the implication that any firm which retained its earnings instead of distributing them in dividends is taking them out of the consumer. I can't understand that at all because again the law of supply and demand is what really fixes the prices. Any concern it seems to me would want to build up a surplus if they feel that in the future that when the time comes for that expansion they want to expand so they have money enough to make it. The same thing is true of a bank itself. If a bank's deposits have gone up and their capital is not at a high enough ratio to deposits, then it cannot pay dividends but must put more in surplus.

In other words, I thought your answer about rationing credit and retaining earnings was perfect when you said the only way we can do it is for the Government to take over the management of those companies.

That is all, Mr. Chairman.

Chairman PATMAN. Mr. Martin, you mentioned in your statement something which is very timely about the selection of a congressional committee or a monetary commission to study monetary problems. You state, of course, that you would be glad to cooperate.

Of course you are promising your cooperation with a commission which is set up by Congress. In other words, whether it is a congressional committee or a monetary commission. But your promise of cooperation doesn't go to a commission which is not selected by Congress, does it?

Mr. MARTIN. We would be glad to cooperate with any responsible group that will endeavor to throw light on this problem.

Chairman PATMAN. Suppose that someone in the executive branch set up a group and said "This is a monetary commission and we want you to cooperate," would you feel inclined to cooperate with them?

Mr. MARTIN. I certainly would.

Chairman PATMAN. How do you reconcile that with the fact that you are always so careful that you can't deal with anybody and give out any information unless it is allowed by Congress? You feel that you are an agency of Congress, and here you say that you would give this information to people outside of those recognized by Congress for that purpose.

Mr. MARTIN. This isn't information. This is an inquiry into—

Chairman PATMAN. It would logically lead to information.

Mr. MARTIN. We want to cooperate with anyone. If the Congress forbade us, if the commission were set up and the Congress adopted a measure forbidding the Federal Reserve as its agents to cooperate with them, we would certainly abide by that decision. We recognize our responsibility to Congress and the status which you have placed us in.

Chairman PATMAN. May I invite your attention to the fact that tomorrow morning before the House Rules Committee a hearing will begin to determine whether or not the House will set up its own committee to study this problem. It is, you see, very timely now. It is also timely, I think, to mention that in April 1949 there was introduced in the Senate by Mr. Maybank, for himself and Mr. Tobey, a bill pro-

viding for the establishment of a National Monetary Commission. In that Commission the membership was to be composed of 18 members. Six of them would be appointed by the President, 3 from the executive branch of the Government, 3 from private life. Six would be appointed by the Speaker of the House of Representatives, 3 from the House of Representatives and 3 from private life. That is a proposal which was pending in 1950, during that Congress.

Senator Douglas had a subcommittee of the Joint Committee on the Economic Report, on monetary, credit and fiscal policies in 1950. I was on that committee. There is one section of the report of that subcommittee that we all agreed to. It is about a comprehensive study of money and credit in which we said :

We recommend that the Joint Committee on Economic Report as well as the Banking and Currency Committees of the Senate and of the House of Representatives continue a fair and complete study of the monetary and credit systems and policies of the United States and that they be provided with funds adequate for the purpose.

2. We recommend that S. 1559, which would provide for the establishment of a National Monetary Commission, be not enacted.

I want to read the reasons that were given because I think they are excellent. Possibly others don't think so, but I think so.

We therefore recommend that the Banking and Currency Committees of the two Houses of Congress and the Joint Committee on Economic Report be given adequate funds for the purpose and that they be requested to make a comprehensive study of the monetary and credit systems and policies of the United States. We believe it important that the study be made by a committee composed exclusively of Members of Congress, rather than, as provided in S. 1559, by a mixed commission composed of Members of Congress, members of the executive department, and members drawn from private life. The study should draw upon the information, judgment, and points of view of people both within and outside the Government. For this purpose the investigating committee should engage experts to make fair studies and reports on various phases of the problem and to invite presentations from all who can be helpful; but the committee that receives the information, weighs it, form judgments about it, and submits reports concerning it to Congress should be composed exclusively of Members of Congress, for only in this way can the study contribute a maximum to congressional understanding of all these complex problems.

* * * Congress should not abandon its function of legislation and, to legislate wisely, it must fully understand the reasons for its legislation. It should not be put in a position of accepting on faith the recommendations made by private citizens, without knowing thoroughly the facts and reasoning that led to those recommendations. There is no substitute for fair congressional investigations and hearings.

I thought it would be well to put that in the record in connection with that matter.

The committee I think has generally understood that there should be some setup whereby all these questions should be looked into. I assume that something will be done. I don't know when it will be done but I hope it will be done by congressional committees because, after all, the people elected the Members of Congress, 435 in the House and 96 Senators to represent them in the legislative branch. I just have the feeling that since the Constitution of the United States specifically delegates that particular power to the legislative branch, the legislative branch should keep hold of it and act in conformity with the recommendations of this report, which incidentally was signed by two men whom I greatly admire and with whom I have worked, members of the opposite party, Senator Flanders, of Ver-

mont, and Congressman Jesse P. Wolcott, of Michigan. They subscribed to this report, too.

Mr. Martin, you stated a while ago in answer to Mr. Kilburn's comment about supply and demand that the law of supply and demand determined the availability of credit. There are certain times in our history at which we have had to abandon the law of supply and demand, of course, and that is to fight depressions and wars. We would never have been able to fight and win World War II if we had stayed with the law of supply and demand, would we, Mr. Martin?

Mr. MARTIN. We can't abolish the law of supply and demand, but by legislative decision we can take measures which will alter the course of supply and demand. We are not eliminating the law of supply and demand. We are just permitting it to operate or vitiating its operation in accord—

Chairman PATMAN. With the particular purpose or emergency.

A while back I read about General Motors having about 10,000 small concerns from which it purchased supplies. Possibly the number is too large or too small. It is not too important in the illustration which I shall attempt to make.

Here is the situation that those concerns were in with a tight money policy. They were all thriving concerns but every one of them was captive of General Motors. If the General Motors representative thinks a certain concern is charging too much and that representative can say, "If you don't submit to our terms General Motors will go ahead and plan to do this itself," because General Motors can get the money. The tight money policy doesn't apply to General Motors. General Motors can get plenty of money. They are connected with banks, insurance companies, all types of companies where money is available, and they have no trouble.

I have recently received from banks the information that large concerns are taking advantage of this situation to the extent that they are abandoning certain small concerns which they do not feel cooperate or for any reason whatever, and putting in their own plants to do the same work. Can't you see Mr. Martin, that a tight money policy works to the great disadvantage of small concerns and in the interest of the large concerns?

Mr. MARTIN. I deplore any such instances if they occur, Mr. Patman, but if you didn't do it by a monetary approach you would have to cope with the problem some other way. I question very seriously whether money has played any part in the sort of practices that you are suggesting.

Chairman PATMAN. How can you say that when a big man can get it and a little man can't.

Mr. MARTIN. I merely say respectfully that I am unconvinced on that issue.

Chairman PATMAN. You are just expressing the hope and deplore it.

Senator WATKINS. It is difficult to hear you over here. I thought you said you didn't agree with the chairman, is that correct?

Mr. MARTIN. That is correct. I said I was unconvinced.

Senator WATKINS. I join in that. I don't agree with him, either.

Chairman PATMAN. In what respect?

Senator WATKINS. He said he didn't agree with the statement you made.

Chairman PATMAN. What part of the statement is it that you don't agree with?

Mr. MARTIN. I said I was unconvinced that the big man was getting the money and the little man wasn't.

Chairman PATMAN. You are not convinced of that, Mr. Martin?

Mr. MARTIN. No, sir; I am not.

Chairman PATMAN. You are not a naive person, I know. You are a very astute person. I recognize that. I just can't understand how you can say that. In answer to some of these questions I think you said something about recognizing that the big man has an advantage. I will try to look it up while the other members are questioning.

Senator Watkins has just come in and I think we ought to call on him.

Senator WATKINS. I haven't heard the testimony or discussion, and I have not had time to read it, so I am not really in a position to ask very many questions. I will listen a while and then ask some.

Chairman PATMAN. When you want recognition you will get it because you are next in line.

Senator WATKINS. Thank you. I will pass for now.

Chairman PATMAN. Dr. Talle.

Representative TALLE. I want to express appreciation to you, Mr. Martin, and the Board of Governors of the Federal Reserve for the good work that was done by the task forces that the System supplied following the hearings on economic statistics which were held in July of 1955. A lot of good work was done by those task forces.

According to my information, the Federal Reserve has been designated by the Bureau of the Budget to coordinate savings statistics. Am I correct in that?

Mr. MARTIN. That is correct, Mr. Talle.

Representative TALLE. I am very glad to know that, and I know that good service will be performed.

Mr. MARTIN. May I say that we ourselves benefited greatly from those studies and were very glad to have an opportunity to work on them.

Representative TALLE. I am delighted to know that the studies proved to be mutually advantageous.

I would like to look at savings for just a moment. There are two sides to that coin. The fact that the interest paid on savings has gone up quite a little in not so many months will tend, will it not, to increase the supply of loanable funds?

Mr. MARTIN. Over a period of time, I am confident that it will.

Representative TALLE. That process cannot be quick, because so many savers are small savers. But, given time, certainly the quantity of funds will be increased, so the reservoir will fill up, although it has been drained down pretty low by intensive demand.

There is another thing we should look at. People who live off pensions are served well by a stable dollar; are they not?

Mr. MARTIN. Yes.

Representative TALLE. The same is true of people who live off annuities, social security payments, people who have insurance policies, people who have savings-bank accounts, and like investments. When we add them all together, it just about includes all of the American people. Reducing the value of the dollar takes something away from

these people who were given to understand that these were good accounts and they could rely on them.

I remember as treasurer of a little college, before I came to Congress, I was very much disappointed in the yield that accrued from an endowment fund. I think the treasurer of every other college is still disappointed in what he can get from endowment funds. If the colleges got more from their endowment funds, they would not need to come to Congress and ask for quite so much money in loans for the purpose of constructing college dormitories. But that is quite a business now in the Housing and Home Finance Agency.

On the other hand, if small businesses were allowed to retain more of what they make as profits instead of paying it out in taxes, they would not need to go to the Small Business Administration to borrow funds which they, themselves, had helped to put there.

We cannot do anything about some of these matters quickly. You point out very well here that savings is a coin of two sides. I happen to be one who is paying interest, and not eager to pay more than I have to. But there is another side, too. There are a lot of people who gain something from the interest that is paid. As I did yesterday, I would like to put in a plug for encouraging the habit of saving. I think that the E-bond program has been a wonderful vehicle for doing precisely that.

If I have a little time, I would like to pose this question: There would be some saving if no interest were paid, would there not?

Mr. MARTIN. There would.

Representative TALLE. Saving for education?

Mr. MARTIN. Right.

Representative TALLE. Saving for travel?

Mr. MARTIN. Right.

Representative TALLE. Saving for a rainy day?

Mr. MARTIN. Right.

Representative TALLE. But, beyond a certain point, consumption now is preferable to waiting a year or 2 or 10 or so on. That means there is a waiting period, and the fellow who waits is not going to do it unless he gets paid for that waiting. Therefore, interest is a price and, like other prices, determined by supply and demand. As for the law of supply and demand, it is an economic law that works all the time, but the conditions back of supply can be changed and the conditions back of demand can be changed. The result is one thing under conditions of free competition and quite another under conditions of monopoly. We can interfere with its operation, but do you not agree that it works all the time?

Mr. MARTIN. I agree that it works all the time. It is inexorable.

Representative TALLE. Thank you, sir.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Bolling?

Representative BOLLING. Mr. Chairman, reference was made to a speech by Chairman Burns, former Chairman of the Council of Economic Advisors. In view of that, and in view of the proper emphasis in these hearings on inflationary trends, it is particularly interesting to look again at two documents.

Members of this committee received a staff memorandum on April 18, 1956, the date that the April Economic Indicators were released.

This memorandum characterized the economic situation as inflationary, and suggested the implications of this for Federal policy. The memorandum followed up and strengthened points made in the staff materials submitted earlier in connection with the committee's annual report.

By way of contrast, a month later, on May 31, 1956, Chairman Arthur F. Burns, of the Council of Economic Advisers, made a speech before the National Federation of Financial Analysts Societies in Boston, Mass., entitled "Some Observations on the Problem of Inflation." Dr. Burns stressed the relative stability of prices in recent years. He played down the danger that the rapid rise in wholesale prices then evident might find a way through to the retail level.

I would to have these two documents inserted in the record at the appropriate point to present the contrast between the accuracy of the advice the committee received from its own staff compared with what was then emanating from the Chairman of the Council of Economic Advisers.

Chairman PATMAN. Without objection, that will be done.
(Documents referred to follow:)

CONGRESS OF THE UNITED STATES
JOINT COMMITTEE ON THE ECONOMIC REPORT
MEMORANDUM APRIL 18, 1956

To: Members of the Joint Committee on the Economic Report.
From: Grover W. Ensley, Executive Director.
Subject: The Economic Situation and Outlook.

Attached is a summary of the economic situation and outlook prepared by the committee staff on the basis of information contained in Economic Indicators for April, released today, and other information received by the staff.

We have also ventured to suggested the implications of this outlook for Federal economic policy.

THE ECONOMIC SITUATION AND OUTLOOK

I. ANOTHER LOOK AT 1956

The first quarter has been marked by continued indications of economic strength. Other trends indicate instability.

A. Total output and employment

With output pressing against capacity in many industries and unemployment close to a minimum, changes in production and employment have been small in the first quarter:

(1) Gross national product, according to preliminary estimates, rose \$1.7 billion from the fourth quarter level to \$399 billion. Much of this increase represented higher prices.

(2) The index of industrial production averaged slightly under the fourth quarter.

(3) Changes in employment and unemployment since last October have represented mainly the usual seasonal movements.

B. Business investment

Business expenditures for new plant and equipment, according to the recent Commerce-SEC survey, are scheduled to reach about \$35 billion in 1956, some \$2 billion more than plans for this year reported in the McGraw-Hill survey of last November, and 22 percent or \$6.2 billion more than in 1955. Considered together the annual and quarterly statistics imply a further, though slower, rise in the second half. About half of the \$2 billion increase over earlier plans may be offset by less construction expenditures than previously expected, principally for housing.

C. Sales, inventories, and new orders

(1) Total business sales have fluctuated within a narrow range since late 1955.

(2) Business inventories reached \$83.5 billion in February, some 8.6 percent above the low of January 1955. With sales leveling out, ratios of inventories to sales have risen in recent months though, in some lines, are still below those prevailing in early 1953. Much of the rise in the value of inventories recently reflects price increases. Trade reports indicate rising steel inventories in anticipation of price increases or work stoppages. Some further rise in total business inventories seems probable although the automobile industry in March, according to press report, brought its inventories down slightly by holding output below sales.

(3) New orders received by manufacturers have continued to exceed shipments, although the trend from December through February was somewhat lower (February about 5 percent below December), reducing the excess of new orders over shipments each month from about 7 percent to about 2 percent.

D. Incomes and prices

(1) Wages continue to rise. Average hourly earnings in manufacturing rose sharply in March, especially in the industries affected by the new minimum wage. The new high of \$1.95 per hour was 5.4 percent above a year ago. Therefore, in spite of a slight decline in the hours of work, average weekly earnings were 4.7 percent above a year ago. Provisions in existing contracts plus the trend of recent collective-bargaining agreements point to further wage increases.

(2) Agricultural income in the first quarter was \$10.4 billion (seasonally adjusted annual rate), in line with the expected decline this year of \$1 billion or less from 1955 levels. However, action by the Department of Agriculture, under existing law, could add \$500 million to farm incomes this year.

(3) Prices continued to increase during early months of 1956 at about the rate prevailing since June 1955. Overall price indexes show less rise than many components since lower prices of crude foods and raw materials have been offsetting increases in finished goods and services. The recent 6-percent increase in railroad freight rates and steel price rises now in prospect are among the harbingers of continued price rises during the year.

E. Consumption

(1) Preliminary results of the annual Federal Reserve Board survey of consumer finances reaffirm consumer optimism.

(2) Personal consumption expenditures increased in the first quarter more than did disposable income, resulting in a reduction in the rate of savings from the fourth quarter. This trend seems to confirm earlier expectations that rising total consumer spending will be a strong factor this year in spite of lower auto sales.

F. International situation

Economic activity abroad continues strong, particularly in Europe and Canada. Both Great Britain and Canada are taking steps to curb excessive inflationary tendencies.

G. Federal fiscal developments

(1) Reports through mid-April indicate that the Federal budget will show an administrative surplus of about \$2 billion and a cash surplus of perhaps \$4 billion for this fiscal year ending June 30, 1956. These committee staff estimates represent increases in receipts of about \$3 billion over estimates in the January budget, which were reaffirmed in February by the Secretary of the Treasury. Expenditures may be about \$1 billion higher (due mainly to handling CCC payments inside the budget rather than by sale of notes to commercial banks).

(2) For the fiscal year 1957, the surplus will probably be larger than estimated in the January budget unless (a) business conditions deteriorate, or (b) legislation increases expenditures significantly more than estimated.

H. Monetary developments

(1) Apart from meeting week-to-week seasonal needs, the Federal Reserve System during the past half year has supplied no added reserves to the banking system. Government security holdings of the Reserve banks are substantially the same as a year ago.

(2) Member banks have doubled their borrowing from the System in the past year. This increased borrowing to support added loans to customers has

occurred in spite of successive increases in the discount rate from 1½ to 2¾ percent and to 3 percent in the San Francisco and Minneapolis districts. (The latest action was taken on April 12.)

(3) Since mid-1955, member bank borrowings have been greater than estimated excess reserves, with a resultant deficiency in the overall reserve position of member banks taken collectively of between 300 and 500 million dollars.

(4) For the year ended March 30, 1956, weekly reporting banks reduced Government securities by about \$5 billion, while increasing commercial, industrial, real estate, and other loans approximately \$3 billion. In spite of restraint, loans to business increased \$1.25 billion in March, or nearly 5 percent in 1 month.

(5) The trend in interest rates is illustrated by behavior of Treasury bond prices. This decline has meant an increase since mid-February of about one-half percent in the yield of Treasury securities with a maturity of 2½ years. The 3 percent's of 1955 have fallen to about 97½.

II. IMPLICATION FOR FEDERAL ECONOMIC POLICY

On balance, the changes in economic indicators in recent months reinforce the view that overall restrictive governmental policy continues to be warranted. As always, there are factors which may be pointed to on the deflationary side. These seem to be outweighed, however, by other considerations.

Some of the present inflationary forces do not appear to be sustainable, and if not now restrained, give prospect of creating maladjustments. The recent rises in industrial prices, stock market prices, inventory accumulation, and bank credit expansion are cases in point. The force of these upward pressures, coupled with foreseeable further increases in steel and other prices, freight rates, and wage rates tend to fan the inflationary forces into a speculative over-exuberance which increases the risks of reversal if allowed to run undampened.

Given this preponderance of inflationary influences at the moment, what are the implications for public policy in the monetary and fiscal fields?

The committee's recommendation of March 1, 1956, against a Federal tax reduction continues at the present time to represent the best fiscal policy. A major guide to fiscal policy should be the state of the national economy, as the Subcommittee on Tax Policy has pointed out (S. Rept. No. 1310). Although long-run projections indicate the possibilities of tax reductions, the emergence at this time of a surplus, either anticipated or greater than originally anticipated, is not persuasive as to the wisdom of tax reduction in the face of a booming economy already pressing the limit of immediate resources and fanned by a variety of upward drafts. The fact is that the emerging Federal surplus of itself is but another indication of the strength of the booming forces present in the economy.

As pointed out above, the Federal Reserve System has been pursuing, and continues to pursue, a monetary policy consistent with this restrictive fiscal policy. A restrictive monetary policy necessarily involves some hazards. The principal of these is that too much or too long restraint can turn the economic situation toward caution or liquidation. Apart from judgments as to specific instruments to be used and their timing, it has been suggested that restriction may fall unequally upon small and large business, that it may unduly enhance bank profits, and that if long persisted in, it may have serious implications for the distribution of income. Continual alertness is necessary in carrying out monetary policy to insure that emphasis is shifted toward encouraging more liberality by lenders as soon as inflationary forces subside.

It is clear that the costs of a monetary policy sufficiently restrictive to maintain stability in the face of a tax cut now would be too great to risk. When inflationary forces slacken, a policy of progressive credit ease can be, and should be, initiated, with changes in fiscal policy reserved until more persistent depressing forces are apparent.

ADDRESS BY ARTHUR F. BURNS, CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
BEFORE THE NATIONAL FEDERATION OF FINANCIAL ANALYSTS SOCIETIES, BOSTON,
MASS., MAY 21, 1956

SOME OBSERVATIONS ON THE PROBLEM OF INFLATION

When you invited me several months ago to speak at this meeting, I sought protection under the umbrella of the title "Our Economy Today." But on look-

ing through your program, I found that you will be reviewing with some care the current fortunes and prospects of our major industries. One of the general problems that you will be pondering in the course of this review is the future of the dollar, and it occurred to me that I might venture a few observations on this very large subject.

It is frequently said that we are living in an inflationary age, that the dollar is depreciating in value, and that it is likely to continue depreciating. The history of recent decades lends some support to this thesis. But it is well to keep in mind that the years from 1933 to 1939 were dominated by efforts to engineer a recovery of prices as well as of production, and that the broad movement of prices from 1939 to 1951 was dominated by war finance or its sequelae. Although the period is very brief, it seems desirable to give special attention to the course of events since 1952 if we wish to sense the forces that may be operating on the general price level in the years immediately ahead.

The past 4 or 5 years have witnessed an extraordinary economic expansion in our own country and Western Europe. People everywhere have been impatient with their standard of living and eager to improve it. Capital expenditures have been rising by leaps and bounds. Spending on armaments has added heavily to the surging demands for raw materials and labor. Unemployment has been low in practically every part of the Western World. Nevertheless, the average level of prices in consumer markets has risen little in most places, and it has been virtually stable in the United States. If there has been a tremendous upsurge of demand during the last few years, there likewise has been a tremendous expansion of supply. We must not overlook this fact.

Since 1952 the domestic level of consumer prices has moved within a range of about 1 percent. It rose eight-tenths of 1 percent between 1952 and 1953, rose another three-tenths of 1 percent between 1953 and 1954, then fell three-tenths of 1 percent between 1954 and 1955. In March the index of consumer prices was three-tenths of 1 percent higher than a year ago, but one-tenth of 1 percent lower than 2 years ago. These are diminutive movements. The essential fact is that the general price level in consumer markets has been quite steady.

We often hear that the steadiness of the consumer price level is largely the result of divergent trends in the prices of foods and other things, and that the price level of consumer goods would now be significantly higher if the prices of foodstuffs had not fallen. This is a dubious argument. For if the prices of foodstuffs had been higher than they actually were, people might have spent more money on food and less money on other things, thus curbing the rise in the prices of goods other than foods.

But it is not necessary to engage in speculation on this point. The vital fact is that the prices of foods have not been alone in declining since 1952. Indeed, the general level of nearly every major category of commodity prices in consumer markets has moved downward. While the average of food prices was 3 percent lower in 1955 than in 1952, the average of apparel prices was 2 percent lower, the average of household appliance prices was 11 percent lower, the price average of furniture and bedding was 3 percent lower, and the price average of automobiles and related supplies was 6 percent lower.

When we take the commodities bought in consumer markets all together, it appears that a decline has occurred every year since 1952. In 1955 the average level of these prices was 3 percent below the level in 1952. This March the average level was six-tenths of 1 percent lower than a year ago.

The basic distinction in recent consumer prices is not between foods and other articles, but rather between commodities and services. While commodity prices have been declining, prices of services have been rising. The prices of some services—such as dwelling rents and medical fees—are still adjusting to the great inflation of the 1940's. These prices have been catching up, so to speak, to the broad price movement that occurred earlier. The prices of other services, such as work by domestic employees, barbers, and repair establishments, have been reflecting the upward trend of wages. When the rising trend of prices of consumer services is combined with the declining trend of prices of commodities, we get a virtually stable price level since 1952, as I've already noted.

I have been speaking of the consumer price level because that is the price level that figures in the thinking and lives of all Americans. What happens to that price level determines how much a typical family can buy with its dollars. What happens to that price level determines whether we can safely rely on the savings that we have accumulated in bank accounts, pension funds, life insurance policies, and Treasury savings bonds. By contrast, the movements of

prices in wholesale markets are of direct concern to only a part of the population—those who are engaged in business dealings. However, wholesale prices are more sensitive to inflationary developments than are consumer prices, and it is therefore desirable to take notice of recent trends in wholesale markets.

Here, some substantial advances have occurred. The average level of prices of processed materials used in industry, including components, parts, and supplies, has risen steadily since 1952, and rather sharply since June of last year. The prices of finished goods purchased by business firms—that is, machinery and equipment—have behaved in similar fashion. Construction costs have likewise risen materially. These are the prices and markets that reflect the pressures of our great expansion in investment. Other price movements have been much tamer. Nevertheless, the average of all industrial prices, which rose gently in 1953 and 1954, began advancing rapidly around the middle of last year. The average of these prices is now 5 percent above the level of last June. It is the broad movement of industrial prices that has caused special concern and renewed fears of inflation.

However, it is well to observe that the wholesale prices that bear most closely on consumer markets are not depicted by an overall average of industrial prices. While the upward push of prices has been conspicuous at the wholesale level of consumer as well as producer goods, the fact is that since 1952 the prices of consumer durables have on the average risen less in wholesale markets than have the prices of producers' equipment. The prices of nondurables, exclusive of foods, have risen still less, while the prices of foods have declined.

In considering the general value of money in wholesale markets, we must take prices all together, regardless of the destination or character of the commodity. When we do that, we find only minor movements. The overall index of wholesale prices stood at 111.6 in 1952, which compares with a figure of 100 in 1947–49. The index dropped to 110.1 in 1953, then rose to 110.3 in 1954 and to 110.7 in 1955. Thus, the average level of wholesale prices in 1955 was about eight-tenths of 1 percent below the average in 1952. In the first 4 months of this year the index of wholesale prices reached 112.7, which is 2 percent above the level of the corresponding months last year, 3 percent above the level in the third quarter of 1954 when the economy resumed its advance after the 1953 recession, and only 1 percent above the level that prevailed during 1952.

The rough stability of the overall level of consumer and wholesale prices in recent years requires explanation. As I see it, four factors are largely responsible for what has happened. First, rising productivity and expansion of industrial facilities. Second, increasing business competition. Third, restraint on the part of many in advancing prices. Fourth, monetary and fiscal discipline on the part of Government.

Since the end of World War II business expenditures on new plant and equipment have been running at a very high level. Every year since 1951 these expenditures have exceeded \$25 billion. Last year they reached \$29 billion, and this year they may amount to \$35 billion or better. While these huge expenditures have put pressure on available resources and have served to raise the prices of metals, building supplies, and machinery, they have also resulted in a great expansion of industrial capacity and in widespread installation of modern and cost-reducing processes.

Back of these investment expenditures are huge outlays on research and development that have been steadily bearing fruit by increasing the amount of output that is obtained per unit of labor. In 1954 over 15,000 companies had research and development programs on which about 160,000 scientists and engineers were engaged. The numbers have grown since then. The more glamorous achievements of technology have recently been registered in electronics, jet and rocket flight, atomic energy and radioisotopes, metallurgy, plastics, and textile fibers. These achievements should not, however, obscure the fact that research and development activities have been expending the variety of materials, products, or processes in virtually every branch of industry.

The drive to reduce costs is omnipresent. The processing stations of the factory are being integrated into continuous productive systems. Mechanization and systematic managerial planning have spread beyond the shop. They are already important features of office work and are almost as typical of the farm as of the factory. Indeed, very remarkable progress in reducing the amount of labor required per unit of production has recently occurred in agriculture, as a result of the spread and improvement of farm machinery, the increasing use of fertilizers, better varieties of seeds, improved breeds of livestock, and other advances.

The upsurge of technology, managerial planning, and capital investment has not only served to increase industrial productivity in recent years, but it has pushed the advance in productivity well above the gains of earlier decades. Between 1950 and 1955 the output per man-hour in the private sector of our economy rose at an average annual rate of about 3 percent per year, in contrast to an average of about 2 percent between 1910 and 1950. Dramatic reductions of labor requirements per unit of output have served to offset the influence on costs of the substantial increases in wages of recent years.

But if advancing productivity has helped to keep unit costs down, business competition has served to keep prices down. Apart from some of the hard-goods industries, there has been a broad shift of late from sellers' markets to buyers' markets. Indeed, much of our business investment and progress in productivity has been stimulated by the intense competition that has developed in industry. Customers are again being wooed. The art of salesmanship, which was dormant during the 1940's, is again being practiced with vigor and ingenuity. The pace of competition has become especially keen in retail markets. New methods of distribution, symbolized by the discount house, supermarket, and suburban shopping center, have spread rapidly. Retail margins have generally narrowed, and emphasis on volume of transactions has increased.

Many businesses have also been conservative in their pricing policies, that is to say, they have hesitated to pass on rising costs to their customers even when they could readily do so. Some businessmen have practiced restraint because they are aware of the dangers of inflation and feel a responsibility to do what they can to keep costs and prices from spiraling. Many other have taken a long view with regard to pricing in order to entrench themselves against competitive displacement when markets become weaker. The restraint of businessmen in advancing prices is often overlooked because it receives no publicity, in contrast to the notice that is taken of every upward revision in prices. Much the same is true of the behavior of workmen. I do not like to contemplate what our present cost-price structure would be if every businessman, salaried official, wage earner, and trade-union leader sought aggressively to charge the full amount that current traffic would bear.

The private economic policies that have helped to keep prices down have been powerfully reinforced by public policies. Through its tax and expenditure program the Federal Government has been encouraging research, innovation, and investment. Vigorous enforcement of the antitrust laws has reduced temptations to escape competition by rigging markets or entering into collusive arrangements. Most important of all, monetary and fiscal policies have sought to contain inflationary tendencies no less than recessionary developments. During a large part of the period since 1952 the banking system has been under pressure, sometimes mild and at others quite substantial, to restrain the expansion of credit. The creation of new money has been held in check. The management of the public debt has been coordinated with general credit policy. While the physical output of goods and services increased 11 percent between 1952 and the first quarter of 1956, the money supply—that is, the sum of demand deposits and currency in the hands of the public—rose only 8 percent. Meanwhile, the Federal budget has moved from a zone of substantial deficits to a modest current surplus.

As a result of both private and public policies, we have thus had during the past 4 or 5 years approximate stability in the value of the dollar in consumer markets. This achievement should make us hesitate about describing our times as an age of inflation. Surely, many of the forces that have recently kept the overall level of consumer prices stable can be counted on to operate in the years ahead.

The cumulative forces on the side of costs and supply are less commonly recognized than the cumulative forces on the side of demand. They are, however, no less vital. Thus, the sources of supply of metals and industrial hard goods are expanding both here and abroad. Research and development are proceeding on a wide front. Indeed, the pace is quickening, partly because markets are generally expected to grow, partly in response to the upward tendency of wages, and partly because of the need felt by progressive businessmen to match or surpass what their competitors may have to offer. This year \$3 billion will probably be spent on research and development by private industry and the universities, and perhaps another \$3 billion will be spent by the Federal Government, in contrast to a combined total of about \$5 billion in 1953 and of about \$3 billion in 1950. As I have already observed, the trend of industrial productivity has of late moved forward at an accelerated rate. The opportunities created by expanding markets, by advances in technology, by business innovations, and by improved management

bid fair to extend this trend. The pressure of wages on prices will therefore continue to be counteracted by a progressive tendency to increase output per unit of labor.

Consumer markets are likely to remain intensely competitive. Even the prices of consumer services will not necessarily continue on their rising course. The process of "catching up" on the part of dwelling rents and other lagging items will probably be completed before long. Mechanization is likely to penetrate in increasing degree various of the manual services that have been exerting an upward push on the consumer price level. Although retail margins may not be reduced further or may even rise a little, it seems likely that marketing research will be stepped up materially and pave the way for lower unit costs of distribution for primary producers and manufacturers. With productivity rising, industrial capacity expanding, the abundance and variety of consumer articles increasing, and our international trade growing, we may expect competition for the consumer's dollar to be very keen in the years ahead.

The main uncertainties with regard to the future of the dollar are therefore, first, whether wages will tend to rise faster than industrial productivity; second, whether businessmen will give sufficient heed to the longer-range consequences of their pricing policies; third, whether the monetary and fiscal policies of Government will be sufficiently disciplined to keep in check such inflationary pressures as may from time to time develop. Experience since 1952, while favorable and encouraging on balance, is much too brief to be conclusive. It may be that our private or public policies will become reckless in later years. It may be that we will throw restraint to the winds. But it cannot be justly argued from the evidence so far available that a high-level economy is necessarily biased in an inflationary direction. It is a disservice both to truth and to social opportunity to describe our times as an age of inflation. We are living in an age that can be either one of inflation or of general price stability, depending on the courage and wisdom that private citizens and Government officials bring to their responsibilities.

What I find most promising in contemplating future prospects is the fact that economic literacy is spreading rapidly. Knowledge of economic movements, and of their causes and consequences, is no longer confined to specialists. Nowadays great numbers of ordinary citizens understand that inflation can wipe out their savings just as effectively as can prolonged unemployment. They understand that inflation creates hardships for many salaried workers as well as for those living on pensions or on income from fixed-interest securities. They know that inflation reduces a nation's ability to sell in foreign markets. They know that inflation distorts the calculation of depreciation costs and of profits and thereby threatens the solvency or growth of businesses on which they depend for their livelihood. They know that inflation is often the precursor of depression and unemployment. Most important of all, they know that inflation is not an act of God, and they believe that a mature people should be able to conduct their private and public affairs so as to avoid both deflation and inflation.

This growth of economic knowledge and understanding has played a large role in maintaining the value of our dollar in recent years. It can be counted on as a major force to promote general price stability in the future, and to do so in other nations as well as our own. The need for monetary discipline is now recognized practically everywhere, and nowhere more than in the countries of Europe that have suffered most from inflation in the past. Experience is also teaching the nations of the world that the effectiveness of traditional monetary restraints has been reduced as a result of growth in the economic scope of the public sector. Under modern conditions an exacting fiscal discipline and some funding of the public debt may well have to accompany monetary restraints when inflationary pressures mount.

I have allowed myself in the course of these remarks to dwell largely on longer-run tendencies and prospects rather than on current developments. However, before closing, I wish to add an observation or two on the immediate situation. I have already noted that the level of wholesale prices has been rising since last year. This advance—which has been especially pronounced in some broad categories of industrial prices—has given rise to renewed fears of inflation. The potential danger of the rise in wholesale prices that has occurred during the past 6 or 12 months should not be minimized. But I think it is also important to see the recent price movements in perspective.

Since 1952 economic activity has been proceeding at a very high level. At no time during these years has our economy been very far from a position of

practically full employment, and during most of this period it has been quite close to it. The physical output of goods and services is currently running at a level that is about 11 percent larger than in 1952 and 5 percent larger than a year ago. Employment now is 6 percent higher than in 1952 and 4 percent above a year ago. Had I been told toward the end of 1951 what the movements of production and employment in our country would be like during the next 4 or 4½ years, and also told of a great boom that would develop in the economy of Western Europe, I seriously doubt whether I would have predicted the degree of stability that has characterized the overall level of consumer and wholesale prices in recent years. In the light of the history of prices during the past century and a half, and especially of their usual behavior during periods of vigorous economic activity, I would have envisaged higher indexes of prices than are currently being recorded. The remarkable thing even about the level of wholesale prices is that, despite the widespread and accumulating pressures of demand, it has risen so little.

When an economy is poised on a very high plateau, as ours has been in recent months, the threat of inflation cannot be very distant. The like, unhappily, is also true of the threat of recession. Aggregate economic activity is now proceeding at peak levels, but divergent movements are going on beneath the surface. Capital expenditures on the part of business have been rising rapidly, and governmental spending as a whole has also been moving upward. Home building and retail trade, on the other hand, have been somewhat sluggish. I have the impression that relations among prices deserve no less attention than the overall level of prices. Rather wide discrepancies have been occurring in price movements. They have resulted in a cost-price squeeze not only in agriculture, but also in home building, the automobile trade, the farm-equipment industry, and some branches of the textile and appliance industries. The present cost-price structure is in process of being tested in the Nation's markets. While it is true that retail prices tend to lag behind wholesale prices, it is not yet clear that the recent advances of industrial prices in wholesale markets will be passed on to the consumer in significant degree. Developments in prices, inventories, and retail trade will bear careful watching in coming weeks and months.

Minor movements of the price level or of general business activity are significant not of themselves, but because of what they may portend for the future. Mistakes in diagnosis are bound to occur at times, and our only real protection against them is vigilance and a willingness to face the consequences of new facts as they develop. Our attention and efforts must center equally on the avoidance of inflation and of depression. The importance of maintaining general price stability is now recognized as widely as the importance of maintaining a high and rising level of production and employment. The paramount lesson of the history of the past few years is that these goals of economic policy are broadly compatible. It is this lesson and its great promise for mankind that I have tried to emphasize this morning.

Chairman PATMAN. May I suggest that I would like to insert into the record at the appropriate place the information I referred to this morning concerning the consumer price level.

Without objection it will be inserted in the record.

Representative CURTIS. Mr. Chairman, I would like to have an opportunity of putting adverse views to those expressed by Mr. Bolling at that point in the record, because I do not agree with his conclusions.

Chairman PATMAN. Without objection it is so ordered.

(Representative Curtis later submitted the following:)

Mr. Chairman, it is obvious that the two documents are not comparable both in scope and purpose. The first document was an internal memorandum by the staff of the committee while the speech of Dr. Burns was a general speech dealing with the overall problem of the future of the dollar for a public audience.

A careful reading of the speech of Dr. Burns shows very clearly that he was aware of the possibility of inflation and also of the danger of the rapid rise in wholesale prices. While this period need not be an age of inflation, he warns that "any time an economy is poised on a very high plateau, as ours has been in recent months, the threat of inflation cannot be very distant." Further, he notes that the future of our economy is very closely dependent on the courage and wisdom that private citizens and Government officials bring to their responsibilities. And

in this connection he states: "Experience is also teaching the nations of the world that the effectiveness of traditional monetary restraints has been reduced as a result of growth in the economic scope of the public sector. Under modern conditions an exacting fiscal discipline and some funding of the public debt may well have to accompany monetary restraints when inflationary pressures mount."

In saying this, ex-Chairman Burns called attention to the need in curbing public expenditures and for converting short-term debt into long-term debt in the interest of repressing inflationary forces.

I do not feel that there is anything in the above speech of Prof. Arthur F. Burns (Columbia University) former Chairman of the Council of Economic Advisers, which cannot be read with profit at any time and I deplore any invidious comparisons with uncomparable documents, even if the latter are written by our able staff.

Chairman PATMAN. Does any other member want to be recognized?
Senator Watkins?

Senator WATKINS. I would like to ask Mr. Martin about the statement he makes on page 3 of his prepared presentation, that—

In 1956 fully half of the increase in gross national product represented a markup in prices.

You do not mean that markup all occurred in 1956, do you?

Mr. MARTIN. In the calendar year 1956; yes, sir.

Senator WATKINS. How can that be justified?

Mr. MARTIN. I think it is very unfortunate.

Senator WATKINS. Where do you get the figures that show that?

Mr. MARTIN. It shows that instead of additional goods and services, which we are all anxious to have, we got a markup in prices that accounted for about half of the increase in gross national product.

Senator WATKINS. That all occurred in 1956?

Mr. MARTIN. That is correct.

Senator WATKINS. How did that compare with the year previous?

Mr. MARTIN. From 1954 to 1955 gross national product rose from \$374 billion to \$401 billion. Price was about one-sixth of it, Senator.

Senator WATKINS. That is for the year previous?

Mr. MARTIN. For the year previous.

Senator WATKINS. What was the full increase in gross national product in 1956? I do not happen to have that figure before me.

Mr. MARTIN. Twenty-two billion.

Senator WATKINS. And half of that would be 11 billion, which you say was a markup?

Mr. MARTIN. A markup in price.

Senator WATKINS. There was no actual increase, but it was merely marking it up to that point?

Mr. MARTIN. That is correct.

Senator WATKINS. The next statement—

Had commercial banks been enabled to generate sufficient new money to satisfy all the demands for funds that were pressing on the market, the result perhaps would have been a smaller rise in interest rates, but at the expense of a sharper rise in prices of goods and services.

How do you justify that? What is the line of reasoning? From what figures do you come to that conclusion?

Mr. MARTIN. I do not have any figures; but if there had not been the restraining impact of higher interest rates, when people went to borrow this money, and you had been supplying this money in excess of savings, it could have done nothing, since the aggregate supply of

goods was not being increased, but the money supply was. It could have done nothing except increase prices.

People were trying to buy more goods than there were, and, under such circumstances, additions to the money supply could only be added to the price.

Senator WATKINS. In what field was there a shortage?

Mr. MARTIN. A shortage of what?

Senator WATKINS. Goods.

Mr. MARTIN. Goods? I think the principal fields probably were in steel and heavy goods and specialized types of machinery.

Senator WATKINS. There was no shortage in consumer goods, was there?

Mr. MARTIN. No. Consumer goods came to the market in substantial supply. That is where the process begins. The fact that we had heavy defense expenditures with no offsetting civilian goods tended to emphasize the creation of soft goods, but it did not eliminate the shortages in the basic materials, which were steel and that type of thing. In other words, the usual imbalances crept into the economy. I am not suggesting there was a shortage in individual items. I am suggesting there was a shortage in the aggregate.

Senator WATKINS. You would have to have individual shortages in order to get the aggregate?

Mr. MARTIN. That is right.

Senator WATKINS. That is why I was interested in knowing what fields you state there was a shortage.

Mr. MARTIN. That is correct.

Senator WATKINS. There certainly was no shortage in foodstuffs.

Mr. MARTIN. No.

Senator WATKINS. There was a surplus all the way through.

Mr. MARTIN. All the way through.

Senator WATKINS. You think the shortages occurred in steel, largely, and in machinery?

Mr. MARTIN. I cite those as the two principal items, yes.

Senator WATKINS. That was a considerable increase, if you add \$11 billion in those.

Mr. MARTIN. That was spread through the whole economy, not just in those items. I am highlighting those items. We will be glad to prepare you a memorandum on that later if you so desire.

Senator WATKINS. I would like to have one. I am very much interested. I think your statement is correct, but I would like to know how to justify it.

Mr. MARTIN. We will try to get you up a memorandum.

(The memorandum referred to was not received at the time the hearings were printed.)

Senator WATKINS. On page 4 I am interested in this statement you make:

In the final analysis, investment must be financed out of savings from current income. This economic principle cannot be vitiated by any form of monetary manipulation. Under our institutions there is no practical way of balancing savings and investment without flexible interest rates.

The other day we had statements made that the new plants and further investments of these large companies should not be taken out of income, but should come out of the money that they go into the

market to get. It is sort of, as I got it, unethical to make consumers help increase supply.

Mr. MARTIN. That is making a judgment on the price that is being charged to consumer.

Senator WATKINS. That was the argument that you had to keep prices down. Otherwise, if you charge the consumer a higher price, then you made him finance your business, without giving him any interest in the business.

Mr. MARTIN. The consumer can, at any time, of course, stop buying. That is one of the problems. There comes a limit to passing an increase in prices on to consumers, and the way unemployment develops out of this is when the profit margin is squeezed to the point that it evaporates. The first thing you do is cut back production and then you have unemployment.

Senator WATKINS. In other words, if the consumer would not contribute, the price would have to be held down to such point that he would not be able to contribute?

Mr. MARTIN. That is a managerial function that applies in different companies in different ways.

Senator WATKINS. Take a private individual, where the savings or the income would all come to him. And we have had some private individuals who have operated in a big way.

Mr. MARTIN. That is right. Retained earnings in the company can be savings as well as any other form of savings.

Senator WATKINS. You do not agree with the statement, then, that it was probably unethical to have the consumers contribute something to the increase and expansion of business, contribute new capital?

Mr. MARTIN. I do not know to what extent the consumers participated in it. If it was done through the business process honestly, that is a perfectly legitimate part.

Senator WATKINS. That was the point. The intimation was that it was unethical and sort of dishonest to finance your business that way.

Mr. MARTIN. I see nothing unethical in the business process.

Senator WATKINS. You do not agree with that generalization?

Mr. MARTIN. No; I do not agree with it.

Senator WATKINS. I believe you are right. It would seem to me that it was contrary to the history of development of this country to say that that should not be done.

I think that is all I have at the moment, Mr. Chairman.

Representative KILBURN. May I have one short question, Mr. Chairman?

Chairman PATMAN. Certainly, Mr. Kilburn.

Representative KILBURN. Mr. Martin, in your statement, the last sentence:

What cannot be accomplished today may become readily attainable in the not too distant future.

What did you mean by that?

Mr. MARTIN. What I mean by that, Mr. Kilburn, is that in an economy as big as this, the balance between savings and investment over a period of 3 or 4 months can change very substantially, and if savings are increasing and spending decreasing, a balance can be arrived at in a very short time. This is a strong, vigorous economy,

and as long as we do not try to push too fast, but just let the forces operate, I think we have the ingredients for an amazing growth on a sound basis.

Representative KILBURN. Thank you, Mr. Chairman.

Representative CURTIS. Mr. Chairman?

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. Mr. Martin, I was following the statements of the chairman, Mr. Patman, which he was making about the difficulties of small business to get the capital necessary to carry on their functioning. I note in your answer to the prepared question you point out quite clearly the situation, at least it seems to me it is clear and very accurate. You state—

The major difference between small and large business is not in their direct access to some source of credit, but, rather, in their access to alternate sources of credit. Unlike most small businesses, most large businesses generally have direct contact with and access to a number of banks as well as to other sources of outside financing.

It seems to me that statement is true, and that is the point, as I get it, that you are making. Small business still has access to its normal sources of credit, but, like any other sources of credit, they are limited in the face of the demand.

I would like to make one other point and see if you have any further information. Inasmuch as General Motors is usually used as an example of a big business, I might call the chairman's attention to the fact that General Motors has deferred building an assembly plant in Ohio and in California. I think we can presume the reason that it is deferred is because there is a shortage of capital. I think it is true that big businesses and small businesses, in fact anyone interested in getting investment capital, are all experiencing this tightness of money.

Would you say that is a fair statement?

Mr. MARTIN. I do not know the reasons why General Motors did that.

Representative CURTIS. I did not mean that specifically.

Mr. MARTIN. But that they have known tight money existed I think is evident from statements that have been made from time to time.

Representative CURTIS. In other words, you would say that businesses have that same problem posed to them, and they are having to face up to it just the way small businesses are?

Mr. MARTIN. I agree.

Representative CURTIS. Thank you.

Chairman PATMAN. Mr. Martin, about this General Motors deferring two projects, I do not agree that tight money did it. From the standpoint of General Motors, I am apprehensive on the part of the consumers. You know they probably do not see the future sales they did a few months ago and, therefore, they want to be a little more cautious in constructing. I do not construe that to mean that General Motors is having any difficulty getting money at all. I want to read something on that question of little business having more difficulty in getting credit than large business which you did not seem to agree with me on, that Mr. Saulnier, the chairman of the Council of Economic Advisers, said about Monday a week ago, before this committee. He said:

It was already becoming evident in late 1955 that small business concerns were having rather special difficulty in satisfying their credit needs.

The President's Economic Report on page 42 says "in the course of the year" and this is the Economic Report that was just sent to us a couple of weeks ago, dated January 1957:

It became increasingly apparent that tighter credit conditions affected unevenly different sectors of the economy and different types of businesses. New and smaller firms appeared to find it more difficult to satisfy their financing requirements than established and large concerns.

Now I want to get down to what Mr. Martin said about this.

Mr. Curtis did not read far enough awhile ago. I will first read that statement that Mr. Curtis read, which I think is timely, in your statement on page 1 of your answers, about halfway down the page:

Unlike most small businesses, most large businesses generally have direct contact with and access to a number of banks as well as other sources of outside financing.

After that, however, you stated:

Consequently, at a time when overall credit demands are greater than can be fully met without inflationary impact, a greater number of small businesses than large ones find it difficult to secure their customary credit accommodation.

It occurs to me that is very authoritative, Mr. Martin.

Mr. MARTIN. I tried to be completely fair in this presentation.

Chairman PATMAN. I know you have, but I am just afraid you overlooked a point.

Senator WATKINS. You are not trying to be fair by going in two directions, are you?

Chairman PATMAN. Well, Mr. Martin, in your statement, on page 3 of your answers, after quoting some figures, you state:

These figures indicate that from mid-1955 to mid-1956 the number and dollar volume of all new business loans made increased to record levels.

During that same time, a survey showed that over half of the small manufacturing companies lost their lines of bank credit. Half of these small concerns were losing their lines of bank credit. So is that not some evidence to you that it was easier for the big ones than little ones, and harder on the little ones than the big ones? Do you not want to revise your statement that you made awhile ago that I referred to?

You left the impression that the little fellow was not having any difficult time at all, that he was just in good shape. You state here in your answers which I read to you that the big fellows have directorships—you did not say directorships, but I am adding that because I know you had it in mind—have directorships in these large banks, and these large insurance companies. They can get all the money they want. You inferentially say so in this statement of yours.

Are you not willing to say that that makes it harder on the little guy?

Mr. MARTIN. I am sorry, Mr. Patman, I do not want to revise my answer.

Chairman PATMAN. Now I want to ask you a question about getting investment capital from consumers. I think it is a major question and becoming more important every day. I respectfully disagree with my distinguished friend, Senator Watkins, on that. Not that I say such a practice is dishonest or dishonorable; I do not. It is not a violation of any law.

Ethical? I do not know whether I can say that it is unethical or not. I am not making the charge.

But I think it is wrong from the standpoint of monopoly and administered prices if we let a few people get so big in this country, and are so dominant that they have administered prices. They can charge any price they want to charge, instead of taking out just enough in prices to cover supplies, labor, equipment, taxes, setting aside enough for fair and generous dividends to stockholders who are entitled to such dividends, and then providing a fair amount of surplus. I agree with that, to take care of contingencies. That is perfectly all right.

But because they have the power they add on something more.

I will give the automobile companies as an illustration without charging them with this although I am sure their reports show that it is done. We will say that they charge the consumer just a hundred dollars extra on every car for purposes of illustration. That part is to go into retained earnings, although they do not designate it that way, I am sure, in the beginning, but they have it in mind, to go into the fund for retained earnings which they will use for investment capital.

Let us analyze that, Mr. Martin, and the effect it has on the person who gives up the hundred dollars and the benefits to the concern that gets it. The person who pays this extra \$100 is paying it as a part of the capital of a concern, in this case 1 of the 3 major automobile companies. He does not get a certificate of stock. He gets nothing. He gave it up. He did not want to do it, but he had to do it. They were big enough to have administered prices and made him pay it or he could not get the car. He had to do it and he did it.

They get, say, \$500 million that way in the course of a year. They turn that over for investment purposes. They spend that for plant and equipment. I do not say that they violated any law, no. But I question it. I question it is right to do it, just because they have that monopolistic power to do it. I think it is contrary to the private enterprise system, and I think it is destructive to private enterprise in the end.

Let us look at it the other way. Suppose that man had not been compelled to give up that \$100, and instead invested it in Chrysler, Ford, or General Motors stock. They would get the money just the same. They can build the same plants and equipment with it. But the difference is instead of the company getting the benefit of his \$100 from here on out, he would get it, his family, his children, and his heirs. So there is a difference there that I think should be considered.

I am not calling it dishonesty. Under our system we have recognized it in the past. I can see where it has been encouraged by policies and practices of Government officials, and even the Congress of the United States. But I question whether it is in conformity with our private-enterprise system because it results in a few large concerns owning the businesses of the country.

Our House Committee on Small Business reported just the other day that if the trend continues the next 18 years like it has the last 5, all manufacturing, processing, and distributing businesses will be in the hands only of concerns of \$100 million and more at the end of 18 years from now, and probably a shorter time than that.

If I can read the signs correctly, Senator, I think that is the direction of socialism. It is such a short step from monopolistic ownership and control to socialism.

You know, your platform used to always say that private monopoly is indefensible, it cannot be tolerated. I have read that wonderful statement in the Republican platform a lot of times.

Senator WATKINS. Do you mean to say there is no competition in the automobile manufacturing business?

Chairman PATMAN. To a degree.

Senator WATKINS. To a degree? I thought it was the keenest type of competition we have in the United States.

Chairman PATMAN. There are many types of competition.

Senator WATKINS. That may be, but it is certainly keen. I see no monopoly in that field.

Chairman PATMAN. How many automobile concerns did we have 20 years ago?

Senator WATKINS. You may have had a lot more of them, but the competition and the obstacles they had to overcome eliminated a lot of them that were not able to manage to do the work satisfactorily.

Chairman PATMAN. It is competition of a sort. I will agree with that, particularly with the salesmen down at the lower level. They fight among themselves.

Senator WATKINS. In the illustration you used of the man who had a hundred dollars, he could either put a little extra money into a car or put it into stock. He made his own election. He was not compelled to do either one.

Chairman PATMAN. He had to do that or not get the car.

Senator WATKINS. Under the circumstances of today, with all the good used cars on the lots, I do not think he was compelled to purchase a new car.

Chairman PATMAN. The effect is passed on down to the used car, don't you think, Senator?

Senator WATKINS. I think you assume a situation that does not actually exist.

Chairman PATMAN. I believe the facts show it, Senator, and if I am wrong about it, I would love for it to be pointed out. It is my view that too much profit is taken from the consumers through administered pricing by monopolistic concerns for the purpose of making the consumers pay the expansion cost of these concerns and denying the consumers any rights or benefits from that price increase.

Senator WATKINS. I would say that, for instance, in the automobile manufacturing business, cars are cheaper today by far as a result of the activities of these large companies and the competition in the industry than if we had not had that competition.

Chairman PATMAN. If we had 50 more companies, we would have had more competition.

Senator WATKINS. We would have more competition on higher priced cars.

Mr. MARTIN. Could I inject one comment on prices, that it takes two people to make a price, a buyer and a seller, and the seller cannot make prices independent of the buyer.

Chairman PATMAN. How about the administered price?

Mr. MARTIN. Even the administered price is up against the law of supply and demand in the long run. On the problem you raise of monopoly, I think you and I are both for free markets, and we both deplore monopoly. But it seems to me that the general money and credit policy is directed toward helping free markets develop and not being used as a force to promote the very things that you are wary of.

Chairman PATMAN. The fellow I mentioned does not have a chance of getting that car without paying the \$100. As Mr. Garner used to say, he does not have any more chance than the lamb has killing the butcher. He cannot get that car unless he pays the extra \$100. This applies all the way through on everything where there is administered prices.

Senator WATKINS. But he does not have to have that particular car. There is no compulsion. It is not one of those things that is an absolute necessity, as I pointed out.

Chairman PATMAN. I see your argument, Senator, and it is a good argument. But, still, it does not convince me, and I am trying to be convinced.

Senator WATKINS. You just try a little harder and we will get you convinced.

Chairman PATMAN. I do not see why we let a few people who have monopolistic powers, through administered pricing, keep on charging people enough to get their expansion capital. This is money that goes into brick, cement, and land. It is an investment from which people earn dividends and returns. But in this case, the consumer provides it and gets nothing, and the fellow who gets it enjoys it from here on out.

Senator WATKINS. Probably in order to buy a car the consumer was receiving his income from some kind of business that was taking advantage of all the other activities the automobile companies were taking advantage of. So I cannot see that he is hurt at all. He probably made money because he raised the prices as high as he could and still get people to buy.

Chairman PATMAN. Two wrongs do not make a right, Senator.

Senator WATKINS. I do not think either one of them is wrong—if you are going to have free enterprise, that is, if you are going to say he can only go so far and from that point on cannot raise prices, that is one thing. If you are going to have a free-enterprise system, I do not think your argument will stand up.

Chairman PATMAN. I will keep trying to see it from your side, Senator Watkins.

Senator WATKINS. I hope you do.

Chairman PATMAN. Mr. Martin, you made a statement a while ago that caused me to want to ask you this: Could monetary policy have restrained the increases in steel and metal product prices in 1956?

Mr. MARTIN. No; I would not say the monetary policy could have.

Chairman PATMAN. I guess they could, at a terrific cost, probably.

Mr. MARTIN. Well, it is doubtful alone whether they could have under those conditions.

Chairman PATMAN. Are there any other questions, gentlemen?

If not, thank you very much, Mr. Martin. You have helped us greatly and we appreciate it.

Tomorrow we have an invited panel on "General views and recommendations of economic interest and research groups."

Without objection, any member of the committee may extend his remarks on matters he believes are germane or appropriate.

The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12:10 p. m., the committee recessed, to reconvene at 10 a. m., Wednesday, February 6, 1957.)

JANUARY 1957 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 6, 1957

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

The Committee met at 10 a. m., pursuant to recess, in room P-63, the Capitol, Hon. Wright Patman, presiding.

Present: Representatives Patman, Talle, and Kilburn; and Senator Goldwater.

Present also: Dr. Grover W. Ensley, executive director of the joint committee, and John W. Lehman, clerk of the joint committee.

Chairman PATMAN. The committee will please come to order.

The members of the panel may take their seats.

Today the Joint Economic Committee concludes its hearing on the President's Economic Report. We have invited for this session the representatives of leading economic interests and research groups. We are anxious to receive their views and recommendations.

In order that there may be time for questioning and general discussion, as indicated in our letter of invitation, the first half of the morning will be divided equally among the panel. The last half of the session will be devoted to committee question and additional statements from the witnesses.

I might say that each witness will be given an opportunity to insert additional materials in the record.

We will proceed with the opening statements and hear from all witnesses without interruption. Each panel member will be recognized for 7 minutes to summarize his views.

Since this is the last hearing on the Economic Report, I want to comment briefly on what is occurring that I think is bad for the country. Our Nation's survival is at stake and we should be very careful about what we say. I know that we have imbalances in our economy. The testimony of the witnesses disclosed that throughout these hearings. But generally our economy, I think, is in a good, healthy condition, with these exceptions: The farmers, particularly the family-type farmers, have been in a depression for some time. Small business has been faring badly for some time, under the hard-money policy in particular with its high interest. The building industry, and I refer in particular to home building, is not entirely on dead center, but almost. It is certainly not keeping up with growth.

I know that the single most important thing in our economic affairs is confidence. Secretary Humphrey has often pointed that out and I believe Secretary Humphrey was exactly right. I believe his statement the other day about a depression that would curl your hair was an unfortunate one because as wise a man as Secretary Humphrey is,

he must have meant that if we keep on spending and do not have a balanced budget, it would possibly lead to a depression. On that I would agree with him.

But we have a balanced budget. Therefore, as long as our budget is within reasonable bounds, and I construe it to be, I do not see that the statement he made is justified, and I am glad that he is clarifying it some.

The single most important thing, as he said, is confidence, but that does not mean that we can accept complacency. We must remain on the alert to make sure that we do everything that is possible to correct any imbalances.

At the same time I hope that all of us will guard any statements we make in the future to make sure that we are not unnecessarily frightening people. I do not think we have anything to be frightened about. I think our country is in fine condition, with some exceptions which can be corrected easily and quickly.

The first witness is Mr. Ralph J. Watkins, chairman of the board of trustees, Federal Statistics Users' Conference.

Mr. Watkins, we are delighted to have you.

STATEMENT OF RALPH J. WATKINS, CHAIRMAN OF THE BOARD OF TRUSTEES, FEDERAL STATISTICS USERS' CONFERENCE

Chairman PATMAN. Mr. Watkins, you may proceed.

Mr. WATKINS. Mr. Chairman and members of the committee, my name is Ralph J. Watkins, and I am director of research for Dun & Bradstreet, Inc., New York. I am a native of Texas and a graduate of the University of Texas. I appear here, however, in response to your invitation, in my capacity as chairman of the board of trustees of the Federal Statistics Users' Conference, a new organization established in Washington on November 15, last.

The conference is a nonprofit organization representing the non-governmental user interest in Federal statistics and made up in its membership of business, farm, labor, and research organizations. The conference agrees with the First Hoover Committee Task Force Report on Statistical Agencies that "statistical records * * * are the foundations of an informed public opinion in a complex society"; and it is our aim to assist in the development of Federal statistical programs of optimum usefulness in the public and private management of the American economy and of American society generally, and at the minimum cost consistent with those goals.

We believe, with your Subcommittee on Economic Statistics, that statistical programs do not take care of themselves, cannot be taken for granted. Like all human activity, they require good management, and they need also the stimulus that can come from constant scrutiny by those whose needs they are designed to meet.

I have a strong feeling that we have in the Joint Economic Committee, a valued ally for our efforts. The Joint Economic Committee is one of the prodigious users of statistics. The committee has recognized that in a free-enterprise economy adequate and timely information about economic conditions and trends and growth potentials is of utmost importance if we are to achieve the twin objectives of reasonable economic stability and dynamic growth. Your Subcommittee on

Economic Statistics and the various task forces established, under the aegis of the Board of Governors of the Federal Reserve System, in response to the committee's recommendations, have made salient contributions in identifying the most serious gaps in our statistical knowledge, and in proposing that something be done about those gaps.

Anyone who studies the President's Economic Report will be impressed with its wealth of statistical information and, indeed, its utter dependence on statistics; but he will also become painfully aware of the fields in which judgments must be formed without benefit of a firm statistical basis. With full appreciation of the advances that have been made in statistics in recent years, we may still refer to construction statistics or inventory statistics or to statistical information about unincorporated business or savings estimates as examples of fields in which serious gaps exist.

These gaps in our statistical knowledge, which your committee has discovered in its responsible work on Federal economic policy, are of concern also to businessmen, farm leaders, labor leaders, and analysts in research organizations. The businessman has to take economic trends and prospects into account when he makes his decisions concerning sales campaigns, investment programs, or inventory policies. In the same manner, farm organizations and labor unions need statistical information for effective operations. Accurate and timely factual information makes possible more efficient economic operations and thereby may on balance reduce the need for Government measures in support of economic growth and stability.

In my presidential address before the American Statistical Association at its 115th annual meeting a little over a year ago, I paid tribute to this pioneering work by your committee; and I there applauded the historic development in your committee's assumption of a much-needed leadership role in the field of economic statistics. I am glad here to repeat my expression of appreciation that in the Joint Economic Committee we have, for the first time in the history of the country, a national public forum before which the adequacy of statistical programs can be reviewed and appraised, and through which sound programs can be furthered. As an impartial entity for serving the joint interests in Federal statistics of agriculture, business, labor, and nonprofit research and professional organizations, the Federal Statistics Users' Conference seeks to serve those same ends.

This hearing today is not the proper time for presenting to you specific recommendations for the improvement of Federal statistics. Even if you asked me for recommendations, I would not be able today to make specific proposals on behalf of the conference, because we are only at the beginning of our work. I hope, however, we will be ready to make a contribution by the time your subcommittee begins to discuss the statistical program. We are preparing, at the present time, a survey of recent developments in Federal statistics programs which is designed to serve as a basis for formulating specific recommendations as to the statistical needs of the members of the conference.

May I thank you for this opportunity to appear before the Joint Economic Committee on behalf of the conference.

With the permission of the chairman, I should like to present, for the record, a brief description of the conference.

Chairman PATMAN. Thank you, sir. You may extend your remarks in any way you desire.

(Document referred to follows:)

FEDERAL STATISTICS USERS' CONFERENCE

The Federal Statistics Users' Conference, organized at a meeting in Washington, D. C., on November 15, 1956, is a nonprofit membership service organization representing agricultural, business, labor, and research organizations with a common interest in the statistical programs of the Federal Government.

The objectives of the conference, as set forth in the certificate of incorporation, are:

1. To provide a research, educational and service organization participated in by all nongovernmental users of Federal statistics.

2. To provide an impartial entity for serving the joint interests of agriculture, business, labor, and the nonprofit and professional organizations in Federal statistics, including appraisal of nongovernmental users' requirements and assessment of the degree to which existing and proposed programs meet such requirements.

3. To coordinate efforts of Federal statistics users in developing Federal statistical programs of optimum usefulness at minimum expense.

The conference will work to achieve these objectives by studying the statistical requirements of its members in the Federal statistics area, furnishing information and analyses of such requirements to the executive agencies and the Congress, providing members with special reports about Federal statistics programs, and cooperating, as the need arises, with the specialized professional societies in the field, concerning existing and proposed Federal statistics programs.

By mutual cooperation, the conference will seek to encourage the optimum type and scope of essential Federal statistics programs at minimum cost. Up to date, 90 corporations, labor unions, farm organizations, and nonprofit research organizations have signed up for membership.

The board of trustees consists of:

Representing business

John W. Boatwright, Standard Oil Co. (Indiana).
Edward J. Carroll, Merck, Sharp & Dohme.
Vincent A. Perry, General Foods Corp.
Charles W. Smith, McKinsey & Co., Inc.
Ralph J. Watkins, Dun & Bradstreet, Inc.

Representing labor

Solomon Barkin, Textile Workers Union of America.
Peter Henle, AFL-CIO.
Herbert Perry, International Brotherhood of Electrical Workers.
Lazare Teper, International Ladies' Garment Workers Union.
Nat Weinberg, United Automobile, Aircraft and Agricultural Implement Workers Union.

Members of the board of trustees from agriculturally organizations and the nonprofit research and professional organizations will be chosen later, as membership in those areas is expanded.

Officers of the conference are:

Chairman: Ralph J. Watkins, Dun & Bradstreet, Inc.
Vice chairman: Peter Henle, AFL-CIO.
Treasurer: Rodney W. Markley, Jr., Ford Motor Co.
Secretary: Gerhard Colm, Washington, D. C.

ROSTER OF MEMBERS OF THE FEDERAL STATISTICS USERS' CONFERENCE

(AS OF FEBRUARY 6, 1957)

Advertising Publications, Inc.	Lehman, Alcuin W. (Adv. Research Foundation).
Alco Products, Inc.	Lilly, Eli & Co.
Alderson & Sessions.	Little, Arthur D, Inc.
Amalgamated Clothing Workers of America.	Look magazine.
Amalgamated Meat Cutters & Butcher Workmen.	Loomis Sayles & Co., Inc.
American Aviation Publications.	McCann-Erickson, Inc.
American Metal Co., Ltd.	McGraw-Hill Publishing Co.
American Federation of Labor-Congress of Industrial Organizations.	McKinsey & Co., Inc.
American Can Co.	Market Research Corp. of America.
American Gas Association.	Massachusetts Investors Trust.
American Stock Exchange.	Mead Johnson & Co.
Architectural Forum.	Mellon National Bank & Trust Co.
Associated Business Publications.	Merck, Sharp & Dohme, Division of Merck & Co., Inc.
Bank of America.	Meredith Publishing Co.
Bankers Trust Co.	Missouri Farmers Assn., Inc.
Bristol-Myers Co.	Monsanto Chemical Co.
Chase Manhattan Bank.	Mortgage Bankers Association of America.
Coca-Cola Co.	National Blank Book Co.
Commercial Investment Trust, Inc.	National Cash Register Co.
Communications Workers of America.	National Coal Assn.
Crown Cork & Seal Co.	National Farmers Union.
Crown Zellerbach.	National Grange.
Curtis Publishing Co.	New York Stock Exchange.
DeVegh & Co.	Nielsen Co., A. C.
Diamond Alkali Co.	Pennsylvania Railroad.
Dun & Bradstreet, Inc.	Plumbing Fixture Manufacturers Association
Farm Journal, Inc.	Polk, R. L. & Co.
Firestone Tire & Rubber Co.	Prudential Insurance Co. of America.
First National City Bank of N. Y.	Republic Steel Corp.
Ford Motor Co.	Retail Clerks International Assn.
General Foods Corp.	Rice Associates, Inc., Stuart.
General Mills, Inc.	Roper & Associates, Elmo.
Gillette Safety Razor Co.	St. Paul Fire & Marine Ins. Co.
Health Insurance Association of America.	Sales Management, Inc.
International Association of Machinists.	Scudder Stevens & Clark.
International Brotherhood of Electrical Workers.	Simmons Co.
International Harvester Co.	Standard Oil Company (Indiana).
International Union of Electrical, Radio & Machine Workers.	Standard Rate & Data Services, Inc.
International Ladies' Garment Workers' Union.	Stanley Home Products, Inc.
International Woodworkers of America.	Stewart, Dougall & Associates, Inc.
Jefferson Standard Broadcasting Co.	Sylvania Electrical Products, Inc.
Kendall Co., The.	Textile Workers Union of America.
Kimberley-Clark Corp.	Union Carbide & Carbon Corp.
Kroehler Manufacturing Co.	United Auto Workers Union.
	U. S. News Publishing Corp.
	United States Savings & Loan League.
	United Steelworkers of America.

Chairman **PATMAN**. Mr. W. E. Hamilton, director of research, American Farm Bureau Federation.

**STATEMENT OF W. E. HAMILTON, DIRECTOR OF RESEARCH,
AMERICAN FARM BUREAU FEDERATION**

Mr. HAMILTON. Thank you, Mr. Chairman.

I have a somewhat longer statement than the time will permit, so I will have to skip through it. I would, however, like to have the entire statement placed in the record.

We are in general agreement with what seems to be the underlying philosophy of this report as summarized in chapter 1, where the President has stressed the importance of a free economy; the role of the Government in creating a favorable climate for private initiative, enterprise, and competition; and the responsibility of farm, labor, and business leaders for helping to avoid economic imbalance and dislocation. Nevertheless, we believe that the Economic Report could have been improved materially by placing more emphasis on the fundamental economic factors underlying our present situation and less emphasis on legislative recommendations.

We agree with some of the President's recommendations, but we disagree with a number of other proposals which seem to us to indicate a reliance on Government activities as the way to economic prosperity. This reliance on Government is inconsistent, we believe, with the basic philosophy expressed in chapter 1.

We agree with three fundamentals of Government budget policy outlined on pages 47 and 48 of the report.

These principles call for (1) strict discipline over expenditures; (2) distribution of the tax burden as fairly as possible with the least possible restraint on the incentives to work, to save, and to invest; and (3) administration of the Government's financial affairs in such a way as "to help stabilize the economy and encourage sound growth."

The Federal budget which has been proposed for the 1958 fiscal year does not appear to us to be consistent with these principles. A budget which proposes to increase Federal spending \$2.9 billion above fiscal 1957 and \$7.2 billion above fiscal 1955 hardly indicates "strict discipline over expenditures." The magnitude of the Federal spending proposed for fiscal 1958 also appears inconsistent with the use of budget policy "to help stabilize the economy."

As the Economic Report points out, our economy experienced an "intensive use of resources and upward pressures on prices during 1956." As long as this continues to be the situation, Federal spending on the scale proposed for 1958 cannot help but have an inflationary effect even though the budget does show a slight surplus. From the standpoint of economic stability, the budget should be cut and payments on the national debt increased substantially in fiscal 1958.

The President has recommended that Congress authorize a National Monetary and Financial Commission to make a thorough study of monetary and financial matters. The American Farm Bureau Federation recommended the establishment of a similar commission several years ago. Although our policy development process has not produced a recommendation for such a study in recent years, we know of no objection to the idea of a properly constituted study commission. If there is to be such a commission, it should be composed of well-qualified individuals who are broadly representative of the public at large, well informed on the subjects to be investigated, and free to devote considerable time to the proposed study.

The membership of the Commission should include individuals with broad experience in business, labor, agriculture, finance, and government; but members should not be chosen in such a way as to cause them to feel that it is their duty to represent the views of any particular group or organization. The views of such groups should be sought through hearings or informal conferences.

We are in general agreement with the President's comments on the agricultural situation.

We are aware of the fact that increased expenditures for farm programs are contributing to the present upward trend of the Federal budget. The present high cost of farm programs is largely the result of past government policies which, contrary to the recommendations of the American Farm Bureau Federation, unwisely encouraged excess production and filled government warehouses with price-depressing surpluses. In order to restore agriculture to a healthy economic situation, we must dispose of existing surpluses in a rapid but orderly manner and take steps to avoid the creation of new surpluses in the future.

The recent developments in the hog situation furnish a dramatic example of the effect on farm prices of adjusting production to market needs. A year ago we had a very unsatisfactory hog situation, but, as a result of reduced hog production in 1956, we have a situation where the price of hogs in January 1957 was 58 percent higher than in the same month of 1956.

The basic ideas back of the soil bank and Public Law 480, which authorizes the sale of surplus farm products for foreign currencies, were developed by Farm Bureau. We regard both programs as emergency measures, which are defensible only if they are administered in such a way as to make a maximum contribution to the objective of bringing the supply of farm products into balance with effective market demand.

We agree with the statement in the Economic Report that any action which would diminish the immediate impact of the soil bank should be avoided. In all of our recommendations on this program we have stressed the underlying principles (1) that a maximum effort should be made to utilize existing surpluses effectively in carrying out all phases of the program, and, (2) that participants should be rewarded only for effective contributions toward balancing supply with demand.

In my prepared statement, I have some more detailed recommendations for improving the soil bank.

With regard to Public Law 480, the President has recommended that the program be extended for 1 year, and that the authorization be increased by \$1 billion. We believe that this program should be extended for 2 years, with an additional authorization of \$3 billion. We agree, however, that this should not be considered a permanent program, and our recommendation for a longer extension and larger authorization than the President has recommended is based solely on the size of the surplus disposal job that is before us, and the conviction that these surpluses must be moved to create a better climate for agricultural prosperity.

I would like to make just a brief comment on foreign aid.

Although the Economic Report does not deal specifically with the subject of foreign aid, we think it appropriate to comment on it because of the importance of this item in the total budget.

Farm Bureau believes that foreign aid should be scaled down rather than increased at this time and that the emphasis should be on loans and the creation of conditions which will encourage private United States investment in foreign countries, rather than on United States grants.

We are opposed to the proposed 4-year program of Federal assistance for public school construction. We believe that construction of schools should continue to be a State and local responsibility and that Federal aid should be limited to those districts which have experienced severe financial burdens as a result of Federal projects.

In this connection, we would like to call attention to the paragraph at the bottom of page 48 and the top of page 49 of the Report. This paragraph states that expenditures of State and local governments have been increasing and that the objectives of this increased spending include schools. It then notes that:

In view of the exceptionally high demand for labor, materials, and equipment needed to carry out these projects, it is inevitable that not all of them can go forward as rapidly, or on as large a scale, as may be desired.

If high demands for labor, materials, and equipment are making it difficult for State and local governments to carry out all of their planned projects, it is difficult to see how Federal aid could result in any appreciable net increase in total school construction without contributing further to the already dangerous inflationary situation so clearly set forth in other portions of the report.

On page 32, the Report notes that all three of the major groups of wholesale prices moved upward during 1956. On page 34, it notes that "wage and salary cost per unit of output, which had been stable during most of 1955, rose significantly last year." On page 68, the Report states that "measures have been taken to improve the income status of individuals" and cites the increase in the statutory minimum wage rate, which became effective in 1956, and a number of administrative actions increasing minimum wage rates. This, incidentally, is one of the statements in the Report which seems to us to indicate an undue reliance on Government action as the way to economic prosperity.

In our judgment, there is some connection between the events noted in these three different statements. Although there were other contributing factors, there is no doubt in our minds that Government actions increasing minimum wage rates were one of the factors which caused wage rates to outrun productivity and contribute to price increases in 1956.

Chairman PATMAN. You may insert your entire statement into the record.

(Statement referred to follows:)

STATEMENT OF W. E. HAMILTON, DIRECTOR OF RESEARCH, AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation appreciates this opportunity to comment on the President's Economic Report.

We have long maintained that the general economic situation is one of the keys to farm prosperity. We recognize, of course, that general prosperity is

no guarantee that conditions will always be satisfactory in an individual industry such as agriculture. This is evident from the fact that farmers have been suffering from a price-cost squeeze and reduced net income at a time when national income has been reaching new highs. Nevertheless, agriculture has been helped immeasurably by the fact that the demand for farm products has been bolstered by high employment and rising productivity in most sectors of the economy.

The Economic Report is a valuable document as an analysis of current trends in our economy, a report on Government activities which affect the economy, and a collection of useful economic statistics.

We are in general agreement with what seems to be the underlying philosophy of this Report as summarized in chapter 1, where the President has stressed the importance of a free economy; the role of the Government in creating a favorable climate for private initiative, enterprise, and competition; and the responsibility of farm, labor, and business leaders for helping to avoid economic imbalance and dislocation. Nevertheless we believe that the Economic Report could have been improved materially by placing more emphasis on the fundamental economic factors underlying our present situation and less emphasis on legislative recommendations.

We agree with some of the President's recommendations, but we disagree with a number of other proposals which seem to us to indicate a reliance on Government activities as the way to economic prosperity. This reliance on Government is inconsistent with the basic philosophy expressed in chapter 1. This point will be further developed as we discuss our position on some of the President's specific proposals.

THE FEDERAL BUDGET

We agree with three fundamentals of Government budget policy outlined on pages 47 and 48 of the report.

These principles call for (1) strict discipline over expenditures; (2) distribution of the tax burden as fairly as possible with the least possible restraint on the incentives to work, to save, and to invest; and (3) administration of the Government's financial affairs in such a way as "to help stabilize the economy and encourage sound growth."

The Federal budget which has been proposed for the 1958 fiscal year does not appear to us to be consistent with these principles. A budget which proposes to increase Federal spending \$2.9 billion above fiscal 1957 and \$7.2 billion above fiscal 1955 hardly indicates "strict discipline over expenditures." The magnitude of the Federal spending proposed for fiscal 1958 also appears inconsistent with the use of budget policy "to help stabilize the economy."

As the economic report points out, our economy experienced an "intensive use of resources and upward pressures on prices during 1956." As long as this continues to be the situation, Federal spending on the scale proposed for 1958 cannot help but have an inflationary effect even though the budget does show a slight surplus. From the standpoint of economic stability, the budget should be cut and payments on the national debt increased substantially in fiscal 1958. We recognize, of course, that increases in some budget items are desirable or unavoidable; however, in the present circumstances, when we are experiencing an intensive use of resources and considerable inflationary pressure, every possible effort should be made to more than offset necessary increases with strict economy, the elimination of nonessentials, and the deferral of all except the most urgent new projects. We believe that Congress has a definite responsibility to reduce total projected Federal spending by a sizable amount.

We agree that there should be no tax reduction that would unbalance the budget under present circumstances. As a matter of equity, however, we believe that Congress should repeal the present 3-percent tax on transportation of property and the corresponding levies on the transportation of coal and oil by pipeline. The transportation tax was a war emergency measure. It is undesirable as a permanent policy because it increases production and distribution costs throughout the economy. It also places a penalty on those who find it necessary to use for-hire carriers rather than private transportation.

MONETARY AND FINANCIAL STUDY COMMISSION

The President has recommended that Congress authorize a national monetary and financial commission to make a thorough study of monetary and financial

matters. The American Farm Bureau Federation recommended the establishment of a similar commission several years ago. Although our policy development process has not produced a recommendation for such a study in recent years, we know of no objection to the idea of a properly constituted study commission. If there is to be such a commission, it should be composed of well-qualified individuals who are broadly representative of the public at large, well informed on the subjects to be investigated, and free to devote considerable time to the proposed study.

The membership of the Commission should include individuals with broad experience in business, labor, agriculture, finance, and government; but members should not be chosen in such a way as to cause them to feel that it is their duty to represent the views of any particular group or organization. The views of such groups should be sought through hearings or informal conferences.

In our judgment, the chief benefit likely to come from the proposed study is a better public understanding of the elements of sound monetary and fiscal policy, and the role of such policies in maintaining a stable and prosperous economy.

AGRICULTURE

We are in general agreement with the President's comments on the agricultural situation.

We are aware of the fact that increased expenditures for farm programs are contributing to the present upward trend of the Federal budget. The present high cost of farm programs is largely the result of past Government policies which, contrary to the recommendations of the American Farm Bureau Federation, unwisely encouraged excess production and filled Government warehouses with price-depressing surpluses. In order to restore agriculture to a healthy economic situation, we must dispose of existing surpluses in a rapid but orderly manner and take steps to avoid the creation of new surpluses in the future.

The importance of keeping the supply of farm products in reasonable balance with effective demand has been dramatically demonstrated by recent developments in the hog situation. A year ago we had more hogs than the market would absorb at prices satisfactory to producers. In January 1956, the average farm price of hogs was \$10.90 per hundredweight and producers were in a real squeeze. Farmers responded by cutting hog production 6 percent in 1956. As a result, the farm price of hogs was up to \$17.30 per hundredweight in January 1957, or 58.7 percent higher than in the same month a year earlier. The adjustments necessary to bring supplies in line with demand are more difficult in the case of commodities where we have piled up huge surpluses under past programs, but the direction we need to take to improve farm prices is clear.

The basic ideas back of the soil bank and Public Law 480, which authorizes the sale of surplus farm products for foreign currencies, were developed by Farm Bureau. We regard both programs as emergency measures, which are defensible only if they are administered in such a way as to make a maximum contribution to the objective of bringing the supply of farm products into balance with effective market demand.

We recognize that circumstances—the late enactment of the legislation, deficiencies in the law as finally adopted, and the fact that it was a major administrative job to get the new program understood and in operation in a short time—sharply limited the contribution of the soil bank to needed agricultural adjustments in 1956.

We agree with the statement in the Economic Report that any action which would diminish the immediate impact of the soil bank should be avoided. In all of our recommendations on this program we have stressed the underlying principles (1) that a maximum effort should be made to utilize existing surpluses effectively in carrying out all phases of the program and (2) that participants should be rewarded only for effective contributions toward balancing supply with demand.

Effective use of existing surpluses for payments in kind under the soil bank would help materially to reduce the total cost of agricultural programs. While the legal authority for payments in kind is somewhat limited, there is opportunity to provide much more incentive for producers to accept payments in kind than was provided in 1956.

The soil bank could be improved also by increased encouragement for farmers to agree to place the same acreage in the bank for successive years. It seems clear that a policy of permitting farmers to put land in the soil bank

for a single year and to return it to production the following year will tend to increase yields and thus defeat the purpose of the program.

The soil bank will fail to make a maximum contribution to the solution of our surplus problem and may even increase production if, as some have advocated, it is converted into free crop insurance and disaster relief.

Farm Bureau supports properly conceived and administered crop insurance and disaster relief programs, but the objective of the soil bank, as we see it, is to help balance agricultural production with effective market demand. In the case of wheat, the Department of Agriculture has moved toward putting the acreage reserve program on a crop-insurance basis by providing that compliance shall be based on the harvested rather than the seeded acreage of wheat. As a result, we are fearful that any reduction in wheat production resulting from the program will be small in relation to the cost.

We agree with the President's statement that new legislation is needed to permit corn farmers to participate in the soil bank. The present corn situation is the result of the unusual conditions which Congress attached to the recent corn referendum. It has long been the practice to require the approval of two-thirds of the producers voting in a referendum for the establishment of marketing controls which carry penalties for noncompliance. In the case of the corn referendum, however, 38.5 percent of the producers voting were able to force reestablishment of the discredited corn acreage allotment program although 61.5 percent indicated a preference for the base acreage program.

Farm Bureau favors immediate legislative action to give corn farmers the kind of program for which the large majority voted in the referendum. The inadequacy of corn acreage allotments has been demonstrated repeatedly. For years corn allotments have been ignored by a majority of the commercial area corn producers who have preferred to produce corn for feed rather than for delivery to the Government.

Under the acreage allotment program land taken out of corn has been shifted to other crops, largely feed grains. In addition, large acreages taken out of such crops as wheat and cotton have been shifted to noncommercial corn and other feed grains. As a result, increased quantities of grain sorghums, barley, and oats have been fed to livestock as a substitute for corn, and feed surpluses have been showing up in the corn supply. This is true even though corn acreage in the commercial area has held steady for a number of years.

In accordance with the law, corn acreage allotments have gone down as the feed surplus in the form of corn has gone up. Normally about 56 million acres of corn are planted in the Corn Belt; however, this year's corn allotment is only 37½ million acres which must be spread over an area somewhat larger than the traditional Corn Belt. Under the base acreage program, which was favored by 61.5 percent of the farmers voting in the referendum, producers would be required to put a part of their cropland into the soil bank and would be encouraged to cut corn acreage below their pro rata share of 51 million acres. This would do much more than the discredited acreage allotment program to bring feed supplies into balance with market demand.

The President has recommended that title I of Public Law 480, the Agricultural Trade Development Act, be extended for an additional year and that the cost limitation on the surplus commodities which may be sold for foreign currencies be increased by \$1 billion. We believe that this program should be extended for 2 years with an additional authorization of \$3 billion. It is not our desire that Public Law 480 or any similar program should become permanent. As the economic report points out, there are some serious disadvantages to this type of program. We believe, however, that the magnitude of our surplus disposal task and the progress that has thus far been made in moving surplus products abroad through sales for foreign currencies fully justifies the longer extension and larger authorization which we are recommending. In order to emphasize the temporary nature of this program, we believe that plans should be made to taper it off in the second year of the proposed 2-year program extension.

Foreign currencies acquired under this program should be used as a revolving fund for the expansion of industry and commerce; to promote United States farm exports on a permanent and sound basis, including United States agricultural participation in trade fairs and the promotion of improved marketing and merchandising methods; to pay United States obligations abroad; and for other purposes as specifically set forth in the law.

We agree with the statement in the economic report that, "as we make progress in the essential task of reducing our huge accumulated surpluses, we

must make sure that statutory formulas do not operate to stimulate unneeded production and thus generate new price-depressing surpluses." This principle should be taken as a guide in the development of future farm legislation.

ORGANIZATION FOR TRADE COOPERATION AND THE EXPORT-IMPORT BANK

We support the principle embodied in the proposed Organization for Trade Cooperation and urge the enactment of legislation authorizing United States participation. This agency should have as its primary objective the cooperative expansion of international trade. It should not have any authority to impose any obligation on any member. We are opposed to incorporating OTC as a specialized agency of the United Nations.

We also support the recommendation in the economic report that the authority of the Export-Import Bank to approve credits be extended beyond the present expiration date of June 30, 1958. It is our feeling that the Export-Import Bank has made a very fine record and that it has been of material assistance in our efforts to expand agricultural exports.

FOREIGN AID

Although the Economic Report does not deal specifically with the subject of foreign aid, we think it appropriate to comment on it because of the importance of this item in the total budget.

Farm Bureau believes that foreign aid should be scaled down rather than increased at this time and that the emphasis should be on loans and the creation of conditions which will encourage private United States investment in foreign countries, rather than on United States grants. In this connection we would like to place in the record the following excerpts from the resolutions adopted by the elected voting delegates of our member State Farm Bureaus at our December 1956 convention.

"Economic aid"

"Economic assistance to other nations has contributed to international peace and security and to building the economies of friendly nations. However, the present size and scope of our foreign-aid program should not be considered a permanent feature of national policy. United States commitments for foreign assistance should be scaled down. Emphasis should be placed on loans rather than grants. The United States Government should make it clear that resources for public loans are limited and inadequate in relation to total needs. Public lending is a poor substitute for private investment. To an increasing extent private investment should replace public loans.

"Military aid"

"Military assistance should aid our allies to build their own defense resources, rather than supply them with military goods produced in the United States. Such dispersal of production of military goods will avoid unbalancing our own economy by undue concentration of defense production in the United States. It will promote the policy of mutual sharing of the burden of the common defense.

"Investment in other countries"

"National security and trade among nations will be furthered by an expansion of industry in underdeveloped areas of the world. This can be most effectively accomplished by private United States investment in such areas. United States foreign policy should have as a major objective the creation of conditions in the various friendly countries of the world which will encourage private investment in industry and commerce.

"Technical assistance"

"The technical assistance program should be continued as an important part of our foreign policy. The primary objective of this program should be to aid underdeveloped countries to develop their manpower and natural resources and expand their production and commerce by educational effort toward improved technology and practices, rather than by loans or grants. Maximum emphasis should be on the development of industries which complement the economy of the area, rather than overemphasis upon agricultural development."

FEDERAL AID TO EDUCATION

We are opposed to the proposed 4-year program of Federal assistance for public-school construction. We believe that construction of schools should continue to be a State and local responsibility and that Federal aid should be limited to those districts which have experienced severe financial burdens as a result of Federal projects.

In this connection we would like to call attention to the paragraph at the bottom of page 48 and the top of page 49 of the report. This paragraph states that expenditures of State and local governments have been increasing and that the objectives of this increased spending include schools. It then notes that, "In view of the exceptionally high demand for labor, materials, and equipment needed to carry out these projects, it is inevitable that not all of them can go forward as rapidly, or on as large a scale, as may be desired."

If high demands for labor, materials, and equipment are making it difficult for State and local governments to carry out all of their planned projects, it is difficult to see how Federal aid could result in any appreciable net increase in total school construction without contributing further to the already dangerous inflationary situation so clearly set forth in other portions of the report.

WAGE RATES AND PRODUCTIVITY

On page 32, the report notes that all three of the major groups of wholesale prices moved upward during 1956. On page 34, it notes that "wage and salary cost per unit of output, which had been stable during most of 1955, rose significantly last year." On page 68, the report states that "measures have been taken to improve the income status of individuals" and cites the increase in the statutory minimum-wage rate, which became effective in 1956, and a number of administrative actions increasing minimum-wage rates. This, incidentally is one of the statements in the report which seems to us to indicate an undue reliance on Government action as the way to economic prosperity.

In our judgment there is some connection between the events noted in these three different statements. Although there were other contributing factors, there is no doubt in our minds that Government actions increasing minimum-wage rates were one of the factors which caused wage rates to outrun productivity and contribute to price increases in 1956. Increases in the minimum-wage rates helped to set off a chain reaction throughout the entire economy as various labor groups sought to reestablish differentials above the minimum rate.

One of the aspects of the current economic situation which is of great concern to farmers is the fact that labor and management in many industries apparently have the ability to divide the gains of increased productivity without passing any part of these gains on to consumers in the form of lower prices. This is of great concern to farmers because, despite the intervention of price supports on some farm commodities, agriculture remains a competitive industry where gains in productivity tend to be passed on to consumers in the form of lower prices. The high cost of things farmers buy is one of the major factors in the present agricultural situation. Net farm income declined \$5.9 billion from 1947 to 1955, but only 19 percent of this decline resulted from a reduction in cash farm sales.

The remaining 81 percent resulted from increases in the production costs.

AREA PROGRAMS

On page 63, the report notes that preference has been given to businesses located in areas of persistent unemployment in awarding Federal procurement contracts and that defense facilities constructed in such areas are accorded special tax amortization privileges. This kind of assistance to such areas seems to us to be inconsistent with the objective of strengthening the national economy as a whole.

The Federal Government is on unsound ground when it awards procurement contracts on the basis of any consideration other than a determination of the lowest responsible bid. The granting of special tax amortization privileges for facilities constructed in selected areas is an outright subsidy to such areas. If the facilities in question are truly defense facilities, they presumably are of a temporary nature which will not contribute to a long-run solution of area problems. If such facilities have normal commercial uses, as they almost certainly do, they represent a Government allocation of capital to uses that private industry apparently considers uneconomic. The fact that accelerated amortiza-

tion is being used to encourage industry to locate in selected areas strengthens our belief that this program has outlived its usefulness and should be terminated.

We believe that it is far sounder to encourage State and local governments, private industry, and local organizations to mobilize their resources in a joint effort to solve local unemployment problems—including the problem of underemployment in agriculture—through education and balanced economic development.

The Economic Report deals with many other topics which are of concern to Farm Bureau; however, we believe that the points which we have discussed are sufficient to indicate our general reaction to this report.

Chairman PATMAN. Mr. Herschel D. Newsom, master of the National Grange.

STATEMENT OF HERSCHEL D. NEWSOM, MASTER, THE NATIONAL GRANGE

Mr. NEWSOM. As farmers and as rural families, we are increasingly aware of the vanishing of our oft-referred-to independent status. There is little point to our describing ourselves as being independent even though there may have been some justification for such assertions in years gone by.

On the contrary, we are increasingly dependent on, and linked with, the wage, price, and general economic level of our fellow Americans. We are much more dependent on all these factors than were our fathers. We are even more influenced by them than we ourselves were just a few years ago.

This is not to say that as individual farm operators any one of us can afford to abdicate responsibility for maximum skill and effort in keeping our own individual affairs in the best possible circumstance. It is, however, completely futile to proceed on the assumption that farm people and rural America can make an intelligent approach to solution of their own affairs, in ignorance of the factors that arise in other segments of America's economy to exert such telling and decisive influence on our own economic status as rural people.

Many of us, therefore, have a deep sense of gratitude for expressions such as that made by the President of the United States calling upon all Americans to use restraint in their demands upon the economic structure of this Nation and, in fact, to guard against unreasonable price and wage increases without due regard for the economy as a whole. In short, we have long felt that somehow every American must sooner or later come to understand that one American's price or wage level immediately becomes the cost to his fellow Americans.

This is not to condemn our friends and contemporaries in business and labor. It is, on the other hand, only to emphasize the fundamental fact that we can never solve the cost-price problem of American farmers entirely within the business of agriculture. It is even more than that; it is again to restate that the Grange philosophy is predicated on the fact that to whatever extent we fail to permit competition and individual enterprise to function in the total American economy, we may find ourselves forced to eliminate or restrict the effect of competition within the agricultural economy. And, conversely, we can only successfully maintain opportunity and enterprise in the agricultural economy in proportion to the degree of freedom and competition that we may preserve in the nonagricultural segments of our American economy.

American farmers know that major factors in the farm-income problem of the present time are to be found in the very substantial increases in prices of products that farmers must buy; in the wage rate that enters into the production of those products; and in the total transportation costs that result from both. The approximate 100 percent increase in wage rates in food production, processing, and distribution which have characterized the last 10 or 11 years; the approximate 80 percent increase in transportation costs, coupled, of course, with the tremendous increase in capital requirements in our farming business—all these, in conjunction with the inability of agricultural investment or farm labor to earn an American level of reward because of the influence of internationally established competitive prices—have in this post-Korean war period had exactly the same kind of an effect on American agricultural economy as has been manifest in the postwar periods following the great Civil War; that period linked with the so-called Cleveland panic; and the agricultural crisis that characterized the twenties following World War I. Indeed, the members of this committee will well recognize that we were again headed in exactly this same direction in 1947 and 1948, so that the effect was beginning to be manifest on the total economy in late 1949 and early 1950. It was in the second half of 1950 that farm markets again expanded as a result of outbreak of war in Korea.

It is not our purpose to belabor this point before this joint committee. It is rather our purpose only to recite a few of the reasons which we think entered into the necessity of our herculean efforts during the past year to regain what, to our American point of view, at least, might be termed "a legitimate share of the world's markets for agricultural products." Through these various devices, such as section 402 of Public Law 665, title I and title II of Public Law 480, as well as section 302 of that same law, we have seen agricultural exports reach a new high level.

In the face of the situation in which we found ourselves at the time of the institution of these programs, the programs themselves were thoroughly justified in the total public interest as well as in the interest of farm and rural people.

Unless or until we have the courage to develop programs which will permit the normal reestablishment of conditions wherein private commercial trade may again assume the preponderance of our export functions, we are certain to find that the anticipated benefit of the present support and export programs will be short of their objective. In fact, our own organization now is face to face with a very real question. Can we conscientiously support the administration's request for only a 1-year extension of Public Law 480 at a probable cost of \$1 billion?

Grange people everywhere are increasingly conscious of the necessity of curtailing governmental expenditures and reducing Government's take from the income and the payroll of our citizens wherever it can be done without impairment of the national safety and diminishing the welfare of American people. But we respectfully submit to the members of this committee that unless or until we can expand the commodity approach to our farm problem, in which the Federal Government has become an increasingly important factor, we will not be able to curtail extraordinary export programs like those mentioned

above, which were necessitated by the continued piling up of the products of American farmers in the hands of their Government.

From an agricultural and rural point of view there is no problem confronting this Congress more important than the problem of removing or curtailing Government interference through our present price-support laws and program, with the normal functions of private trade in these agricultural products. This is most especially true with respect to the normal American farm exports such as cotton, wheat, and rice.

But we must accomplish this objective without driving farm income to that level which would be dictated by price levels determined by free international competition. American agriculture can no longer afford such market shrinkage as took place between 1953 and 1956 when American cotton acreage was shrunk by 32 percent while the cotton acreage in the rest of the world was increased by 49 percent; when American wheat acreage was reduced by 29 percent while the wheat acreage of the rest of the world was increased by 12 percent; and while American rice acreage was reduced by 18 percent while the rice acreage of the rest of the world was increased by 11 percent. But neither can American farmers pay 1957 or 1958 production costs nor living costs out of income that would result from a full free-market operation.

In the National Grange we are unwilling to concede that competition should not be given some range of operation in our American economy. To so concede invites the extreme likelihood of virtual abandonment of the right of individuals to choose that utilization of their own skills and energies and of resources at their command, in such a manner as to most likely enhance their own individual welfare and that of their families.

This is why our organization has insisted that increasing reliance should be placed on competition rather than on Government regulation in our transportation industry. This philosophy has, in turn, brought us into head-on conflict with the Interstate Commerce Commission. This represents a changed philosophy on the part of the Grange over the 90 years of our history. Changed circumstances, however, dictated this modification of emphasis. When the Grange originally sought the creation of a regulatory body, it did so because of the monopoly in transportation. We are now seeking to safeguard the integrity of "agricultural exemptions" from the regulated tariff category in the hope that a reasonable degree of competition will help America to achieve the most efficient transportation system possible.

In the same manner we have sought to move in the direction of equitable return on labor input and capital investment in our agricultural industry by such devices as marketing orders and marketing agreements, such as the Sugar Act of 1936 and the Wool Act of 1954. In each of these devices the fundamental philosophy which we in the Grange call domestic-parity philosophy is that American farm producers are entitled to a great measure of the American domestic primary market at an American price level, but that we must basically preserve some measure of price function in influencing the production levels and in effecting allocation of resources and effort. To fail to do so is to invite the necessity of substituting some other method of allocation of those resources and that effort. We know of no acceptable substitute.

Even in the face of conclusive evidence that the rising level of production and the improving standard of living in America is the natural consequence of a fundamental economic change wherein millions of consumers have been lifted into middle-income brackets for a relatively long period of time—long enough in fact that these higher levels of consumption and of living have, for the most part, taken on normal or minimum if not desirable levels—we still have some people who seemingly talk about solving our agricultural cost-price squeeze by placing total emphasis on the cost side of this equation. This is indeed very shortsighted to use one of the most charitable terms I can think of. Obviously we must work on both sides of this equation. We must do everything that we legitimately can to hold down unreasonable increases in both wage levels and price levels as they enter into our cost factors. But to place all the emphasis there is to either fail to achieve our objective of balancing the agricultural equation itself, or, even worse, to destroy the very foundation from which we may well build an equitably prosperous agriculture within the American economy.

Perhaps our major difficulty insofar as rural America is concerned is that on the whole we have not yet adequately and intelligently defined our objective. With this in mind, the Grange is disappointed in the report of the Department of Agriculture indicating continued adherence to the present parity concept under which "purchasing power per unit of production as in the 1910-14 base period." There is no defense for continuing to assume that any units of production should have the same purchasing power that they enjoyed 45 years ago. Neither is there logic in assuming that even the agricultural index as a whole should be frozen in a static relationship with the American economy over a long period of time.

In like manner, we believe there is frustrating confusion economically back of continued insistence that all in the world we need do basically in our farm program is simply lower the level of price support until those price supports no longer constitute a major factor in market influence or domination. The logical result of pursuance of such philosophy is to condemn agriculture to a continually lowering income until it is finally determined at a level indicated by full free-market operation internationally as well as nationally. Let us be realistic about it.

Whatever justification transportation regulation programs may have, it is clear that that regulation has a tendency to increase transportation costs. Regardless of the merit, or even compulsion, of certain trade quota and import duty mechanisms on behalf of certain American industries, there is no doubt but that these institutions raise the cost level of many products in America. Does any presume for a minute that we are going to completely cancel out, even over a long period of time, the provisions under the Employment Act of 1946 under which this hearing is even now being held, or any one of several other economic institutions which have in themselves done much to give rise to the present level of the American economy? Is it not equally inexcusable to talk about an ultimate result even though it may be an unconscious objective of some of our contemporaries when they talk about simply but progressively lowering the level of price support?

The solution to the agricultural problem is not going to be found in any level of price support under the present program, especially as it applies to natural or normal export agricultural products.

The National Grange therefore urges this committee to diligently examine the proposition that equity—parity, if you please, in the true sense of the word—for agricultural and rural people must be defined in terms of reasonable return on investment capital and labor input in the agricultural product. We have not contended and do not now contend that that equitable return need be defined as being identical to the relatively high return on equity capital in nonagricultural investment. There are many differences that must be taken into account. There are even substantial differences between what might reasonably and economically be defined as fair return on real-estate investment as contrasted to a fair return on agricultural equipment and production supplies. Perhaps there is even economically justifiable reason to assume that the labor return need not be exactly comparable.

The mere fact that some careless assumptions on these matters has led those who have investigated the matter to a conclusion that this method of determination of parity would give an income figure as a target that clearly is unattainable, at least for a long period of time, is not sufficient reason to abandon an idea that is fundamentally consonant with the capitalistic concept which has motivated America.

Having thus defined a sound objective—having tried to establish our direction and some indication of distance to be traveled—we would then hope that the members of this committee would find the progress already attained in a few instances where such commodity programs have been established as they now find in the case of the Wool Act, in the case of the Sugar Act, and in the case of marketing orders and agreements, of real significance in determining the type commodity programs that should be designed to consistently and progressively move us toward the objective of equity or parity as defined above.

Suffice it to say that we believe that there must ever be some reasonable opportunity for competitive influence in practically all segments of the economy if we are to maintain opportunity for individuals. Programs which in the final analysis will needlessly destroy competition are almost certain to unreasonably restrict opportunity. We, therefore, solicit the continued interest and concern of the members of this committee in establishing sound and constructive objectives within all of the American economy and in diligently examining our present or proposed programs in terms of such objectives.

Thank you.

Chairman PATMAN. Thank you very much.

Mr. John A. Baker, coordinator of legislative services, National Farmers Union.

STATEMENT OF JOHN A. BAKER, COORDINATOR OF LEGISLATIVE MATTERS, NATIONAL FARMERS UNION

Mr. BAKER. Mr. Chairman, I, too, appreciate this opportunity to present our views before your committee.

I would like, also, Mr. Chairman, very heartily to commend you for your introductory statement. I would like to say that we agree fully with the comments that you have made.

The President's Economic Report is, in some respects, mildly encouraging to us and in other respects greatly disappointing.

The report is encouraging to the extent, even though limited in scope of action, that it recognizes various severe gaps in our so-called national prosperity, and states the great need for Federal, State, and private action to provide the social investments required to keep an expanding economy expanding at the necessary rate.

We are encouraged that not only are these gaps and needs recognized but that at least some recommendations are made for mildly forward-looking Federal actions and movement in the correct direction, to overcome the gaps and fill the growing needs.

We rejoice that the President has recognized the need for (1) strengthening personal security through expanding the coverage to additional people of minimum wage and maximum hour legislation, old-age and survivors insurance, higher standards and increased Federal aid to public assistance programs, and similar matters; (2) raising of health standards; (3) improving housing standards; (4) passage of a Federal action program to aid local rural and urban areas of persistent unemployment and underemployment; (5) better educational facilities to improve general educational and research facilities and standards and promote more widespread acquisition of skills and technology; (6) widening the opportunities for small business; and (7) strengthening economic ties with other nations.

In regard to these fields, we shall continue to work with the legislative and appropriations committees and the Congress, urging them to support the President to move forward in these fields, even as we will continue to urge that the committees and the Congress make greater progress than the President has seen fit to recommend.

It is our conviction that the President will not be opposed to greater progress in these matters than he has charted. He appears to have accepted the fundamental propositions, for example, of adequate minimum wage coverage and amount, and of the need for substantial Federal aid to education. We do not believe that he will veto bills giving him more nearly adequate programs than he has specifically asked for. In any event, we are hopeful that with the combined support of the President and of liberals on both sides of the political aisle in both Houses on matters listed above, a substantial amount of fundamentally improved welfare legislation can be put on the books in this session of Congress. We shall give our full cooperation to all who wish to help do so.

The President's Economic Report is greatly disappointing to us in several very important regards.

First, the report makes an entirely incorrect diagnosis and characterization of the weaknesses of the existing economic situation. Briefly, the major danger to future economic growth and full employment is not economywide inflation, as the report declares, but rather the economy is in an unbalanced state with a sharply falling rate of economic growth. The main danger now is that we are allowing our great economic growth potential and progress to grind to a shuddering halt. And this leads into my next point.

Second, the incorrect diagnosis of inflation as the major problem leads the President and his advisers to the almost completely unwise

and inaccurate prognosis outside the welfare area that continuation of the high interest rate hard-money policy and further promotion of the so-called free market for the defenseless sectors of the economy, notably farmers, and small business, is the appropriate or workable way to overcome the major dangers to future economic growth.

There are no recommendation in the report that are designed to or that will do anything at all to raise farm family income above the depressed level to which it has been caused to fall in the past 5 years. There is no recognition in the report at any place that farm people are being asked to accept a continuing situation where they have an opportunity to earn considerably less than half of the income that the Nation has come to believe that nonfarm people are entitled to earn.

We had hoped but were disappointed not to find any indication of any thought or chart or guidelines by which farmers might find a path toward a parity of take-home pay with other members of the national society. Instead, we find nothing at all except a vague promise of continued promulgation of the sliding scale farm policies of the past with their ultimate goal of a completely free farm commodity market.

At this point, I want to say that I want to agree with the things that Mr. Newsom just said with respect to the unworkability of a completely free farm economy market, in view of the fact that we are trying to operate an almost completely administered economy outside of farming.

As members of the committee know, we have been actively urging the adoption of a new farm income parity formula to replace the existing system of price parity formulas, so that the depressed economic condition of farm people will at least be measured by a yardstick that is 36 inches long instead of one that is only 19 inches long.

We are, also, disappointed not to find in the Economic Report any indication whatsoever of any shift from the backward looking and depressive national resources and public power policies of the past 4 years. Our views on this matter are well known to members of the committee, so I will not comment further but submit our recently drafted legislative analysis memoranda on the subject for your hearing record.

Now in the brief time remaining for my statement, may I hit a few other points?

We welcome and support the President's call for more vigorous enforcement of the antitrust legislation and other measures to bring about removal of restrictions by industrial and business management on the operation of competitive markets. We are disappointed that this call was not balanced by a correct recognition of the need for those groups unable to protect themselves with administered prices to obtain the help of the Federal Government to acquire and use countervailing power in the commodity, service, and money markets of the Nation.

Finally, I want to say that we are disappointed that a report that has collected and presented one of the world's finest, more comprehensive, and accurate compilations of national economic statistics should perpetuate, by incorrect assertion in the narrative parts of the report, that there was some improvement in farm family net income from 1955 to 1956. The correct statement would be that na-

tional net farm family income after taking account of inventory change was almost exactly at the same low level of 1956 as in 1955.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you.

(Mr. Baker's prepared statement follows:)

BRIEF COMMENTS OF J. A. BAKER, COORDINATOR OF LEGISLATIVE SERVICES, NATIONAL FARMERS UNION, ON THE 1957 ECONOMIC REPORT OF THE PRESIDENT

I appreciate this opportunity to present to your committee the reaction to the President's Economic Report of Mr. James G. Patton, president of National Farmers Union.

Mr. Chairman, the President's Economic Report is both mildly encouraging to us in some aspects and greatly disappointing in several others.

The report is encouraging to the extent, even though limited in scope of action, that it recognizes various severe gaps in our so-called national prosperity, and states the great need for Federal, State and private action to provide the social investments required to keep an expanding economy expanding at the necessary rate. We are encouraged that not only are these gaps and needs recognized but that at least some recommendations are made for mildly forward looking Federal actions and movement in the correct direction, to overcome the gaps and fill the growing needs. We rejoice that the President has recognized the need for (1) strengthening personal security through expanding the coverage to additional people of minimum wage and maximum hour legislation, old-age and survivors insurance, higher standards and increased Federal aid to public assistance programs and similar matters; (2) raising of health standards; (3) improving housing standards; (4) passage of a Federal action program to aid local rural and urban areas of persistent unemployment and under-employment; (5) better educational facilities to improve general educational and research facilities and standards and promote more widespread acquisition of skills and technology; (6) widening the opportunities for small business; and (7) strengthening economic ties with other nations. Our deep conviction that none of the President's recommendations in these fields are bold or far-reaching enough does not diminish the great significance we attach to the fact that the President has clearly and firmly recommended that we move in the right direction on them.

In regard to these fields we shall continue to work with the legislative and appropriations committees and the Congress, urging them to support the President to move forward in these fields even as we will continue to urge that the committees and the Congress make greater progress than the President has seen fit to recommend. It is our conviction that the President will not be opposed to greater progress in these matters than he has charted. He appears to have accepted the fundamental propositions, for example, of adequate minimum wage coverage and amount, and of the need for substantial Federal aid to education. We do not believe that he will veto bills giving him more nearly adequate programs than he has specifically asked for. In any event, we are hopeful that with the combined support of the President and of liberals on both sides of the political aisle in both Houses on matters listed above, a substantial amount of fundamentally improved welfare legislation can be put on the books in this session of Congress. We shall give our full cooperation to all who wish to help do so.

The President's Economic Report is greatly disappointing to us in several very important regards.

First, the report makes an entirely incorrect diagnosis and characterization of the weaknesses of the existing economic situation. Briefly, the major danger to future economic growth and full employment is not economywide inflation, as the report declares, but rather the economy is in an unbalanced state with a sharply falling rate of economic growth, where some incomes and prices are too high and other are too low to maintain stable economic growth. Some forms of investment are growing too rapidly and others are being made at too slow a rate. The main danger now is that we are allowing our great economic growth potential and progress to grind to a shuddering halt. And this leads into my next point.

Second, the incorrect diagnosis of inflation as the major problem leads the President and his advisors to the almost completely unwise and inaccurate

prognosis outside the welfare area that continuation of the high-interest-rate hard-money policy and further promotion of the so-called free market for the defenseless sectors of the economy, notably farmers, is the appropriate or workable way to overcome the major dangers to future economic growth.

There are no recommendations in the report that are designed to or that will do anything at all to raise farm family income above the depressed level to which it has been caused to fall in the past 5 years. There is no recognition in the report at any place that farm people are being asked to accept a continuing situation where they have an opportunity to earn considerably less than half of the income that the Nation has come to believe that nonfarm people are entitled to earn. Even though such might not be attainable in the year immediately ahead, we would have been less disappointed if the President would have stated forthrightly how much farm income would be required to give an income parity position to farm families. We would have been encouraged, instead of disappointed, if he would have applied the same reasoning in the farm area that he applied in the welfare area of at least charting and recommending action and movement in the right direction. We had hoped but were disappointed not to find any indication of any thought or chart or guidelines by which farmers might find a path toward a parity of take-home pay with other members of the national society. Instead we find nothing at all except a vague promise of continued promulgation of the sliding scale farm policies of the past with their ultimate goal of a completely free farm commodity market.

As members of the committee know, we have been actively urging the adoption of a new farm income parity formula to replace the existing system of price parity formulas, so that the depressed economic condition of farm people will at least be measured by a yardstick that is 36 inches long instead of one that is only 19 inches long. We are also asking Congress to adopt a National Food, Fiber, and Family Farm Policy Act similar in nature to the Employment Act of 1956, to chart out the elements of the broad, sound, comprehensive Federal farm program that is required to provide the conditions under which farm families will have an equal opportunity to work up to a situation where they can earn with their work, property ownership and management a parity of income and living standards with people in other walks of life. We believe that a majority of the Congress is agreed upon these goals and policies. And as a simple joint congressional resolution such action would not be subject to the veto. We believe that adoption of such a joint resolution would have a healthy and effective influence in at least making the attitude of the Congress clear with respect to preservation and improvement of the family farm. I shall not go into detail in this oral statement. Our legislative analysis memorandums setting forth our views of the type of comprehensive Federal farm income improvement and protection program adequate to the need are being placed in the record of these hearings. We hope as much of this program will be adopted as could be expected to escape the fate of a veto.

We are, also, disappointed not to find in the Economic Report any indication whatsoever of any shift from the backward looking and depressive national resources and public power policies of the past 4 years. Our views on this matter are well known to members of the committee so I will not comment further but submit our recently drafted legislative analysis memoranda on the subject for your hearing record.

Now in the brief time remaining for my statement, may I hit a few other points.

We welcome and support the President's call for more vigorous enforcement of the antitrust legislation and other measures to bring about removal of restrictions by industrial and business management on the operation of competitive markets. We are disappointed that this call was not balanced by a correct recognition of the need for those groups unable to protect themselves with administered prices to obtain the help of the Federal Government to acquire and use countervailing power in the commodity, service, and money markets of the Nation. Along this line we urge that the Anti-Monopoly Investigating Committee examine the recently proposed idea of "vertical integration" in food processing and distributing industries and indeed of the extent to which such vertical integration has already occurred.

Finally I want to say that we are disappointed that a report that has collected and presented one of the world's finest, most comprehensive and accurate compilation of national economic statistics should perpetuate, by incorrect assertion, that there was some improvement in farm family net income from 1955 to 1956. The correct statement would be that national net farm family income after

taking account of inventory change was almost exactly at the same low level in 1956 as in 1955, namely \$11.7 billion compared with a parity income figure of nearly \$25 billion. The result was that in 1956 the per person income from all sources, farm and nonfarm, of people who lived and worked on farms was not more than 41 percent of the per person income of nonfarm people. Instead of progress toward parity income for farm people we as a nation have been moving steadily in the opposite direction. We seriously doubt if such a condition is conducive to justice in a democracy nor to continued stable economic growth at a desirable rate.

(The legislative analysis memorandums referred to are as follows:)

LEGISLATIVE ANALYSIS MEMORANDUM No. 56-1 (REVISION No. 3)

DECEMBER 5, 1956.

FULL PARITY FAMILY FARM INCOME IMPROVEMENT PROGRAM

This memorandum lists and briefly describes the legislative phases of the family farm income improvement program recommended by National Farmers Union.

SUMMARY

I. Income protection for farm families.

A. Expansion of existing Federal farm price support and related legislation to provide mandatory 100 percent of parity income protection for family farm production of all commodities by means of workable combinations of parity income supplement payments and price-support loans, purchase agreements and purchases.

B. Revitalize and expand Federal crop-insurance program.

C. Continued improvement of social security old-age and survivors insurance program for farmers.

D. Supplemental programs for low-income farm families in depressed rural areas.

II. Maintain national security reserve of food, fiber, and oils.

III. Expand human use and demand for farm commodities.

A. Expand domestic consumption:

1. Expanding full-employment economy.

2. National food allotment stamp plan.

3. Expand school-lunch program to all schools.

4. Federal financing of two half-pints of milk per schoolchild per day.

5. Credit program to encourage improvement of terminal markets for perishable farm commodities.

6. Better terminal market inspection of perishables.

7. Provide more nearly adequate nutrition standards for public institutions.

8. Increase emphasis on expanding industrial uses of farm commodities.

9. Elimination of poverty and depressed industrial and rural areas.

B. Expand exports:

1. Establish international commodity agreements for all farm commodities that enter importantly into international trade, and improvement and renewal of International Wheat and Sugar Agreements.

2. International Food and Raw Materials Reserve (World Food Bank).

3. Expand Agricultural Trade Development and Assistance Act.

4. Expand point 4 program of assisting free world economic growth and development.

5. Continue and use Reciprocal Trade Agreements Act and further customs simplification.

6. Trade adjustment aids to United States industries, communities, workers, and farmers injured by tariff and import quota reductions.

IV. Keep market supply in balance with augmented demand.

A. Establish workable voluntary conservation acreage reserve.

B. Enact marketing premium payments program.

C. Revise and extend marketing quotas.

D. Acreage allotments.

E. Revise and extend marketing agreements and orders and provide other legislation to protect farmers in bargaining with buyers of farm commodities.

V. Revitalize and expand Farmers Home Administration into an effective "yardstick" family farm loan agency.

INCOME PROTECTION FOR FARM PEOPLE

Almost all family farms today are commercial farms. They must buy an increasingly large part of the services, machinery, and supplies used for farm operation and for modern family living. They sell a very large part of what they produce, averaging over 89 percent. The terms they are able to trade on make a big difference in the standard of living the family can earn.

The prices of things that farmers buy, both production and family living items, are retail prices like the prices all consumers pay.

These retail prices, and the wholesale prices behind them, are administered prices—prices set by manufacturers, money-market bankers, railroad companies, and others, on the basis of their ability to withhold supply of goods and services to maintain the set price.

Experience has shown that these prices paid by farmers and consumers rise fast enough in periods of inflation. However, experience has also shown that the prices paid by farmers for things and services they must buy from nonfarmers do not drop very much even in periods of economic stagnation.

This is because manufacturers and the others protected by tariffs, corporation laws, Government commissions, and many other private and public actions provided through or permitted by State and Federal Governments, can hold down production and maintain price partly because of the relatively small number of firms, or persons, in each industry. They can do so profitably because overhead fixed costs are a small proportion of total costs. Thus they can make large cuts in costs by reducing production or withholding services.

On the farmers' side of the market bargaining process, there are about 3½ million fulltime farmers selling farm commodities and buying farm production supplies in competition with each other and buying family living items in competition with more than 45 million other consumer units.

No one farm family controls a significantly large enough share of the total market to raise prices received by withholding supplies from the market. Nor have they so far been able successfully to band together voluntarily to do so. Moreover, unlike the industrialist, a farmer's fixed costs are a very high proportion of total costs. He cannot reduce costs much by curtailing production.

Operating alone, the only out for the individual farmer is to produce more as long as he can to raise gross income by increasing volume of sales. In fact, farmers in 1956 continue to compete against each other to get additional land to increase output. As a consequence farm land values continue to rise in the face of the drastic drop in farm income.

The increased supply resulting from 3 million farmers each doing this causes a very large drop in prices and income received by farmers. The nature of demand for food and clothing is such that a small percentage increase in supply or decrease in demand will cause a 5-to-10 times greater percentage drop in prices received by farmers.

Coupled with these chronically adverse terms of trade for farmers, which are associated with industrial structure sanctioned by Government, it is the tendency for improving farm technology to cause farm production to increase faster than population and improving diets even if special governmental consumption-expanding measures are put into effect.

The net result of farmers' adverse terms of trade is chronic farm economic depression when farm income is not specifically protected from the forces of the so-called free market. The indication of recent history is that even in a relatively full employment economy farm family incomes will drop continuously about 5 percent per year in the absence of fully adequate specific governmental farm income protection programs.

This drop will continue until such time as farm families exhaust a substantial portion of their assets and net worth, until they are living in utter poverty and have worn out this capital equipment and exhausted their soil and water resources. History indicates the bottom of the free market sliding scale is a parity ratio somewhere between 50 and 60 percent of price parity, or about 35 percent of income parity.

Experience has shown the only solid protection available to even-up farmer bargaining power and the only way that farmers can obtain fair terms of trade is to make use of programs of the Federal Government:

To increase demand and markets through direct action programs;

To establish farm income protection programs to protect farm income against adverse terms of trade; and

To enable farmers to keep the market volume of farm products in reasonable balance with augmented demand.

INCOME PROTECTION FOR FARM FAMILIES

National Farmers Union continue to urge the enactment of laws needed to transform existing farm price-support legislation into a comprehensive law requiring the Government to use workable combinations of parity income supplement payments and price-supporting loans, purchase agreements, and purchases to maintain 100 percent of parity income per unit of commodity of the family farm production of all farm-produced commodities. And this market income protection program must be augmented by an expanded and revitalized crop insurance program and a continually improved social security old-age and survivors insurance program for farmers.

Parity for any farm commodity should be figured as the return per unit of the commodity that would give farm families who produce it an opportunity to earn the equivalent income and purchasing power that can be earned by people in other occupations in an expanding full employment economy.

Family farm volume protected.—Any individual farm operating family would be eligible for payments and price support protection on their actual sales up to the maximum volume of output of a fully adequate and efficient family farm. Sales above that volume by any one production unit would not be eligible.

Methods of support.—Price supporting Government purchases of commodities would be used only where required to relieve temporary seasonable market gluts and where either the commodity can be economically stored from year to year or where noncommercial outlets are in sight for the commodities purchased. Price supporting purchase agreements and nonrecourse price support loans would be used to maintain orderly marketing and market stability for storable commodities.

Government purchases without reference to need for price support would also be used where needed to develop and maintain the Nation's safety reserve, strategic stockpile or ever-normal storehouses of food and fiber commodities.

But primary reliance for farm income protection or commodities marketed would be placed upon use of parity income supplement payments direct to farmers to make up the margin by which market prices received by producers of that commodity were below the parity level for that commodity.

Adoption of this program would mean an average income per farm family in 1956 of approximately \$5,000 instead of the \$2,300 per family they actually were able to earn and a total national farm net income of \$25 billion instead of the \$11.5 billion.

Under existing law the income of wool producers is protected up to 110 percent of parity price (about 100 percent of income parity). Sugar is supported by means of production payments at approximately 67 percent of income parity; tobacco at about 60 percent of income parity (90 percent of parity price). Mandatory protection for wheat, peanuts, cotton, corn and rice, and milk is at about 58 percent of parity income (75 percent of parity price) by means of price support loans and purchases. Honey and tung nuts must be supported at least at 60 percent of their parity prices. Price supports for oats, rye, barley, grain sorghums, dry edible beans, soybeans, cottonseed, flaxseed, and other storables is mandatory but no minimum level of support is specified by the law.

Any farm commodity may be supported by means of price-supporting loans and purchases at not more than 90 percent of price parity (except levels may be set higher in event of national emergency).

CROP AND LIVESTOCK INSURANCE

Farm commodity income protection programs are effective against unfair economic hazards resulting from farmers' weak bargaining power in the market. They do not protect farm income when the farmer has nothing to sell if his crop or livestock is a failure because of drought, flood, insects, or other natural disaster.

To fill the latter need National Farmers Union continues to urge revitalization and rapid expansion of the Federal crop insurance program. Its provisions should be expanded to cover farm livestock.

The fundamental idea of this program is that Americans never do sit idly by as their neighbors in another part of the country are subjected to great loss and destruction due to natural causes. Billions of dollars of relief funds in past years have been expended to overcome the suffering due to drought and such after they happened. The idea of crop and livestock insurance is that the people in the Nation, by paying the administrative and experimental costs of such a program, enable farmers through the annual payment of premiums to insure themselves against the income loss due to natural hazards, and thus reduce the future need for special "disaster relief" expenditures.

Under existing law, the crop insurance programs operate in about 900 of the 3,000 rural counties, and some administrative costs are charged in the premiums.

SOCIAL SECURITY OLD-AGE AND SURVIVORS INSURANCE FOR FARMERS

Existing law now extends to farmers the protection of the Federal social security insurance system against the economic hazards of death, disability, and old age. National Farmers Union will support continued improvement and expansion of this program.

SUPPLEMENTAL FAMILY FARM DEVELOPMENT PROGRAMS

In addition to the general comprehensive farm income improvement programs required in the interests of all family farmers, special supplemental programs of credit, technical advisory assistance, and other services are required to meet the problems of family-farm development of low-income farm families in widespread disadvantaged rural areas of chronic underemployment.

These special supplementary measures should include:

(a) Supplemental income deficiency payments to small farmers to bring their per person income up to a parity level with the nonfarm population, the amount of such payments being figured on the first \$7,000 of gross sales and limited to \$500 or 10 percent of sales, whichever is the smaller;

(b) Compliance payments on diverted acres to small producers of crops under marketing quotas of not to exceed \$250 per farm family, calculated by multiplying the announced acreage reserve payment for the year by the number of units by which the producer's marketing quota for any year is less than the normal yield of his base acreage calculated through 1953;

(c) Establishment of larger minimum marketing quotas, or acreage allotments, below which the family's quota or allotment would not be cut, for wheat, cotton, corn, rice, and any commodities to which existing authority to utilize the marketing quota privilege may be extended;

(d) Increased agricultural conservation payments for small farmers, by amending the present schedule of augmented small payments in the law to double the percentage increases provided for small payments.

(e) Inauguration of a comprehensive family farm development credit program for operation in the 500 most poverty-stricken farm counties of the Nation.

We have, also, invited the favorable attention of Members of Congress to collateral proposals that will assist in the solution of these low-income farm problems. Particularly the depressed areas development bill and the proposal for Federal aid to area vocational schools.

EXPANDING FULL EMPLOYMENT ECONOMY

The domestic market demand for farm products resulting from increasing farm productivity can be maintained only in an expanding full-employment economy. The economic history of the Nation shows that, over the 45 years for which statistical data are available, farm family incomes fall in any year when the total national economy grows by less than 10 percent above the previous year. Except in years when total national economic growth is 10 percent or more per year, the terms of trade are against farmers for the reasons discussed in a previous section.

Economic growth as rapid as 10 percent a year might in most years bring inflation in the prices of industrial products. Yet a slower growth rate means falling farm income. Consequently National Farmers Union continues to urge adoption

of governmental policies for maintenance of a national economic growth rate of at least 6 percent per year, recognizing, however, that such policies alone will not overcome the adverse market position of farmers.

With national economic growth rate of about 6 percent, industrial unemployment would be reduced to a fractional minimum and consumers' purchasing power for farm and other products would be at a maximum consistent with a stabilized price level. This would mean that increasing demand for farm products would lack only about 1 percent per year in keeping up with increasing farm productivity and net farm income would drop only 3 percent per year in the absence of a specific farm income protection program. This is a much more favorable situation that would result from national economic growth of less than 6 percent per year.

National Farmers Union continues to support all policies and programs that encourage economic growth, such as interest rate reduction; increased personal income-tax exemption; expanded school, hospital, highways, hydroelectric and irrigation dam construction, and other public works; higher minimum wages; more nearly adequate social security protection for unemployed, disabled, and retired citizens; and protection of rights of organization and collective bargaining of those who work for employers.

EXPANDING DOMESTIC CONSUMPTION AND MARKET DEMAND

Effective advertising and merchandising of farm-produced commodities are of some value in expanding domestic markets for farm products. But they cannot be relied upon to bring about any very large expansion in the total United States demand for all food and fiber.

The Nation's leading economists are agreed that the only way very greatly to increase consumer demand for food and fiber is through increased purchasing power of groups of consumers that do not now have sufficient buying power to buy the food and clothing they need and want. Increased emphasis upon increasing industrial uses of farm commodities may also help to expand domestic demand.

The largest untapped market for farm products is made up of the unemployed, the dependent widows and children, permanently handicapped and disabled, the aged, and other low-income consumers. These people, with incomes from private and governmental sources of less than \$1,000 per person per year, simply do not have enough purchasing power to maintain all the needs of life, and still spend as much for food and clothing as they want and need for adequate standards. These people want to buy more. They will accept commodities provided through direct Government distribution as provided in existing law but they would prefer to be able to buy them at regular stores like anybody else.

To make this possible, and bring about a vast increase in United States consumption of food commodities, National Farmers Union

Adoption of a nationwide food allotment certification stamp plan;

Expansion to all schools of the national school lunch program now serving less than one-third of the schools;

Improvement and expansion of the fluid-milk-for-schoolchildren program to provide free at least 2 half-pints of milk per child per day and pay local school district administrative costs (currently less than one-third of the Nation's schools have been included in this program and local administrative costs are paid by school districts);

Adoption of improved Federal standards and inspection of perishable farm commodities in terminal, as well as shipping, markets with adequate Federal financing (bill has passed House, pending in Senate Agriculture Committee);

Adequate nutrition standards for the Armed Forces and veterans' hospitals, penal institutions, hospitals, and other public and private nonprofit agencies by means of commodity donation or food subsidies;

Adoption of a credit program to encourage modernization and improvement of perishable farm commodity terminal markets (bill is before House Rules Committee);

Elimination of poverty and depressed industrial areas.

Adequately financed, the programs listed here would add considerably to consumer demand for farm commodities in the United States. As poverty and depressed areas were gradually eliminated the special low-income consumer subsidy could be reduced in scope.

EXPANDING FOREIGN CONSUMPTION AND MARKET DEMAND FOR UNITED STATES FARM COMMODITIES

An important part of United States produced farm commodities, up to 10 per cent of total production, must in normal years find a market outside our national boundaries. This market can and should be expanded.

Additional agricultural attachés and improved advertising and merchandising will help some. But just as in the case of domestic market, the really big increase in market demand for United States produced farm commodities can come only from increased purchasing power in foreign countries, or from United States Government financing or subsidization of exports.

We are convinced that this total could be raised immediately to at least \$4.5 billion annually by the combined and coordinated use by our Nation of the following (and we will be protecting our farmers at the same time, by intelligent methods, rather than restrictive ones against the ill effects of imports that compete with United States farm products) :

Negotiation and establishment of additional international commodity agreements for all raw materials that enter importantly into international trade, similar to the International Wheat Agreement, which will bring into agreement all of the importing nations as well as all of the exporting nations for each commodity.

Negotiation and establishment of an international food and raw materials reserve or clearing house (world food bank), to stabilize supplies, relieve famines, and stabilize prices of all food and other raw material commodities that enter importantly in international trade; promote economic development and improved educational standards;

Expand the authorizations of the Agricultural Trade Development and Assistance Act to provide for \$1.3 billion per year of donations and sales for soft currencies of United States farm commodities and expand the purposes for which donated commodities and loans of soft currency may be used to include establishment and operation of systems of universal free general and vocational education in nations of the free world where such do not now exist;

Continuation and intelligent expansion of the point 4 program of United States aid to economic development of other free nations in a way that will increase the rate of coordinated economic growth of the nations of the free world;

Continuation of the reciprocal trade agreements providing for worldwide tariff reductions and customs simplification;

Inauguration of parity income supplement payments as primary reliance in supporting farmers' returns on those farm commodities, a part of the United States supply of which is imported in addition to wool and sugar or a part of the United States production of which is exported as part of a nationwide program of trade adjustment aids to United States industries, communities, workers, and farmers injured by tariff reductions and elimination of import quotas.

In combination with the domestic consumption-expansion programs, these special export programs would mean a considerable expansion for the foreseeable future in the "effective" (money) demand for farm products.

KEEPING FARM MARKETINGS IN BALANCE WITH AUGMENTED DEMAND

Vastly increased domestic consumer and export demand for United States farm commodities would be insured by adoption of the programs discussed earlier. However, such increases would not in any particular year be evenly spread over different commodities. Nor is it likely that increased or decreased production due to technological development and weather conditions would be spread evenly over all commodities. With output of a farm commodity expanding faster than augmented demand in any particular year or over a period of years, this is a constantly depressing force upon prices received by farmers and farm-family incomes.

For these reasons and those discussed earlier, parity-income-supplement payments and price-supporting loans and purchases must be available for use at all times to keep farmers' returns at the parity level. These are very effective for short periods of time, but will soon become worn out, economically and politically, if used too constantly.

To remove the strain of constant heavy use from the parity-payment and price-support program, National Farmers' Union continues to urge Congress to adopt realistic workable programs that farmers can use to keep the market supply of farm commodities in reasonable balance with export and domestic consumer demand as augmented in the ways discussed earlier in this memorandum.

The production and marketing adjustment programs urged by National Farmers' Union are (1) conservation acreage reserve, (2) marketing premium payments, (3) revised and extended marketing quota authority, (4) acreage allotments, and (5) improved and extended marketing agreements and orders.

Both total national farm production and the production of individual commodities have a constant tendency to exceed effective market money demand. Each 1 percent by which total farm production exceeds demand at 100 percent of parity brings a drop in prices received by farmers of 5 to 10 percent. Each such 1 percent of market supply above market demand reduces farm-family income by at least 12 percent below full-income parity.

The objective of the farmer-controlled production and marketing adjustment programs is to keep market supply of farm commodities in reasonable balance with augmented market demand as a means of protecting farm income and reducing pressure on the income-protection program.

There is no good reason why farmers should use up their soil, water, and capital resources and suffer deplorably low incomes by producing more than the augmented market will buy. If a 100-percent supply will sell as it will at 100-percent prices and return 100 percent of parity gross and net incomes to farm people, it is not reasonable to produce a 103-percent supply, sell it at 79-percent prices for an 81-percent gross and 64 percent of parity net family income. Yet under existing laws and policies that is almost universally and exactly what farmers are required to do.

National Farmers' Union continues to urge marked improvement in the conservation and acreage reserves of the Soil Bank Act and the expansion of the privilege of farmers to use the conservation acreage reserve, marketing premium payments, marketing goals, and commodities in reasonable balance with augmented market demand.

A partial conservation acreage reserve is provided in the 1956 Farm Act as the soil bank, but it is far from adequate and is designed to reduce Commodity Credit Corporation stocks and substitute for price supports rather than as an integral part of an adequate farm-income improvement and protection program.

Under the conservation acreage reserve, the Secretary of Agriculture would determine, by using official statistics, the acreage of farmland, including grazing land not needed in total, to fill augmented domestic consumer demands at a full-employment level of national economy plus expected exports. These acres would be placed into the national conservation acreage reserve voluntarily by farmers in return for adequate rental and conservation payments from the Government.

The program would be entirely voluntary for the individual farmer, who would be free to put all, none, or any part of his land in the reserve. The conservation acreage reserve would be used to adjust total production of all farm commodities to expected augmented total market demand.

To establish this program will require at least the following improvements in the Soil Bank Act: (a) Large acreage payments for small farmers, (b) more realistic payments per acre in the acreage reserve, (c) much larger acreage payments for the conservation reserve, and (d) making grazing land eligible to be put into reserve.

Marketing premium payments.—The volume of livestock products placed on the market can be regulated by varying the weight at which animals are sold. To bring about marketing of livestock at desirable weights, National Farmers Union urges adoption of marketing premium payments.

Marketing quotas.—Even with the demand-expanding programs and the Conservation Acreage Reserve in full operation, fluctuations in weather and export demand and erratic rates of growth of improved farm technology will bring about temporary maladjustments for individual farm commodities.

To protect against the hazards of these developments and to enable dairy, egg, chicken, and livestock processors to utilize the same principle, National Farmers Union continues to urge that the authority for farmers to make use of marketing goals and quotas be extended to the producers of all farm commodities whose producers favor this method over the marketing order approach.

The national marketing goal or quota for any commodity in any year would not be set below volume of sales by farmers equal to expected total United States consumption, as augmented by the programs discussed in the beginning section of the statement, plus expected exports, plus needed additions to the national security reserve. This is now true for the commodities covered; each has a national minimum.

Each individual producer family would be allocated his appropriate share of the national marketing quota.

The individual producer would be, as under existing law, free to produce and sell as little or as much of the commodity as he desired. If he chose to stay within the goal or quota assigned to his family, he would be eligible to receive parity income supplement payments and obtain price-support loans and purchase agreements. If he chose to sell more than his assigned quota, he could do so by selling at the market price and paying to the county farmer committee a fee (or penalty) on his overquota sales.

Adoption of the marketing goal or quota system would be determined as under existing law in a referendum by secret ballot and would be adopted only if two-thirds of more of the producers who vote were in favor.

Under existing law only the producers of sugar, tobacco, wheat, peanuts, cotton, and rice are privileged to make use of marketing quotas.

MARKETING AGREEMENTS AND ORDERS

Marketing agreements and orders have worked well in protecting the income of producers of milk for retail fluid sales and for certain fruits, vegetables, and nuts. Authority to use this or similar devices should be extended to producers of all farm commodities where this approach is more feasible than the marketing goal or quota approach.

ACREAGE ALLOTMENTS

Existing law authorizes the Secretary of Agriculture to establish acreage allotments for any crop the price of which is supported. Compliance with acreage allotments or base acreage is required for eligibility for price supports for corn. This should be continued, expanded to other feed grains, and used until such time as a workable marketing quota or goal program can be adopted and used for feed grains and livestock.

ADEQUATE NATIONAL SAFETY RESERVES OF FOOD, FIBER, ORGANIC OILS, AND TIMBER

National Farmers Union comprehensive full parity farm income improvement program calls for maximum efforts to expand domestic consumption and export of United States farm commodities. The program also calls for using the laws of economics to help farmers rather than to hurt them. The program also calls for the use of all workable devices to keep supplies marketed in a reasonable balance with expanded domestic and export demands. This means the tailoring of annual production and sales to annual disappearance. To be sure that mistakes in the operation of such policies and programs or unexpected natural disasters do not result in unplanned and harmful scarcities of farm commodities, National Farmers Union continues to urge the establishment, separate from the price-supporting loan operation, of a national food and fiber safety stockpile or safety and security reserve of food, fiber, and organic oils.

ADEQUATE FAMILY FARM CREDIT

The credit needs of family farming are tremendous and growing. Credit should be available at the times needed and its terms and conditions should be adapted to characteristics of farming as a combined business and way of life that includes grassland and timber agriculture as well as conventional crops and livestock.

Much of the credit needs of family farming can be met by loans obtained from private individuals and such private credit institutions as banks and insurance companies. Farmers themselves can meet many of their credit needs cooperatively through the institutions of the farm credit system and through organization of credit unions and similar institutions. Altogether, it should be expected that these sources would supply the great bulk of the credit needs of family farms.

However, inasmuch as all of these institutions must obtain the bulk of their funds from commercial money markets and conduct their operations along traditionally conservative financial lines, they find themselves unable to perform the entire farm credit job.

Such institutions find it difficult to pioneer in the meeting of newly recognized or newly emerging farm credit problems. They are not set up to use their credit resources to meet the high risk needs of severe disasters and emergencies, economic or natural. They cannot afford to participate in credit operations when a relatively high intensity of technical assistance and loan servicing are required to render loaning activities essentially sound from a strictly financial viewpoint.

Moreover, all of these private individual and corporate and cooperative institutions have a marked tendency in the absence of outside stimulation to become traditional, custombound, and increasing restrictive in their credit policies.

There is nothing morally wrong about this nor even economically unsound. It just means that the legitimate interests of family farmers require a separate supplemental and yardstick credit operation.

This can best and most efficiently be supplied to the Nation by the Federal Government. Such an agency should have the legal authority and sufficient funds to meet all of the family farm credit needs not filled on reasonable terms by private cooperative and other corporate lending agencies.

This is a problem not strictly of young farmers, nor of low-income farm families, nor of disaster situations. It is a need that extends across the board. Such an agency would stand ready to meet any legitimate farm-credit need not met by existing private agencies on reasonable terms. The agency would both make direct governmental loans and insure loans of private lending agencies.

To meet this need National Farmers Union continues to urge adoption by Congress of legislation to transform Farmers Home Administration into a Federal family farm loan agency that will serve in a "yardstick" capacity to make available to family farmers all types of needed credit adapted to family farm needs in appropriate amount on reasonable terms where the family is unable to obtain such credit from established private sources.

The need for an expansion of "yardstick family farm credit" of the type now provided to a very limited degree by Farmers' Home Administration is particularly severe in areas of high-risk farm production, for low-income farm families and to help young farmers get established.

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LEGISLATIVE ANALYSIS MEMORANDUM No. 56-15

OCTOBER 4, 1956.

FEDERAL CROP INSURANCE

State and National Farmers Union adopted programs have consistently, over the years, included supports of the crop-insurance program as one of the services we think the Federal Government should offer.

The Farmers Union fought hard to get the legislation which set up the crop-insurance program. To begin with, and it was recognized at the time, there were inequities. With almost any new program that has been true.

But the principles of a sound, a basic, and an honestly administered crop-insurance program are still in the basic legislation.

Following is excerpt from National Farmers Union official program, 1956-57, relating to crop insurance:

ADEQUATE CROP INSURANCE

"The Federal crop-insurance program should be expanded to all farm counties, with administration and experimental costs paid by the Federal Government. Premiums should be based on actuarial risks calculated with 50 percent of the weight on the basis of county experience, and 50 percent on statewide experience. Such a program should be administered by democratically elected farmer committees."

REVIEW OF FEDERAL CROP INSURANCE

1. Federal Crop Insurance Act enacted in 1938 after severe droughts of the 1930's. Only for wheat, starting in 1939.

2. Cotton added in 1942.

3. Losses sustained in first 5 years of program. Part of losses due to defects in new program.

4. From 1939 to 1948 farmer could insure either 75 or 50 percent of long time average yield. Most insurance written was for 75 percent.

5. From 1939 to 1948 the insured was paid losses on the basis of 75 or 50 percent of average yield even though crop failed early in the season. Now the protection is progressive as the crop advances during the season.

6. Closing dates for applying for insurance are advanced from what they were at beginning.

7. Originally, insurance contracts had to be made each year.

8. No minimum participation within a county, originally.

9. Prior to 1945 loss adjustment was responsibility of local committee.

10. Original concept was one of insurance in kind in order to avoid price risks. However, this developed into cash payments and receipts or warehouse certificates.

11. War and good crops: Little crop insurance in effect in 1944 and 1945, crop-insurance program liquidated at the end of 1943.

12. New legislation reviving crop-insurance program at end of 1944. Flax added as insurable crop. Legislation also provided experimental insurance on other commodities in not more than 20 counties each. Corn and tobacco were started.

13. Starting in 1945 were some changes: Progressive coverage, adjustment of losses by employees (rather than local committees).

14. Results were in the black financially, except for cotton, in 1945 and 1946. Drought in Southwest caused cotton loss.

15. By end of 1946, \$75 million or \$100 million original appropriation had been lost. Premiums exceeded indemnities by \$8½ million in 1947.

16. Congress reduced program to experimental basis. Insurance authorized in only limited number of counties—200 wheat, 56 cotton, smaller number for other crops.

17. Since then insurance has been started on beans and citrus fruits and with multiple-crop insurance started in 1948, it has been applied to many different crops.

18. Soybean insurance in a few counties in 1955; some insurance on barley in 1956.

It should be noted here that in 1947 there were 2,400 county crop-insurance programs being carried on, and in 1948 there were 375.

19. Since the experimental program went into effect in 1948 the insurance experience, from a financial standpoint, has been satisfactory and the program, still on an experimental basis, has been gradually expanded.

20. Amendments in 1947 authorized private insurance companies to conduct a similar insurance program, with reinsurance by the Federal Government.

WHAT HAPPENED IN 84TH CONGRESS (1955-56)

This was mostly a period during which we tried to hold our own in regard to crop insurance. Nothing new was introduced except in the first session in 1955. The Department of Agriculture in the spring of 1955, attempted to obtain passage of a bill which would have included in the premium payments farmers pay for crop insurance, the administrative costs. These costs had never been included before. In accordance with National Farmers Union program which states, in effect, that the cost of the program should be borne by all the people. We opposed this bill. It was not passed.

While there were other suggestions made regarding the crop-insurance program, no other bills changing the program were introduced.

It would seem, at this time, that the crop-insurance program is a "step child" for sure. Not even its opponents are paying much attention to it. The career people of the Federal Crop Insurance Division of the Department of Agriculture seem all to be on the side of the Farmers Union approach.

From the report to Congress of the Federal Crop Insurance Corporation, submitted by Secretary Ezra Benson on January 24, 1956, the following is quoted:

"1. The stated purpose of the crop-insurance legislation is to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance and providing the means for the research and experience helpful in devising and establishing such insurance.

"2. Crop-year 1955 illustrated in dramatic fashion the need that exists for widely expanded and soundly operated all-risk insurance of the money farmers must invest in their crop-production efforts.

"3. Losses from natural hazards made headlines from the start of 1955 to its close. To the many farmers who suffered severe crop losses, prices were of secondary importance since they had little or nothing to sell although nationally total farm production was at a high level.

"4. For many farmers crop insurance provided the disaster protection needed on their crop investments in the face of crop catastrophes beyond their control. It did not provide them profit from disaster, but it did return to them money spent to produce the crop."

There is no doubt but that the Federal crop-insurance program should be expanded. That is what the Farmers Union has been urging for many years. Farmers Union, according to its program, believes that the experimental period is long past and that we should have all-risk coverage for all commodities. There will have to be many changes made to attain what Farmers Union believes in.

1948 CHANGES

In 1948 some changes were made in the program in addition to those already noted.

Prior to 1949 crops were insured on the basis of average yield over a period of years as determined by the local or county production marketing committee. Those participating in the program could insure for 50 or 75 percent of their historical average yield.

Since then and in 1956, producers may insure only to the limitation of the average cost of production per county. This cost of production is determined for each county. This rule does not hold for all areas. In some recent high-risk areas those who are participating in the program are insured for below the county average cost of production. This is in line with the effort of the administration to make the crop-insurance program a paying program, or "balance the budget" at the expense of the farmers.

WITHDRAWAL OF CROP INSURANCE FROM 14 COUNTIES

It is not an ideal of United States citizens to hit a person when he is down. A person who is sick in bed for 5 years and keeps up his life insurance is not suddenly cut off and told that his life insurance is void. Yet that is what happened in 1956 to the farmers of 14 counties which had been included in the crop-insurance program.

In the Southwest there had been a severe drought for the preceding 4 years. It covered parts of Texas, New Mexico, Kansas, Oklahoma, and Colorado. In addition it has been felt in many other States. In these States the Federal crop-insurance program has been the last resort of security for many farmers to secure loans from local lending agencies including Farmers' Home Administration. An example is Baca County, Colo. This county, during World War II had a record wheat production which was urgently needed at that time. Now it is one of the 14 counties which is denied the opportunities and benefits of the crop-insurance program.

Here are facts to consider:

1. Under the present law and administration there must be at least 200 units insured in any one county before the program can go in effect.
2. A farmer insures for only cost of production, that is the county average, and the coverage is for the extent of the crop growth.
3. Not all crops are covered.
4. Premium rates are not equitable even though there is in many cases, a 30-year history.

The Farmers Union program recognizes the importance of the Federal crop-insurance program. We were instrumental in its creation. For its improvement there are several approaches which might be considered:

1. Expansion to include all commodities.
2. Not based on progressive average cost of production.
3. 100 percent of average yield coverage.
4. All counties included to allow widest possible coverage.

From the records of the Federal Crop Insurance Corporation it is evident there is not a broad enough coverage of any crop to make one or any crop actuarially sound. There must be a wider or broader program in order to spread the risk, reduce losses, and put the program on a sound actuarial basis. However, the experimental and administrative costs of that program should be borne by the general public as a part of the price support and production payment program which we hope to achieve.

This sort of crop insurance program could be offered along with marketing quotas.

Under the present administration the crop insurance program has suffered. Administration political appointees are not concerned or worried about it. Civil service people and others, who honestly believe in this kind of program to help family farmers and to insure the wealth, health and welfare of all our citizens are very concerned about it. The Farmers Union will continue to work for its betterment.

Attached is a list of counties participating in the 1956 crop insurance program.

Number of 1956 crop insurance programs and counties (June 20)

State	Wheat	To- bacco	Cot- ton	Corn	Mul- tiple	Flax	Beans	Barley	Soy- beans	Total	
										Pro	Con.
Alabama.....			15							15	15
Arizona.....			1							1	1
Arkansas.....			13		1					14	14
California.....	4		1							5	5
Colorado.....	12				2		2			16	16
Connecticut.....										1	1
Florida.....		1								17	17
Georgia.....		18								18	18
Idaho.....	12						5			17	16
Illinois.....	23			7	11				1	42	30
Indiana.....	20			11	7					38	27
Iowa.....				26	16				3	45	33
Kansas.....	68			6	5					79	75
Kentucky.....		33								33	33
Louisiana.....			9		2					11	11
Maryland.....	1			1						2	1
Massachusetts.....		1								1	1
Michigan.....	14			1	2		5			22	17
Minnesota.....	12			16	17	29		1	1	76	46
Mississippi.....			23							23	23
Missouri.....	20			12	4					36	24
Montana.....	18							2		20	18
Nebraska.....	29			10	3		2			44	40
New Mexico.....			3							3	3
North Carolina.....		27	5							32	31
North Dakota.....	44				9	16		3		72	53
Ohio.....	23	3		7	2				2	37	30
Oklahoma.....	22		1							23	22
Oregon.....	9				2			1		12	11
Pennsylvania.....	2			1	2					6	4
South Carolina.....		10	10							20	16
South Dakota.....	24			7	10	7		1		49	40
Tennessee.....		27	9		3					39	39
Texas.....	14		26							40	35
Utah.....	3				1					4	4
Virginia.....		15								15	15
Washington.....	12						1	1		14	12
Wisconsin.....		2		8	1					11	5
Wyoming.....	3				1		1			5	3
Total.....	389	143	116	113	101	52	16	9	7	1948	1803

¹ Totals include 2 citrus counties.

LEGISLATIVE ANALYSIS MEMORANDUM No. 56-17, REVISION No. 1

AUGUST 30, 1956.

YARDSTICK FAMILY FARM CREDIT LEGISLATION

Alone among the farm organizations, Farmers Union invited the attention of the 84th Congress to the credit problems of family farmers. Our efforts resulted in significant improvements in the credit programs provided by Farmers' Home Administration and succeeded in blocking the destruction of the yardstick 5-percent interest rate set up in existing law. Its repeal was repeatedly recommended and demanded by the Eisenhower administration.

LEGISLATIVE DEVELOPMENTS IN 84TH CONGRESS

Improved yardstick family farm credit legislation (H. R. 1154) was adopted by Congress. Farmers Union made a big push to obtain enactment of legislation that would rehabilitate the Farmers' Home Administration and reestablish it as a comprehensive, fully effective "yardstick family farm credit agency." The Eisenhower administration fought our efforts, putting their main emphasis on eliminating the 5-percent interest rate yardstick in existing law. Under existing law, a farm family that cannot obtain adequate needed credit from usual commercial and cooperative sources at not more than 5 percent interest is eligible to receive a loan from Farmers' Home Administration. Farmers Union urged this yardstick rate be dropped to 3 percent. Eisenhower recommended that the

"5 percent" be changed to "a reasonable rate." Administration witnesses testified in both House and Senate that the words "reasonable rate" would be interpreted to mean the "prevailing rate in the local community, 6 percent, 8 percent, 12 percent, whatever it is." Adoption of such language would have completely destroyed the "yardstick" feature of the Farmers' Home Administration and the laws it seeks to administer.

A yardstick family farm credit bill (S. 3790) more nearly adequate to the current needs than H. R. 11544 was introduced in the Senate on May 7, 1956, by Humphrey, George, Hennings, Kerr, Clements, Lehman, Mansfield, Morse, Murray, Neely, Neuberger, Scott, and Sparkman. Companion bill in House was introduced by Polk, Metcalf, and Knutson.

H. R. 11544, as enacted by Congress, reflects Farmers Union recommendations as somewhat watered down by Eisenhower administration recommendations. Farm Bureau did not appear at the hearings on this important subject. The net result is to have obtained some quite significant improvements in the way of yardstick farm credit. Major among these are full authority for Farmers' Home Administration to make loans to refinance existing indebtedness, somewhat larger appropriations or authorizations for various types of loans, direction to the executive branch to tailor repayment schedule to fit characteristics of such needed credit as frozen-out prune orchards and the like, and specific mandatory expansion of real estate loan authority to include existing as well as prospective farm owners. Applicants to be eligible would not have to show that more than half of their income came from farming.

FARMERS UNION RECOMMENDATIONS

There is a developing farm credit crisis out in the country. We are in another of those eras that have come twice in the past 50 years when the Nation will, and must make a major reform in its farm credit policy.

Growing awareness in the period 1908-14 of the basic disadvantage of farmers in the Nation's money and capital markets led to the establishment of the Federal land bank system.

Later, the total failure of the then existing farm credit institutions to cope with the 1921-33 farm depression led to the complete reform and improvement of national farm credit policy and institutions in 1933-34.

NEED NEW CONCEPT OF YARDSTICK FARM CREDIT

Now, in 1956, we seem to be in the middle of another era of broadening farm credit concepts, an awareness brought on by the apparent inability of the now existing institutions and policies to cope with the problems of the growing farm depression and recurrent drought, dust storms, floods, and falling farm income.

National Farmers Union continues to urge enactment of a comprehensive "yardstick" family farm credit bill, incorporating the good features of the bills that have been referred, and expanding and extending the excellent features of existing Federal "yardstick" family farm credit laws.

EXISTING LAW

Existing legislation covering direct and insured general family farm credit loans is incorporated mainly in the Bankhead-Jones Farm Tenant Act, as amended; the Water Facilities Act, as amended; Public Law 38 (emergency loans), as amended; and Public Law 727 (emergency credit), as amended.

RECOMMENDED AMENDMENTS TO WATER FACILITIES AND SOIL CONSERVATION LOAN ACT

The Water Facilities and Soil Conservation Loan Act of August 28, 1937, as amended (16 U. S. C. 590r-x), needs to be improved and modernized.

This act has provided very much needed loan facilities during its nearly 10 years of operations. Its scope was broadened several years ago to cover the entire United States. It authorizes the Secretary of Agriculture to make direct and insured loans to farmers and stockmen and reclamation, irrigation, and grazing associations for soil and water resource improvement and conservation purposes.

However, with increased costs of such measures, the loan limitations have gotten out of date. We recommend raising the limitation on indebtedness of drainage, irrigation, and grazing associations and other corporations and agencies, as provided in section 8 from \$250,000 to \$1 million.

We also urge that the maximum rate of interest chargeable under this program be set at 3 percent per annum. If this should require Federal subsidy in a period of a general hard-money policy, we feel the difference is justified both by the generally deflated condition of the farm economy and by the general public welfare benefits derived from increased soil and water conservation on the farms of the Nation.

RECOMMENDED AMENDMENTS TO DISASTER LOAN ACT OF 1949, AS AMENDED

Public Law 38 of the 81st Congress, as amended, is the act of April 6, 1949, as amended (12 U. S. C. 1148a). This act makes provision for 3 percent interest on production disaster, economic disaster and special livestock loans.

We recommend striking out both termination dates so the programs can be continued, where needed, beyond July 14, 1957, the termination date in existing law. We continue to urge removal of the words "for \$2,500 or more" from the language of the act since this provision was repealed by Congress in Public Law 175 within a month of its original passage. We find the idea of a minimum loan as repugnant now as did the Congress in 1953. This language should be cleared up.

We also urge the following amendments to this act:

Provision should be made in subsection 2 (c) to authorize the expenditure of the proceeds of these special livestock loans to repay existing indebtedness.

The repayment period should be made 10 years instead of 3. The existing congressional limitation of not more than 3 percent per annum interest on these special livestock loans should be made explicit in the language of subsection 2 (c), as it is in subsections 2 (a) and 2 (b). This would mean deletion of the fourth and fifth sentences of this subsection.

RECOMMENDED AMENDMENTS TO EMERGENCY LOAN ACT OF AUGUST 31, 1954

This is the Emergency Loan Act of August 31, 1954. Except for the new legislation, it would expire on June 30, 1957. The new law extends it to June 30, 1959.

We recommended the following amendments to this act:

1. Remove the prohibition against the refinancing of existing indebtedness in section 1.

2. Eliminate the termination date in section 1 and thus establish a permanent authorization for the program.

3. Eliminate the requirement for proclamation of emergency area in section 1.

4. Eliminate the size of loan limitation in section 2.

5. Eliminate the limitation on amount of total indebtedness in section 2.

In our considered judgment, there are a great many individual emergency situations outside of areas of widespread emergency. Moreover, when a fully adequate family farmer is in an emergency situation a loan no larger than \$15,000 is often not enough to get him out of his trouble and enable him to get into a position to overcome his temporary emergency financial difficulty.

AMENDMENT TO BANKHEAD-JONES FARM TENANT ACT, AS AMENDED

Suggested extension and expansion of the Bankhead-Jones Farm Tenant Act, as amended consist of suggested additional titles, and suggested amendments to titles I, II, and IV.

RECOMMENDED FAMILY FARM DEVELOPMENT ACT

A crash program to eliminate farm and rural poverty in the United States is provided for in H. R. 4300, introduced by Mr. Wright Patman.

We strongly urged that Mr. Patman's bill, in its entirety, be included in the comprehensive new law as a new title to the Bankhead-Jones Farm Tenant Act. This new title was not adopted.

RECOMMENDED TITLE V ECONOMIC EMERGENCY REFINANCING LOANS

We pointed out the need for a new title to provide a specific program of constructive rehabilitation credit to farmers, ranchers, and farm-related small businesses in rural areas who are heavily indebted as the result of the farm de-

pression that is no fault of their own. This new title was not adopted but several of its provisions were incorporated in the new law.

H. R. 11544 COMPARED WITH FARMERS UNION RECOMMENDATIONS AND ADMINISTRATION POSITIONS

Using Farmers Union recommendations as a measuring stick of relative adequacy, the following paragraphs set forth the major provisions and omissions of H. R. 11544 as adopted by Congress and compares them with the positions taken by the Eisenhower administration on the proposed legislation.

Farm ownership and real-estate loans.—H. R. 11544 adopts Farmers Union proposal to authorize insured as well as direct loans for purpose of making "improvements needed to adjust farming operations to changing conditions." Adopts Farmers Union proposal to make existing farm owners clearly eligible for such loans, and to allow such loans to be made to farm owners and tenants who have had to seek outside sources of income to augment dwindling farm income (which must still be a "substantial portion" of the family income rather than "major portion" as in existing law).

Does not adopt Farmers Union recommendation to reduce interest rates on loans and eligibility requirements from 5 to 3 percent. Nor does bill eliminate the 5 percent limitation as recommended by the administration.

H. R. 11544 does not change the limitation in existing law that units financed must be of smaller value than "average value of efficient family-type farm units * * * in the county." Both Farmers Union and the administration urged elimination of this limitation.

Bill does not raise the authorized annual appropriation from \$50 million to \$150 million as recommended by Farmers Union; nor is amount appropriated for insured-loan revolving fund raised as recommended by Farmers Union. However, limitation on outstanding indebtedness in any one fiscal year on insured loans is raised as Farmers Union recommended.

Elimination of 10 percent equity requirement as recommended by Farmers Union is not included in H. R. 11544, except for refinancing loans. Administration recommended keeping equity requirement for all loans.

Payment by borrower of special fees and mortgage insurance premiums are not eliminated as recommended by Farmers Union.

"Until June 30, 1959" direct and insured FHA real estate or farm ownership loans may be made or insured, as recommended by Farmers Union, "for refinancing secured and unsecured indebtedness of eligible farmers on farms of not larger than family size who are presently unable to meet the terms of their outstanding indebtedness and are unable to refinance such debts" through private commercial channels "at rates and terms which they could reasonably be expected to fulfill."

This is done in H. R. 11544 by means of a new section 17 added to title I of the Bankhead-Jones Farm Tenant Act rather than as a new title V as proposed by Farmers Union, but with following exceptions it does provide the real estate refinancing lending authority recommended by Farmers Union. Farmers Union proposed that, in addition to individual farmers, the following also be made eligible for refinancing loans: "farm partnerships, grazing associations, irrigation companies, and the owners of farm-related small businesses in rural areas;" these were omitted in H. R. 11544.

Refinancing loans secured by farm real estate, under H. R. 11544, can be made up to the amount certified by the county committee to be the "value of the real estate" plus the "reasonable value of the applicant's livestock and farm equipment"; this is in substantial agreement with Farmers Union recommendation, if administered according to intent of the House. (Farmers Union has suggested a limitation of not less than \$50,000 per farm.)

Eisenhower administration has steadfastly opposed the provision of authority for refinancing of existing indebtedness as an approved purpose of any type of FHA loan.

Operating loans (production and subsistence and rehabilitation loans).—Existing law sets 5 percent maximum interest rate for loans and eligibility. Farmers Union recommended cutting rate to 3 percent. Eisenhower administration recommended eliminating maximum. H. R. 11544 leaves 5 percent as the maximum rate chargeable.

Accepts Farmers Union proposal to allow borrowers to substantially augment from outside sources their dwindling farm income without losing eligibility for these loans.

Raises maximum size of initial loan from then-existing \$7,000 to \$20,000 rather than to \$25,000 recommended by Farmers Union; maximum allowable total outstanding indebtedness is raised from \$10,000 to \$20,000 rather than to \$40,000 as recommended by Farmers Union.

Farmers Union recommended elimination of 7-year repayment maximum; H. R. 11544 continues this provision but softens it by extending the 7-year period to "7 years plus number of years the area in which the borrower is located has been designated as a disaster area by the President," for such existing borrowers as may now be located in such a disaster area or who in the past had been a recipient of a disaster loan.

Recommendations by Farmers Union to simplify and improve efficiency of administration of uncollectible accounts are incorporated in H. R. 11544.

Authority for making refinancing loans secured by chattel mortgages as recommended by Farmers Union is included in H. R. 11544 as a new section 51, to title II of the Bankhead-Jones Farm Tenant Act, rather than as a new title V as recommended by Farmers Union. However, Secretary of Agriculture is authorized to make use of "Operating loans" funds for "the refinancing of existing indebtedness." Such loans would be limited to \$20,000 per borrower rather than \$50,000 per borrower as recommended by Farmers Union. The loans would be at 5 percent interest rather than 3 percent and the maximum repayment period would be 7 years rather than 15 years as recommended by Farmers Union. Such loans would be available only to farmers and stockmen; Farmers Union recommended that farm partnerships, grazing associations, irrigation districts, and farm-related small businesses also be made eligible to obtain these refinancing loans. Bill does not provide that such loans could be made to assist "eligible farmers and stockmen to purchase stock in irrigation companies or grazing associations." In fact such loans appear to be expressly forbidden by language elsewhere in the bill.

The Eisenhower administration opposed authorizing loans of any kind for refinancing of existing indebtedness.

OTHER SPECIFIC OMISSIONS OF H. R. 11544

H. R. 11544 as passed by the Congress includes no change in Water Facilities and Soil Conservation Loan Act.

No changes were made in Disaster Loan Act, except to include in the report of the House Agriculture Committee Farmers Union recommendation to direct the Secretary of Agriculture to make orchard disaster loans (such as for Oregon prune orchard freeze) with reasonable repayment terms.

Farmers Union recommended farm loan and technical assistance programs assist low-income farm families to develop "economically adequate full-time and part-time" farms are, with exception of extremely long-term farm forestry loans, incorporated in the title I and title II revision of the Bankhead-Jones Farm Tenant Act that are included in H. R. 11544. Maximum interest rates on such loans is set at 5 percent in the bill rather than the 3 percent recommended by Farmers Union and the "no maximum" recommended by Eisenhower administration.

H. R. 11544 has no provisions for aid to low-income farmers respecting employment services for off-farm employment, no provisions for additional vocational education services, and no provisions for industrial dispersion to low-income farming areas.

However, provision for these latter were incorporated in a separate bill which passed the Senate and favorably reported by the House Banking and Currency Committee. Unfortunately, this bill died when House floor consideration was blocked by executive branch pressure. This bill would have designated rural redevelopment areas as a section of a general depressed areas redevelopment program for both urban and rural areas of chronic unemployment and underdevelopment.

Economic disaster loans.—Farmers Union recommended that authority for this type of loan be made permanent legislation. H. R. 11544 extends the program through June 30, 1959. Interest rate is continued at 3 percent as recommended by Farmers Union. However, H. R. 11544 does not eliminate need for area to be designated before loans can be made; does not eliminate maximum size of \$15,000 and maximum indebtedness of \$20,000 as Farmers Union had recommended. H. R. 11544 increases from \$15 million to \$65 million the total amount of such loans that may be made. Farmers Union recommended no maximum limitation. H. R. 11544 does not permit such loans to be made for refinanc-

ing of existing indebtedness; Farmers Union had recommended that such be permitted.

VOLUNTARY FARM DEBT ADJUSTMENT

H. R. 11544 includes Farmers Union recommendation for increased emphasis to Secretary of Agriculture to reactivate the voluntary farm debt adjustment program that was so helpful to debt-ridden farmers in their attempts to climb out of the farm depression that started in 1920 and hit bottom in 1932. Eisenhower recommendations did not mention farm debt adjustment as a needed activity.

REESTABLISHMENT OF FULLY EFFECTIVE VARIABLE REPAYMENT PLANS

H. R. 11544 does not authorize reestablishment of authority for utilization of a fully effective variable repayment plan, without regard to previous excess payments. Farmers Union recommended that the Secretary be authorized to adjust repayments on all types of FHA loans to the net earnings and ability of the borrower to repay from year to year. Existing law, left unchanged by H. R. 11544, allows such variable repayment adjustments only in cases where the borrower has gotten ahead of schedule in previous years.

OPPOSITION ARGUMENTS

Following is the official executive branch recommendation opposing enactment of S. 3790 which would greatly improve the "yardstick" family-farm credit program of Farmers' Home Administration.

JULY 3, 1956.

HON. ALLEN J. ELLENDER,

*Chairman, Committee on Agriculture and Forestry,
United States Senate.*

DEAR SENATOR ELLENDER: This is in reply to your request of May 9 for a report on S. 3790, a bill "to strengthen the Nation by providing auxiliary credit resource required to preserve the family-size farm, providing additional credit for farm enlargement and development, refinancing of existing indebtedness, expansion, and simplification of farm ownership and operations credit programs by amendment of the Bankhead-Jones Farm Tenant Act, and extension and simplification of emergency and disaster farm credit by amendment of the acts of April 6, 1949, as amended, and of August 31, 1954, and for other purposes."

The Department recommends that the bill not be passed.

The bill would amend the Bankhead-Jones Farm Tenant Act, the Water Facilities Act of 1937, Public Law 38, and Public Law 727. In addition, it would add two new titles to the Bankhead-Jones Farm Tenant Act; namely, title V, "Rural Adjustment Credit," and title VI, "Family Farm Development Act." The Department recognizes that some changes are needed in its existing credit authorities and is in agreement with some of the objectives of the bill, particularly those which would extend and improve the credit services available to farmers under titles I and II of the Bankhead-Jones Farm Tenant Act. The specific recommendations of the Department have been submitted to the Congress and are embodied in S. 3429 and S. 3559.

One of the reasons enactment of S. 3790 is not recommended is that this bill would change substantially the character of the credit services of the Department and make it directly competitive with private and cooperative lenders. This position would be in sharp contrast to the present status of the Department in the farm credit field; namely, as a supplementary source of credit to be used only when applicants cannot obtain loans from other creditors at reasonable rates and terms. More specifically, the bill would provide that applicants who could not obtain credit for real estate and operating purposes from other sources at rates of not more than 4 percent would be eligible for loans under the Bankhead-Jones Farm Tenant Act. Since the going rate of farm loans, particularly operating loans, is more than 4 percent most farmers who need credit could establish their eligibility for assistance under the Bankhead-Jones Farm Tenant Act. Increasing the loan limits on title II loans to \$40,000, eliminating the 7-year continuous indebtedness period, as well as authorizing chattel and real estate loans up to \$50,000 under title V of the proposed bill, would permit loans to farmers and stockmen whose operations are substantially larger than family size. At present, loans under the Bankhead-Jones Farm Tenant Act can be made only to farmers whose operations are not larger than family size.

The minimum 3-percent interest rate for insured loans specified in S. 3790 would make the insured loan authorities practically inoperative in the current money market. Our experience has been that at present a 3-percent interest rate is not sufficiently attractive to lenders to assure an adequate supply of funds for insured farm ownership and soil and water conservation loans. This provision, unless compensated for by increased direct appropriations, would curtail rather than expand the credit facilities available to farmers.

The bill proposes a number of lending authorities which are not directly related to extension of credit to bona fide farmers. Title V, for example, authorizes loans to "farm-related small businesses." This type of credit program should be administered by an agency other than the Department of Agriculture. Title VI includes loan authorities with respect to both farm and nonfarm aspects of a comprehensive rural development program. Since the Bankhead-Jones Farm Tenant Act is primarily a credit statute, this Department is of the opinion that the portions of title VI that pertain to phases of a comprehensive rural-development program other than credit to farmers are not germane to the Bankhead-Jones Farm Tenant Act.

The bill, if enacted, would establish additional lending authorities under the various titles which would differ in only minor respects. These small differences with respect to eligibility, loan purposes, and terms of loans would be difficult to explain to farmers and would unnecessarily complicate the administration of the Department's credit services. Furthermore, there would be considerable duplication of lending authorities under the various titles for chattel and real estate purposes.

The Bureau of the Budget advises that there is no objection to the submission of this report.

Sincerely yours,

[s] TRUE D. MORSE,
Acting Secretary.

CONCLUSION

Relating to the need for a comprehensive "yardstick" family farm credit agency, James G. Patton told the Senate Agriculture Committee on June 7, 1955: "The credit needs of family farming are tremendous and growing. Credit should be available at the times needed and its terms and conditions should be adopted to characteristics of farming as a combined business and way of life.

"Much of the credit needs of family farming can be met by loans obtained from private individuals and such credit institutions as banks and insurance companies. Farmers themselves can meet other needs cooperatively through the institutions of the Farm Credit System. Together, it should be expected that these sources should supply the great bulk of the credit needs of agriculture. However, inasmuch as all of these must obtain their funds from commercial money markets and conduct their operations along traditionally conservative financial lines, they find themselves unable to perform the entire farm credit job. Such institutions find it difficult to pioneer in the meeting of newly recognized or newly emerging farm-credit problems. They are not set up to use their credit resources in meeting the high-risk needs of severe disasters and emergencies, economic or natural. They cannot afford to participate in credit operations when a relative high intensity of technical assistance and loan servicing are required to render loaning activities essentially sound from a strictly financial viewpoint. Moreover, all of these private individual corporate and cooperative institutions have a marked tendency in the absence of outside stimulation to become traditional, custom-bound, and increasingly restrictive in their credit policies.

"There is nothing morally wrong about this nor even economically unsound. It just means that the best interests of family farmers require a separate supplemental and yardstick credit operation. This can best and most efficiently be supplied to the Nation by the Federal Government. Such an agency should have the legal authority and sufficient funds to meet all of the family farm credit needs not filled on reasonable terms by private cooperative and other corporate lending agencies.

"This is a problem not strictly of young farmers, nor of low-income farm families, nor of disaster situations. It is a need that extends across the board. Such an agency would stand ready to meet any legitimate farm credit need not met by existing private agencies on reasonable terms. The agency would make both direct governmental loans and would insure loans of private lending agencies."

BIBLIOGRAPHY

1. S. 3790, Family Farm Credit Act introduced by Senator Humphrey and other Senators.
2. House Report No. 2260, Farm Loan Programs.
3. Acts of Congress administered by Farmers' Home Administration compilation.

LEGISLATIVE ANALYSIS MEMORANDUM No. 56-18

PARITY FORMULAS

DECEMBER 1, 1956.

Farmers Union continues to urge enactment of legislation to require full program and reporting use of the parity farm income formula in the Agricultural Adjustment Act of 1938, as amended, to replace the utilization for such purposes of the existing system of price-parity formulas (see appendix A). The one word "parity" is a widely accepted concept of fairness. The degree to which farmers are able to attain it is considered to be a fair measure of the relative economic health and well-being of farm people. Yet price parity, as a measure, compares to income parity about as a foot compares to a yard. Attainment of 100 percent price parity in 1952 enabled farm people to earn only 52 percent of income parity. Family income (take-home pay), not price per unit or wages per hour, is the basic economic factor in family living and welfare.

Existing law contains definitions of both parity farm income and parity farm prices. But it is the parity price concept that the law gives life and functions. The law spells out a definite system of formulas by which parity prices of different commodities shall be calculated. Other provisions of law require use of parity prices to establish mandatory minimum and permissive maximum limits of governmental farm-income improvement and price-support activities.

Farmers Union supports the idea of transferring these jobs to the parity income concept. Thus the income goal, the true gage of progress, would become the officially used measuring stick rather than price ratios. All governmental reports of prices received by farmers and income of farm people would be published in terms of parity income rather than parity-price ratios and goals. Realized results of farming operations would be measured against the important fact of the income goal for the human factor in farming rather than the intangible and inanimate concept of farm commodity purchasing power.

LEGISLATIVE DEVELOPMENTS

Parity farm income and parity farm price formulas seem destined to become a major congressional and farm-policy battleground in 1957 and 1958. Debate and decision will revolve around the issues of: What is the correct measuring stick of the economic health and well-being of the farming industry? And what formula is the best, most realistic, most workable, in the best interest of farmers, or in the general public interest as the gage to which farm-income improvement and price-support programs should be geared? Which formula would be most understandable to farmers and the general public? Which would be the most defensible?

Parity-formula revision has been pushed up for unusual attention by the next session of Congress by the coincidence at this time of several developments.

Chief among them is a requirement in the 1956 Farm Act that the Secretary of Agriculture make a report to Congress prior to January 31, 1957, relating to ways in which the parity formula may be improved. The 1956 Farm Act stops, for 1957, the previously scheduled 5 percent rollback of the parity prices of wheat, cotton, corn, and peanuts. This 1-year moratorium was justified in committee and conference as the period needed by Congress to consider and act upon a complete revision and improvement of the parity-formula situation.

In the 1952 election campaign both presidential candidates and particularly the successful one, made parity farm income the explicit goal of national farm and economic policy. Both parties did the same again in the 1956 election. The Democrat's platform specifically pledged annual progress toward the goal with substantial fulfillment by 1960. The Republican platform pledged parity income for farmers as the goal of their party. Both presidential candidates honored their platforms in this regard by specific acceptance in campaign speeches. In both campaigns the concept of farm-price parity was given less

attention and farm-income parity was given more attention than in previous campaigns and general public discussions.

At least every 2 years and sometimes oftener, since the cessation of hostilities in World War II, Congress has found it necessary to enact laws making revisions, adjustments, or amendments to parity formulas, definitions, and calculations. None of the major interest groups concerned have been entirely satisfied with any of this series of temporary adaptations. Some groups, including Farmers Union, have supported the year-to-year improvisations as the best possible system of formulas and definitions under the given legislative situation. Others, including Farm Bureau, never supported use of the old parity-price formula for any commodity after 1948.

During these presidential campaigns and in the congressional and other discussions of the intervening years, it had become rather widely known that 100 percent of parity prices would enable farmers to earn only about 52 percent of parity income under market and production conditions of the 1950's.

EXISTING LAW

The Agricultural Adjustment Act of 1938, as amended, provides both a definition for parity farm income and a system of formulas for calculating farm parity prices (see appendix A).

Parity farm income is defined as that gross income from farming that would enable farm operators and their families to obtain a standard of living equivalent to that of people in other occupations.

Parity prices for farm commodities are now calculated under existing law by a complicated system of formulas that start with the 1910-14 average price received by farmers for the particular commodity and make one or more mathematical adjustments in that 1910-14 average price to arrive at the parity price for that commodity.

The first adjustment is to multiply the 1910-14 average price by the increase to date since the 1910-14 base period in the index that indicates the change in the prices, interest, wages, and taxes paid by farmers [the so-called parity (or price parity) index]. This gives the "old" parity price for the commodity. It is the formula that was in use for all commodities prior to the enactment of the "modernizing" amendments enacted by the 80th Congress in 1948. "Old parity price" is not now used for any commodity.

The second mathematical adjustment raises or lowers the old parity price of the commodity by the extent to which the average prices received by farmers for that commodity over the period of the immediately preceding 10 years was above or below the old parity prices for the commodity. The result of applying both these adjustments to a commodity's 1910-14 base period average price is its modernized parity price.

The old parity price for each commodity is, then, adjusted downward by application of the "transitional" formula. The transitional parity price for wheat, corn, tobacco, rice, and peanuts is the old parity price minus 5 percent for 1956 and 1957; minus 10 percent for 1958; minus 15 percent in 1959; and dropping an additional 5 percent each year thereafter. The cumulative 5-percent annual rollback or transitional feature for all other commodities began in 1950 and has not since been interrupted by changes in the law.

Finally the "effective" parity price for a commodity is selected as either the modernized parity price or the transitional parity price, whichever is higher. In 1957, the modernized parity price will probably be the effective parity price for all commodities, except wheat, corn, and peanuts. These three commodities will probably make use of the transitional parity price because it is 5 percent higher than modernized parity price in the case of corn, 15 percent higher in the case of wheat, and 20 percent higher in the case of peanuts than the modernized parity price.

PROPOSALS FOR CHANGE IN PARITY FORMULAS

Other than the Farmers Union proposal previously mentioned, the following changes have been proposed in the existing system of parity formulas. (No attempt is made here to spell out specific details of calculation in any of these proposals.)

1. The National Grange has been discussing and studying a "farm income parity" formula designed to set parity farm income at a figure that would be the total of (1) the product multiplying the United States Department of Agriculture estimated farm man-hours in productive work by the average industrial

hourly wage; plus (2) the product of multiplying the total value of farm assets by the average rate of interest on farm mortgages.

2. Use the "old" parity formula but change the base periods from 1910-14 average to the 1947-49 average.

3. Use the "modernized" parity formula but change the 1910-14 base period to 1947-49.

4. There has been some talk of using a post-Korea war base period—maybe 1953-55—for calculating modernized parity. There are some indications that this may be favored in the Office of the Secretary.

5. Calculate a separate parity index of price, interest, wage, and taxes paid by producers of each different commodity. Some want to do this so that parity prices drop with increased application of technology and higher productivity of a commodity. Others want this feature to reflect increased use of materials and services from off the farm which has happened more with some commodities than with others.

These five appear to be the major proposals other than Farmers Union's. Undoubtedly other and many variations will be brought up for discussion.

Probably all of these and possibly other proposals will be analyzed, "appraised" and discussed in the report that the Secretary of Agriculture must make to Congress prior to January 31, 1957.

FARMERS UNION INCOME PARITY PROPOSAL

The 1956-57 program of National Farmers Union adopted by members and delegates in national convention defines a "fair parity income" for farmers in similar words to the definition of a parity farm income in existing law. That is that parity farm income is one that will enable farm people to have the same income and living standards as people have who do not live on farms.

Farmers Union recognizes that some refinements would possibly be needed to make this definition legally and statistically specific. Farmers Union, also, recognizes that additional refinements may be needed in farm and nonfarm income and cost statistics now regularly published by the United States Department of Agriculture, if the income parity, rather than price parity concept is to be put into the central position in farm program legislation.

A legally binding formula directing the steps for calculating income parity and translating into usable goals for different commodities will need to be added to existing law.

With these qualifications in mind, the following is an illustration of how the formula and arithmetic of the Farmers Union proposal would work out (using data as of September 1956 for the calculations):

1. Start with: Nonfarm population per person income, year before (1955)-----	\$1,935
2. Divide into: Farm population per person income, year before (1955)-----	\$881
3. Gives: Net farm family income parity ratio-----	0.456
4. Divided into: National farm operators net income, year before (1955)-----billions---	\$11.7
5. Gives: Parity farm family net income, year before (1955)---do---	\$25.7
6. Plus: Farm production expenses, year before (1955)-----do---	\$21.6
7. Gives: Parity farm gross income, year before (1955)-----do---	\$47.3
8. Divided by: Average parity index, year before (1947-49 equals 100)-----	112
9. Equals: Parity farm gross income 1947-49-----billions---	\$42.2
10. Multiplied by: Sept. 15, 1956, parity index (1947-49 equals 100)---	115
11. Equals: Current annual rate farm gross income goal---billions---	\$48.5
12. Divided by: Average farm gross income, base period (1947-49)-----do---	\$33.1
13. Equals: Income parity adjustment factor-----percent---	147

WHEAT

14. Multiplied by: Average price received by farmers, base period (1947-49)-----	\$2.14
15. Gives: Income parity price, current date, (Sept. 15, 1956)-----	\$3.15

Parity prices calculated by proposed new income parity formula compared with parity prices calculated by price parity formulas in existing law, Sept. 15, 1956

Commodity	Parity price calculated by—		Average prices received by farmer	
	Proposed income parity formula	Price parity formula in existing laws	1947-49	Sept. 1, 1956
Beef cattle, per hundredweight.....	\$30.00	\$21.70	\$20.40	\$16.20
Beef calves, per hundredweight.....	33.20	23.70	22.60	16.30
All chickens, per pound.....	.431	.287	.293	.17
Eggs, per dozen.....	.685	.465	.466	.34
Hogs, per hundredweight.....	32.19	21.40	21.90	15.50
Corn, per bushel.....	2.41	1.78	1.64	1.43
Wheat, per bushel.....	3.15	2.44	2.14	1.95
Barley, per bushel.....	1.87	1.35	1.34	.95
Oats, per bushel.....	1.25	.864	.852	.68
Rye, per bushel.....	2.19	1.70	1.49	1.20
Flaxseed, per bushel.....	6.10	4.51	4.15	2.89
Butterfat, per pound.....	1.05	.735	.712	.57
All milk, wholesale, per hundredweight.....	6.50	4.71	4.42	4.17
Manufacturing milk, per hundredweight.....	5.45	3.92	3.71	3.40
Cotton, per pound.....	.459	.356	.312	.32
Rice, per hundredweight.....	7.92	5.54	5.39	4.56
Peanuts, per pound.....	.150	.133	.102	.11
Potatoes, per hundredweight.....	3.59	2.36	2.44	1.66
Wool, per pound.....	.676	.614	.460	.41

REFERENCE

1. For a brief outline of Farmers Union full parity family farm income-improvement program see: Legislative analysis memorandum No. 56-1.
2. Agricultural Adjustment Act of 1938, as amended, section 8e (2) and section 301.
3. Agricultural Prices, various issues but particularly January and July 1956.
4. Official program 1956-57, National Farmers Union adopted by delegates to convention March 23, 1956, Denver, Colo.
5. Parity Handbook Document No. 129, Senate, 82d Congress, 2d session. Published for the Senate Agriculture Committee by the Government Printing Office.
6. Page 83 and following of Full Prosperity for Agriculture—Goals for Farm Policy published by the Conference on Economic Progress.
7. 1956 Republican and Democratic platforms adopted by national conventions.

APPENDIXES

APPENDIX A. PARITY DEFINITIONS IN NATIONAL FARMERS UNION 1956-57 OFFICIAL PROGRAM

In 1956-57 official program adopted by delegates to national convention in Denver, Colo., March 23, 1956, includes the following:

In aims and principles: "1. Parity farm income—we assert the right of farm families by their work, management, and property ownership to be able to earn incomes equivalent to those earned by people in other walks of life."

And in action program:

Under "1. Parity income protection": "A fair parity must be defined as the prices and income required to enable farmers to earn rewards for their work, management, and property ownership comparable with income earned by persons in other walks of life."

APPENDIX B. PARITY INCOME AND PRICE FORMULAS IN AGRICULTURAL ACT OF 1938
AS AMENDED

PARITY INCOME

Public Law 897, 80th Congress, Agricultural Act of 1948, title II, section 201 (a) (2), [Sec. 8e (2), title III of the Agricultural Adjustment Act of 1938, as amended], reads:

"'Parity', as applied to income, shall be that gross income from agriculture which will provide the farm operator and his family with a standard of living equivalent to those afforded persons dependent upon other gainful occupation. 'Parity' as applied to income from any agricultural commodity for any year, shall be that gross income which bears the same relationship to parity income from agriculture for such year as the average gross income from such commodity for the preceding ten calendar years bears to the average gross income from agriculture for such ten calendar years."

PARITY PRICES

The Agricultural Act of 1938, as amended, section 301, defines parity price in these words:

"The parity price of any agricultural commodity, as of any date, shall be determined by multiplying the adjusted base price by the parity index.

"The adjusted price * * * shall be (i) the average of prices received by farmers for such commodity * * * during each year of the 10-year period ending on December 31 last before the date * * * divided by (ii) the ratio of the general level of prices received by farmers for agricultural commodities during such period to the general level of prices received by farmers for agricultural commodities during the period January 1910 to December 1914, inclusive. As used in this subparagraph the term prices shall include wartime subsidy payments made to producers under programs designed to maintain (ceiling) prices established under * * * Price Control Act of 1942.

"The parity index of any date shall be the ratio of (i) the general level of prices of articles and services that farmers buy, wages paid hired labor, interest on farm indebtedness secured by farm real estate, and taxes on farm real estate, to (ii) the general level of such price wages, rates, and taxes during the period January 1910 to December 1914, inclusive.

"Notwithstanding (other) provisions * * * the transitional parity price shall be used as the parity price * * * until such date as the transitional parity price may be lower than parity price * * * The transitional parity price for any agricultural commodity as of any date shall be (i) its parity price determined in the manner used prior to * * * January 1, 1950, less (ii) five percentum of the parity price so determined multiplied, in the case of non-basic commodities, by the number of full calendar years which have elapsed after January 1, 1949, or in the case of basic commodities by the number of full calendar years that have elapsed after January 1, 1955.

"The definition of the term 'parity price' prior to January 1, 1950 was that it shall be the price of the commodity purchasing power with respect to articles that farmers buy equivalent to the purchasing power of such commodity in the (1910-14) base period."

TABLE XI.—Parity prices as calculated by old parity formula, not effective parity prices

	1929	1932	1933	1934	1935	1936	1937	1938	1939	1947	1949	1952	1955 ¹
Wheat, per bushel.....	\$1.46	\$1.10	\$1.05	\$1.13	\$1.13	\$1.12	\$1.17	\$1.11	\$1.09	\$2.03	\$2.14	\$2.48	\$2.49
Barley, per bushel.....	1.02	.768	.737	.792	.792	.786	.817	.780	.761	1.42	1.50	1.73	1.75
Flaxseed, per bushel.....	2.79	2.10	2.01	2.16	2.16	2.15	2.23	2.13	2.08	3.89	4.09	4.73	4.77
Oats, per bushel.....	.658	.495	.475	.511	.511	.507	.527	.503	.491	.918	.966	1.12	1.13
Rye, per bushel.....	1.19	.893	.857	.922	.922	.914	.950	.907	.886	1.66	1.74	2.02	2.03
Sorghum grain, per hundredweight.....	2.00	1.50	1.44	1.55	1.55	1.54	1.60	1.52	1.49	2.78	2.93	3.39	3.41
Beef cattle, per hundredweight.....	8.94	6.72	6.45	6.94	6.94	6.88	7.15	6.83	6.67	12.50	13.10	15.20	15.30
Beef calves, per hundredweight.....	11.10	8.37	8.03	8.64	8.64	8.57	8.91	8.50	8.30	15.50	16.30	18.90	19.00
Eggs, per dozen.....	.355	.267	.256	.275	.275	.273	.284	.271	.264	.494	.520	.602	.606
Hogs, per hundredweight.....	12.00	9.01	8.65	9.31	9.31	9.23	9.60	9.16	8.94	16.70	17.60	20.40	20.50
Butterfat in cream, per pound.....	.434	.326	.313	.337	.337	.334	.347	.331	.323	.605	.636	.736	.742
All milk, wholesale, per hundredweight.....	2.64	1.98	1.90	2.05	2.05	2.03	2.11	2.02	1.97	3.68	3.87	4.48	4.51
Wool, per pound.....	.302	.227	.218	.234	.234	.232	.242	.231	.225	.421	.443	.512	.516
Potatoes, per bushel.....	1.08	.760	.760	.850	.870	.860	.920	.860	.840	1.72	1.79	2.04	2.00
Soybeans, per bushel.....	1.58	1.19	1.14	1.23	1.23	1.22	1.27	1.21	1.18	2.21	2.32	2.69	2.71
Cottonseed, per ton.....	37.20	28.90	26.80	28.90	28.90	28.60	29.80	28.40	27.70	51.90	54.60	63.10	63.60
Sweet potatoes, per bushel.....	1.45	1.09	1.04	1.12	1.12	1.12	1.16	1.11	1.08	2.02	2.12	2.46	2.48
Lambs, per hundredweight.....	9.70	7.29	7.00	7.53	7.53	7.47	7.76	7.41	7.23	13.50	14.20	16.50	16.60
Rice, rough, per hundredweight.....	2.99	2.244	2.15	2.32	2.32	2.30	2.39	2.28	2.23	4.16	4.38	5.07	5.10
Corn, per bushel.....	1.06	.796	.764	.822	.822	.815	.847	.809	.790	1.48	1.55	1.80	1.81
Peanuts, per pound.....	.079	.060	.057	.061	.061	.061	.063	.060	.059	.110	.116	.134	.135
Tobacco, per pound ².....	.282	.199	.197	.224	.229	.227	.240	.224	.229	.451	.469	.534	.524
Beans, dry edible, per hundredweight.....	5.56	4.18	4.10	4.31	4.31	4.28	4.45	4.25	4.15	7.75	8.16	9.44	9.50

¹ Sept. 15, 1955.

² Flue-cured tobacco.

TABLE XII.—Percentage that average market prices received by farmers are of of the parity price as calculated under the old parity formula

	1929	1932	1933	1934	1935	1936	1937	1938	1939	1947	1949	1952	1955 ¹
Wheat, per bushel.....	71	35	70	75	73	92	82	50	63	113	88	84	77
Barley, per bushel.....	53	29	58	87	48	99	66	47	54	120	69	78	51
Flaxseed, per bushel.....	100.7	42	81	79	66	88	84	75	70	158	89	79	57
Oats, per bushel.....	64	32	71	94	51	88	57	48	63	107	68	71	50
Rye, per bushel.....	72	31	73	78	43	89	73	37	49	136	70	86	43
Sorghum grain, per hundredweight.....	66	36	207	110	63	108	55	46	68	118	68	83	49
Beef cattle, per hundredweight.....	63	58	60	87	85	98	96	107	147	151	160	102	
Beef calves, per hundredweight.....	59	58	57	83	84	91	93	101	132	139	137	88	
Eggs, per dozen.....	52	54	61	82	81	75	74	65	92	87	70	72	
Hogs, per hundredweight.....	37	41	44	93	102	99	84	70	144	103	87	77	
Butterfat in cream, per pound.....	55	61	68	82	97	94	79	75	118	97	101	77	
All milk, wholesale per hundredweight.....	65	68	76	85	95	94	85	85	116	102	108	92	
Wool, per pound.....	39	95	96	83	117	133	83	96	100	111	104	71	
Potatoes, per bushel.....	122	50	108	53	68	133	58	65	83	94	72	96	36
Soybeans, per bushel.....	119	45	82	80	59	104	67	55	69	151	93	101	74
Cottonseed, per ton.....	83	37	48	114	106	116	65	77	76	166	79	110	69
Sweetpotatoes, per bushel.....	77	43	65	67	60	82	67	63	68	107	101	137	57
Lambs, per hundredweight.....	61	72	78	97	108	114	95	107	152	158	147	107	
Rice, rough, per hundredweight.....	74	42	80	75	69	80	62	62	73	144	94	116	88
Corn, per bushel.....	75	40	68	100	80	128	61	60	72	146	81	85	69
Peanuts, per pound.....	50	33	50	50	50	67	50	50	50	91	83	85	86
Tobacco, per pound.....	64	55	65	95	78	104	83	91	65	98	98	94	100
Beans, dry edible, per hundredweight.....	123	47	69	82	68	125	70	60	78	150	81	92	74

¹ Sept. 15, 1955.

TABLE XIII.—New parity prices, 1952 and 1955, compared with average market prices received by farmers

	1952 (Jan. 15, 1953)			1955 (July 15, 1955)		
	"New" parity price	Average market price received by farmers	Percent price received is of "new" parity price	"New" parity price	Average market price received by farmers	Percent price received is of "new" parity price
Wheat, per bushel.....	\$2 10	\$2.09	99.5	\$2.14	\$1.92	89.7
Barley, per bushel.....	1 38	1.35	97.8	1.33	.90	67.6
Flaxseed, per bushel.....	4.57	3.72	81.4	4.44	2.74	61.7
Oats, per bushel.....	.89	.79	88.8	.86	.56	65.1
Rye, per bushel.....	1.71	1.73	101.0	1.67	.87	52.0
Sorghum grain, per hundredweight.....	2 56	2 80	109.0	2 52	1 67	66.3
Beef cattle, per hundredweight.....	21.40	24.30	114.0	21.20	15.60	73.6
Beef calves, per hundredweight.....	23.80	25.80	108.0	23.30	16.80	72.1
Eggs, per dozen.....	.47	.42	89.4	.46	.44	95.6
Hogs, per hundredweight.....	20.60	17.80	86.4	21.20	15.70	74.0
Butterfat in cream, per pound.....	.75	.75	100.0	.73	.57	78.0
All milk, wholesale, per hundredweight.....	4.74	4.85	102.0	4.66	4.16	89.3
Wool, per pound.....	(¹)	.54	-----	.59	.40	67.8
Potatoes, per bushel.....	1.66	1.96	118.0	1.45	.71	48.9
Soybeans, per bushel.....	2.81	2.72	96.8	2.89	2.00	69.2
Cottonseed, per ton.....	73.00	69.60	95.3	70.80	43.70	61.7
Sweetpotatoes, per bushel.....	2.72	3.38	124.0	2.76	1.42	51.4
Lambs, per hundredweight.....	23.10	24.30	105.0	23.30	17.70	75.9
Rice, rough, per hundredweight.....	5.41	5.87	108.0	5.42	4.50	83.0
Corn, per bushel.....	1.62	1.53	94.4	1.60	1.24	77.5
Peanuts, per pound.....	.11	.11	100.0	.11	.12	109.0
Tobacco, per pound.....	(¹)	.50	-----	(¹)	.52	-----
Beans, dry, edible, per hundredweight.....	8.97	8.67	96.7	9.02	7.07	78.3

¹ Not available.

TABLE XIV.—*Transitional parity prices, where effective, 1952 and 1955 compared with average market prices received by farmers*

	1952 (Jan. 15)			1955		
	Transitional average		Percent price received is of parity price	Transitional average		Percent price received is of parity price
	Parity price	Market price		Parity price	Market price	
Barley, per bushel.....	\$1.45	\$1.35	93	(1)	(1)	(1)
Oats, per bushel.....	.944	.79	84	(1)	(1)	(1)
Rye, per bushel.....	1.69	1.73	102	(1)	(1)	(1)
Sorghum grain, per hundredweight.....	2.85	2.80	98	(1)	(1)	(1)
Eggs, per dozen.....	.51	.42	82	(1)	(1)	(1)
Potatoes, per bushel.....	1.73	1.96	113	(1)	(1)	(1)

¹ No longer effective.

TABLE XV.—*Level of support in any year in which a price-support program was in effect—Average prices at which CCC has supported agricultural commodities, annually, 1933-55*

	1933	1934	1935	1936	1937	1938	1939	1947	1949	1952	1955
Wheat, per bushel.....						\$0.59	\$0.63	\$1.84	\$1.95	\$2.20	\$2.08
Barley, per bushel.....								1.03	1.09	1.22	.94
Flaxseed, per bushel.....								5.75	3.74	3.77	2.91
Oats, per bushel.....								.63	.69	.78	.61
Rye, per bushel.....							.35		1.27	1.42	1.18
Sorghum grain, per hundredweight.....								2.12	2.09	2.38	1.78
Beef cattle, per hundredweight.....											
Beef calves, per hundredweight.....											
Eggs, per dozen.....								1.45	1.47		
Hogs, per hundredweight.....								15.50	15.80		
Butterfat in cream, per pound.....							(²)	(³)	.59	.69	.56
All milk, wholesale, per hundredweight ⁴								(³)	3.14	3.85	3.15
Wool, per pound.....						1.18	.18	.42	.42	.54	.62
Potatoes, per bushel.....								⁵ 1.42	¹ 1.10		
Soybeans, per bushel.....								2.04	2.11	2.56	2.04
Cottonseed, per ton.....									49.50	66.70	46.00
Sweetpotatoes, per bushel.....								1.82	1.72		
Lambs, per hundredweight.....											
Rice, rough, per hundredweight.....								3.76	3.96	5.04	4.66
Corn, per bushel.....	\$0.45	\$0.55	\$0.45	\$0.55	\$0.50	.57	.57	1.37	1.40	1.60	1.58
Peanuts, per pound.....						(⁶)	(⁶)	¹ .10	¹ .11	.12	.12
Tobacco, burley, per pound:											
Type 31.....								.40	.40	.50	
Flue-cured, types 11 to 14.....								.15	.40	.43	.51
Beans, dry, edible, per hundredweight.....								7.13	6.55	7.87	6.36

¹ Computed from announced percent of parity.

² Supported at 75 percent of parity.

³ Supported at 90 percent per parity. No purchases made because of high commercial price.

⁴ Milk for manufacturing.

⁵ Early and intermediate potatoes; late equals \$1.53.

⁶ CCC made nonrecourse loans to peanut cooperatives to facilitate surplus removal program.

TABLE XVI.—Level of support in any year in which a price-support program was in effect—Average prices at which CCC has supported agricultural commodities, annually, 1933–55—Percent of parity at which CCC has supported commodities

	1933	1934	1935	1936	1937	1938	1939	1947	1949	1952	1955
Wheat, per bushel.....						52	56	90	90	90	82½
Barley, per bushel.....								73	72	80	70
Flaxseed, per bushel.....								160	90	80	65
Oats, per bushel.....								69	70	80	70
Rye, per bushel.....							38		72	80	70
Sorghum grain, per hundredweight.....									76	70	80
Beef cattle, per hundredweight.....											
Beef calves, per hundredweight.....											
Eggs, per dozen.....								90	90		
Hogs, per hundredweight.....								90	90		
Butterfat in cream, per pound.....							75	90	90	90	76
Allmilk, wholesale, per hundredweight ²											
Wool, per pound.....						75	178	101	94	90	106
Potatoes, per bushel.....								90	60		
Soybeans, per bushel.....								90	90	90	70
Cottonseed, per ton.....									90	90	65
Sweetpotatoes, per bushel.....								90	80		
Lambs, per hundredweight.....											
Rice, rough, per hundredweight.....								90	90	90	85
Corn, per bushel.....	60	68	55	66	58	70	69	90	90	90	87
Peanuts, per pound.....								90	90	90	90
Tobacco, per pound:											
Burley, type 31.....								90	90	91	90
Flue-cured, types 11 to 14.....								75	90	90	91
Beans, dry, edible, per hundredweight.....									90	80	85
											70

¹ Computed on basis of announced support level.

² Milk for manufacturing.

TABLE XVII.—Price support programs (established by Secretary of Agriculture under applicable laws)—Support price of farm commodities

Commodity	1952		1953		1954		1955	
	Actual	Per cent of parity	Actual	Per cent of parity	Actual	Per cent of parity	Actual	Per cent of parity
Wheat ¹	\$2.20	90	\$2.21	90	\$2.24	90	\$2.08	82½
Corn.....	1.60	90	1.60	90	1.62	90	1.58	87
Cotton.....	.31	90	.31	90	.32	90	.32	90
Peanuts.....	.120	90	.119	90	.122	90	.122	90
Rice.....	5.04	90	4.84	90	4.92	90	4.66	86
Tobacco.....		90		90		90		90
Butterfat.....	.692	90	.673	90	.562	75	.562	76
Milk, manufacturing.....	3.85	90	3.74	90	3.15	75	3.15	80
Wool ².....	.542	90	.531	90	.532	90	.62	106
Honey.....	.114	70	.105	70	.102	70	.099	70
Tung nuts.....	67.20	62	63.38	65	54.96	60	(³)	(³)
Barley.....	1.22	80	1.24	85	1.15	85	.94	70
Oats.....	.78	80	.80	85	.75	85	.61	70
Rye.....	1.42	80	1.43	85	1.43	85	1.18	70
Sorghum grain.....	2.38	80	2.43	85	2.28	85	1.78	70
Flaxseed.....	3.77	80	3.79	80	3.14	70	2.91	65
Soybeans.....	2.56	90	2.56	90	2.22	80	2.04	70
Beans, dry edible.....	7.87	85	7.79	87	7.24	80	6.36	70
Cottonseed.....	66.70	90	54.20	75	54.00	75	46.00	65

¹ 1956 support price: \$1.81, 76 percent of parity.

² 1956 clip will be supported at 106 percent of parity.

³ Not yet announced.

LEGISLATIVE ANALYSIS MEMORANDUM No. 56-19 (REVISION No. 2)

FEBRUARY 1, 1957.

FARM PRODUCTION AND MARKETING ADJUSTMENTS

(For current legislative and economic developments relating to this subject see supplements Nos. 1 and 2, respectively, of LAMs Nos. 56-20, 21, 22, and 23)

National Farmers Union continues to urge further improvement and expansion of various production and marketing adjustment programs as essential parts of a comprehensive farm income improvement program.

Such programs fulfill these major functions:

- (a) Prevent wasteful use of farm labor, capital, and natural resources;
- (b) Assist farmers to keep market supplies of farm commodities in reasonable balance with market demand and thereby:
 - (1) Reduce the Government cost of the income-protection and price-support levels or above free market levels in the absence of support
 - (2) In some cases directly raise prices received by farmers above support levels or about free market levels in the absence of support programs.

National Farmers Union considers such supply adjustment programs to be an essential third line of defense for farmers after everything possible has been done to expand domestic and foreign human use and demand for farm commodities through maintaining and expanding a full employment economy and carrying out specific action programs to expand international trade and operating special demand and export expanding action programs.

SUMMARY

The production and marketing adjustment programs recommended for adoption by National Farmers Union as amendments to existing law are:

1. A workable voluntary conservation acreage reserve through improvement of the Soil Bank Act;
2. Marketing premium payments for sale of livestock at desirable weights and types (not now authorized by existing law);
3. Extension in workable ways to producers of all farm commodities of the privilege of using improved market sharing and marketing quotas, now restricted by existing law to the producers of only 7 commodities; and
4. Extension in workable ways to producers of all farm commodities of the protection and right to utilize private collective bargaining techniques under marketing agreements and orders and similar protective Federal and State legislation.

ECONOMICS OF SUPPLY ADJUSTMENT

The desirable results of these adjustment programs are derived from two facts.

First, no one seriously believes that farmers should waste their time and use up their resources to produce commodities that will not be used but whose presence on the market will reduce farm prices and incomes to the bankruptcy level.

Second, the inelasticity of the demand for farm commodities as a whole and for many individual farm commodities is so severe that increased quantities can be sold only at greatly lowered prices. Or conversely, for all farm food commodities as a group, a 1-percent cut in supply will have a 6, 7, or even 10 percent raising effect on farm prices and an 8 to 12 percent raising effect on farm net income.

For example, a 2-percent cut in total production of farm food commodities at present levels would reduce the Government cost of an adequate income-protection and price-support program by more than \$2 billion or in the absence of such a program would raise gross and net farm income by more than \$2 billion.

As a result, such adjustment measures reduce the Government cost of the farm income-protection price-support program, if one is in operation. If the cut in volume marketed is large enough, market prices can be raised above the support level. In the absence of an income-protection or price-support program, production and marketing reductions can raise farm family income directly by reducing supply and raising prices received by farmers by a much larger percentage than the percentage by which the volume of sales are cut.

For example, the acreage reserve in the Agricultural Act of 1956 would raise prices of basics 5 percent above support level, if strongly administered. Under existing law, marketing quotas operate in connection with support programs. Marketing agreements usually operate in conjunction with surplus-removal operations. But only in the case of milk do marketing orders operate along with a price-support program. In this case each strengthens and improves the income-raising features of the other. Marketing orders protect producers in bargaining collectively with buyers of the produce.

Marketing premium payments would help raise farm income from livestock whether operated alone or along with a specific income protection or price-support program.

Acreage allotments are operated in conjunction with price-support programs for corn.

NEED FOR ADJUSTMENT PROGRAMS

The need for farm production and marketing adjustment programs to raise farm income directly or to make specific farm income improving programs more workable is derived basically from the chronically adverse trade situation of farmers.

In the absence of specific income-protection measures, farm family income tends to fall from year to year except in years when the national economy expands by as much as 10 percent.

However, such a rapid rate of expansion would set up conditions that lead to inflation of industrial prices and increased farm costs of production. In view of this, National Farmers Union favors a more modest national economic growth rate of about 6 percent per year. However, such a rate of national economic expansion is not great enough to raise farm family income toward a parity position.

To expand human use and demand for farm commodities, National Farmers Union continues to urge new, improved and expanded programs of increased domestic and foreign consumer purchasing power and the use of farm commodities as capital assets to further intelligent foreign economic and humanitarian domestic public-assistance programs.

In any particular year, however, the expansion of the National economy and of farm exports and the scope of the special demand-expanding programs may not, and in the foreseeable future probably will not be sufficient to provide the effective demand required to keep price received by farmers at a level that will enable farm people to earn parity incomes or a tolerable percentage thereof. Moreover, while the level of general demand for all farm commodities may be satisfactory one or more individual commodities may at any time run into specific difficulty.

To protect farm income and to improve it in such circumstances requires the use of specific farm income-protection and price-support measures through workable combinations of parity supplement payments and price-supporting loans and purchases.

However, such programs quickly become subject to political attack if they must be used in large magnitude continuously.

If annual production increases too fast and exceeds the rate of expansion of augmented annual demand for domestic consumption and exports, stocks pile up in Government ownership and Government costs for parity supplement payments would mount rapidly. Either or both occurrences soon lead to a political clamor to lower the high rigid support level.

To forestall these developments, National Farmers Union favor the use of federally sanctioned production and marketing adjustment programs to enable farmers to keep market supplies in reasonable balance with augmented demand.

OPERATING RELATIONSHIP

National Farmers Union favors improvement of the Soil Bank Act to provide for the use of a voluntary conservation acreage reserve as a satisfactory incentive program to bring total farm production into general balance with total market demand. Under this program, a predetermined part of total farm acreage (cropland, meadow and pasture) would be placed in a conservation reserve each year and removed from production for commercial sale.

So that the production and sale of individual farm commodities could be brought into better balance with their own specific domestic and export market demand, National Farmers Union supports improvement of marketing quotas,

acreage allotments and marketing agreements and orders and their extension to other commodities and the enactment of a program of marketing premium payments on sales of livestock of desirable weights and types for use in conjunction with parallel action by farmers in connection with their farmer-owned and controlled business activities and protective laws adopted by State legislatures.

NATIONAL WELFARE PROMOTED

Considerations of national welfare demand continuous concern for the income status of farm people.

In the first place, in a democracy within a republic the income situation of any segment of population, particularly one as large as the 22 million plus people who live on farms cannot and should not be disregarded.

In the second place, the immediate and longer run future welfare of the entire population is directly and intimately involved. By 1975, the population of the United States will be at least 228 million, 35 percent or 59 million more than at the end of 1956. For national safety, the Nation must develop by 1975 a farm productive plant capable of producing approximately one-third more food, fiber, oil and timber than in 1956.

Third, continuation of national prosperity with full employment, full production and relatively full consumption is seriously endangered when any large segment of the economy such as farming continues in a depressed economic condition. It is abundantly clear in American history that major national depressions are farm led and farm fed.

Moreover, continued and deepening farm depression acts as a powerful stimulant to the increase of industrialized agricultural production, corporate farming, and an increasing prevalence of tenancy. Such trends as these are inimical to the preservation and strengthening of the family farm pattern of American agricultural production which is one of the Nation's major bulwarks of political and social stability and democracy within a republic and which is one of the Nation's best examples of hope and inspiration to the 2 billion of the world's people who live by farming but have not yet made the ultimate choice between democracy and some form of Fascist or Communist totalitarianism.

In terms of general national interest (and that of farm people) in maintaining family farm income, production and marketing adjustment rather than support level adjustment is the most intelligent action to reduce pressures on the farm income protection program.

If the 4 percent "oversupply" is adjusted by lowering support levels farm family income drops drastically, because the support level must be dropped by 25 percent. If the adjustment is made by reducing production and marketing, farm family income falls but slightly.

The arithmetic is as follows:

104 percent (supply) multiplied by 75 percent (prices)=78 percent gross income.
78 percent gross income minus 52 percent (costs)=26 percent net income.

100 percent (supply) multiplied by 100 percent (prices)=100 percent gross income.

100 percent gross income minus 56 percent (costs)=44 percent net income.

Net income index by cutting production-----	44
Net income index by cutting price-----	26

Difference 69 percent-----	18
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Net farm-family income would be nearly 70 percent higher by cutting the volume marketed by 4 percent than by allowing prices to drop the 25 percent required to get the market to absorb the additional output in the market.

NATIONAL WELFARE PROTECTED

Farm commodity supply adjustments should be viewed as supplemental to farm income-protection programs and not as income-improving devices in themselves for several impelling national welfare reasons.

First, if such devices are designed to tailor each year's production to what the market will take at prices that will enable farmers to earn full-parity incomes, there is an ever-present danger that adverse crop conditions may result in low yields, and, therefore, lead to severe shortages. Moreover, in periods of recession and depression the cutting of the production of farm commodities to the volume that the depressed market will take at fair prices to farmers would so severely reduce supply that starvation and food riots would result.

This is, of course, exactly the principle upon which big industry, big business, private profit utilities, and organized labor operates to maintain prices, wage rates, and profits while cutting production.

In 1932 steel production for the year was cut to only 20 percent of capacity. If farmers had cut their production by a similar proportion, then more than 4 of each 5 persons in the towns and cities of the United States would have starved to death. Obviously the Nation as a whole cannot allow farmers to use production adjustments as a means of income protection to anything like the same extent that it allows steel producers to use it. But it is patently unfair to sanction and condone enforced scarcity as an economic tool of steel producers, the prices of whose products make up a large share of farm production expenses, and completely deny the use of the same tool to farmers.

In 1954 the steel industry operated at only 71 percent of capacity, average for the year. Total industrial production dropped by 8 percent from 1953 to 1954 although industrial prices were raised. Industrial employment was cut by 7 percent but hourly wage rose 2 percent.

National Farmers' Union has opposed milk strikes and other violent means of curtailing market supplies of such necessities of life as food and fiber. Moreover, we are opposed to use of such severe production and marketing adjustments as those used by the steel and other industries.

National Farmers' Union places the following limits on the use of federally sanctioned and administered farm commodity market supply adjustments:

1. Production and marketing adjustments should not be used to reduce the size of already existing carryover of commodities. These should be insulated from the market, and such of them as are not needed for the national security reserve should be disposed of in nonwasteful, noncommercial channels.

2. Production and marketing adjustments should not be utilized to reduce total annual production of any commodity below the volume that the market will buy at prices which will return parity farm income in view of that year's augmented domestic and export demand in a full-employment economy.

To reduce production below these levels would be a great deal more serious in the case of food and fiber than in the case, for example, of steel and automobiles.

CONTINUED INCREASE IN FARM PRODUCTIVITY

Since World War II, there have been 7 years when prices received by farmers averaged 100 percent of price parity or more. During these years, farm output per man-hour increased on an average of 3 percent per year (table I). No one knows, of course, whether such increases in farm productivity will continue in future years. But we do know that farm technological improvements already tested but not yet adopted on most farms are more than sufficient to maintain the above rate of increasing efficiency for the next 5 or 10 years, if farm income is maintained anywhere above the 50 percent of income parity level.

In contrast, population is increasing only 1.7 percent per year and per person consumption is expanding at a rate not faster than three-tenths of 1 percent per year. This makes a total growth of demand for farm commodities of not much more than 2 percent per year, leaving a 1 percent per year drop or net drag. No one, of course, can predict future demand for farm commodities with exact accuracy.

However, if an adequate 100 percent of parity farm income's protection program is to be operated in what appears to be the future situation some means must be used to hold down advancing farm productivity. In the short run this cannot be done by reducing price-support levels as experience of the Eisenhower-Farm Bureau sliding scale program dramatically demonstrated. (See table II.)

In the longer run such a policy can be effective in halting the increase of farm production only by driving down farm prices and income further and further until farm families mortgage their assets to the hilt, lose their net worth, use up their available credit, and wear out their soil, water, and other capital assets and several generations on our farms have gone through the wringer of bankruptcy.

If the preceding estimate of an approximately 1 percent drag per year is correct, and complete reliance is placed in the so-called free-market, this mounting excess of farm commodity supply over effective demand would push down prices received by farmers and gross farm incomes by about 6 to 10 percent per year. With relatively fixed costs of production, net farm income would tend to drop by about 10 to 15 percent per year. If such farm income drop were long contin-

ued, farm production increases would, of course, ultimately be stopped. But at what a cost to farmers and the general welfare.

With an adequate farm-income protection and price-support program in operation, the great inelasticity of demand for farm commodities can be utilized as a powerful pry-fole to raise the income of farm people and make the income-improvement program more easily workable and much less costly to the Federal or State governments. Used against farmers in the free market, this inelasticity is a hard club that will beat family-farm operators to their economic knees.

WEAKNESS OF FARM BUREAU PROPOSALS

The Eisenhower administration, following the policy of the national officials of American Farm Bureau Federation, appear to favor the complete elimination of acreage allotments and marketing quotas, favoring instead a policy of cutting price-support levels.

Moreover, the Eisenhower-Farm Bureau soil-bank proposal was designed almost exclusively to enable Commodity Credit Corporation to dispose of the stocks owned by it on the domestic commercial market. The small conservation reserve provided for in the proposal would not have lifted the prices received by farmers for nonbasic commodities above the already deplorably low support-loan levels to which they have been progressively dropped over the past 3 years.

First, the Eisenhower soil-bank proposal would not have improved farm income; and second, it was designed and is still justified as a device to cut annual production of basics below annual market takings at support level so that existing Commodity Credit Corporation stocks could be reduced.

WEAKNESS OF EXISTING LAW

In addition to specific detailed weaknesses of existing production and marketing adjustment laws that will be discussed in separate memorandums, several major weaknesses should be listed here. These are:

1. Except for the small conservation reserve of the soil bank, only a small select list of the basic commodities—wheat, cotton, sugar, corn, milk, peanuts, tobacco, rice, and a few fruits and vegetables—are eligible to use the devices;
2. Too little attention is paid to protecting the income base of small family farmers;
3. They are rendered cumbersome by inapplicable or unworkable gadgetry; and
4. The \$450 million appropriation authorized for the small conservation reserve is grossly inadequate to the job assigned to it.

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10. Legislative Analysis Memorandum No. 56-23 Marketing Premium Payments and Supplements Nos. 1 and 2.

TABLE I.—Parity price ratio and increasing farm efficiency and productivity, 1946–55

Year	Farm price parity ratio	Index of farm output per man-hour in following year	Percent increase in farm productivity above preceding year	Year	Farm price parity ratio	Index of farm output per man-hour in following year	Percent increase in farm productivity above preceding year
1946.....	113	92	1	1951.....	107	120	6
1947.....	115	104	13	1952.....	100	123	2
1948.....	110	104	0	1953.....	92	126	13
1949.....	100	112	8	1954.....	89	130	
1950.....	101	113	1	1955.....	84		

¹ Average for 7 years.

TABLE II.—Sliding scale has not reduced farm production

[When support levels were reduced, production increased, except where marketing quotas were put into effect]

Commodity	Level of support			Production (million of units)		
	1952 per unit	1955 per unit	Percent change	1952	1955	Percent change
Wheat, per bushel.....	\$2.20	\$2.06	-6	1,209	1,938	1-28
Rice, per hundredweight.....	\$5.04	\$4.66	-8	48	153	1+10
Cotton, per pound and bales.....	\$0.31	\$0.31	0	15.1	14.6	1-3
Corn, per bushel.....	\$1.60	\$1.58	-1	2,977	3,185	2+7
Oats, per bushel.....	\$0.78	\$0.61	-22	1,260	1,576	+25
Sorghum grain, per hundredweight.....	\$2.38	\$1.78	-25	83	232	+180
Soybeans, per bushel.....	\$2.56	\$2.04	-20	298	371	+30
Milk, percent.....	.90	.75	-17	80,812	87,773	+9
Barley, per pound.....	\$1.22	\$0.94	-23	226	391	+73
Flaxseed, per bushel.....	\$3.77	\$2.91	-23	30	41	+37
Rye, per bushel.....	\$1.42	\$1.18	-17	16	29	+81

¹ Marketing quotas in operation in 1955 but not in 1952.

² Acreage allotments in operation in 1955 but not in 1952.

Source: Crop Production 1955, published by Agricultural Marketing Service, U. S. Department of Agriculture.

LEGISLATIVE ANALYSIS MEMORANDUM NO. 57-2

JANUARY 8, 1957.

PUBLIC POWER AND RESOURCE PROGRAM FOR THE UNITED STATES

Principal elements of the power policy

1. Recognize a Federal responsibility to foster conditions in which all electric systems, however owned, have access to low-cost wholesale power supply from private or public regional power pools supplied by large and economical generating plants.

2. Expedite the Federal development of hydroelectric power through comprehensive river-basin programs, in order to obtain for the regional power pools the maximum amount of useful hydro power as quickly as feasible, together with the important benefits of flood control, irrigation, navigation, and recreation characteristic of multiple-purpose comprehensive river basin development. Only the Federal Government can do this job properly. Turning it over piecemeal to individual utilities results in the loss of many of the potential benefits to the people of the United States and is wasteful, costly and downright foolish.

3. Continue the expansion of TVA power supply to meet the requirements of its market area as a yardstick regional wholesale power supply pool.

4. Provide for Federal Power Commission authorization of non-Federal regional wholesale power pools, whether privately, publicly, or cooperatively owned or jointly owned by some combination of these, subject to statutory requirements protecting the public interest.

5. Provide for Federal Power Commission regulation of non-Federal wholesale power pools to require, in addition to the usual financial, accounting and rate regulation, that such pools assume responsibility for (a) furnishing the power supply requested by all electric systems in the region authorized to serve ultimate cost through construction of generating capacity itself or through arrangements for joint financing of capacity by the electric systems in the region or through Federal construction of river basin or atomic projects.

6. Enable such regional wholesale power pools to finance all wholesale power construction on a low-cost basis (as the private utilities desire) principally through revenue bonds based on long-term contracts with electric systems serving ultimate consumers.

7. Provide for the establishment of Federal regional wholesale power supply, subject to specific congressional action, where local electric systems clearly fail to provide the region with the advantages of modern wholesale power, as a necessary backup or reserve power to make the FPC regulation effective.

8. Retain in full force the antimonopoly preference to public bodies and co-operatives in the marketing of power from Federal projects as a reserve power to back up the general requirement that the pools supply to all systems the low-cost power they request.

9. Authorize Federal agencies responsible for river basin or atomic power programs to cooperate with the regional wholesale power pools in their planning activities and to utilize, construct, and operate projects to make the maximum contribution to the availability of abundant low-cost power supply from such pools under appropriate conditions.

10. Authorize appropriate Federal agencies to construct full-scale demonstration atomic powerplants in order to advance the technology and reach the point where this resource can be used by the publicly and privately owned utilities and the rural electric cooperatives to supply the people with low-cost power.

SPECIFIC POWER AND RESOURCE ACTION PROGRAM FOR 1957 AND 1958

Proposed National Farmers Union legislative program

The principles upon which this program is based are:

1. Planning, construction, and operation of comprehensive water, power, and atomic energy programs is a proper and legal, as well as most necessary, function of the Federal Government under a wide range of constitutional power. From an economic and engineering point of view, Federal leadership is required in comprehensive river basin programs to develop our interstate waterways which belong to the people for power, flood control, navigation, water supply, irrigation, recreation, pollution control, and fish and wildlife benefits.

2. For a dynamic, expanding economy and higher living standards for an increasing population at home and to meet the Soviet challenge abroad, tremendous new supplies of low-cost power will be required—a minimum of 320 million kilowatts by 1970 and 600 million by 1980.

3. These power requirements can be met by policies and programs whereby Federal responsibility to foster conditions whereby all electric systems, however owned, have access to low-cost wholesale power supply from private or public regional power pools supplied by large and economical generating plants.

4. Atomic power programs should be carried forward by the Federal Government not only in full-scale demonstration nuclear powerplants, but to the point where this resource can be used by publicly and privately owned utilities and rural electric cooperatives to supply the people with abundant low-cost power.

5. There must be continuance in full force of the antimonopoly preference to publicly and cooperatively owned bodies in the marketing of power from Federal projects, and the yardstick competition to private utilities they so effectively carry out in the interests of lower-cost power to consumers.

6. The Public Utility Holding Company Act must be enforced against private utility monopoly combinations, interlocks, and attempts to avoid Federal regulation in the public interest.

Projects

1. *Authorization.*—(a) Hells Canyon, 924,000 kilowatts prime power; 3.88 million feet active storage.

(b) Niagara, 1,240,000 kilowatts of firm power.

(c) Gore-Holifield bill to authorize AEC to undertake a large-scale Federal atomic power demonstration program at AEC installations.

- (d) Fryingpan-Arkansas: Eastern Colorado, water supply and power.
- (e) River Bend, Potomac River, Md.: 120,000 kilowatts installed capacity; 1.1 million acre-feet of storage.
- (f) Atomic insurance bill: Government underwriting liability insurance for non-Federal utilities on nuclear powerplants.
2. *New starts—construction funds.*—(a) Fort Randall-Grand Island transmission lines, Nebraska.
- (b) John Day, Columbia River, Oreg.-Wash., 1,105,000 kilowatts installed capacity; 500,000 acre-feet active storage.
- (c) Green Peter-White Bridge, North Santiam, Oreg., 96,000 kilowatts installed capacity, 322,000 acre-feet usable storage.
- (d) Dardanelle, Ark., 120,000 kilowatts installed capacity: Greer's Ferry, Ark., installed capacity, 96,000 kilowatts; Bufaula, Okla., installed capacity, 30,000 kilowatts. Construction started in fiscal 1956.
3. *New starts—Planning funds.*—(a) Big Bend, Missouri River, S. Dak., installed capacity 120,000 kilowatts.
- (b) Yellowtail, Big Horn River, Mont., 200,000 kilowatts installed capacity.
- (c) Beaver Ark., installed capacity 64,000 kilowatts.
- (d) Keystone Reservoir, Okla.: For desiltation of downstream multipurpose reservoirs.

Substantive power legislation

1. Amending Federal Power Act to compel privately owned electric utilities to use same rate of depreciation for both taxes and ratemaking purposes.
2. Requiring Federal certifying agencies to report annually to the Congress on approval of accelerated amortization applications, both as to the amount approved for certification and the tax revenues lost.
3. Establishing national water-resources policy (Trimble-type legislation).
4. TVA revenue bond self-financing legislation. TVA's proposal ran counter to that of the Budget Bureau last year.

Congressional investigations

1. Accelerated amortization.
2. Interlocking relationships and control of privately owned electric utilities.
3. Federal Power Commission.
4. Investigation of radiation hazards created by both peacetime and weapons programs of AEC.

LEGISLATION OR PROJECTS TO OPPOSE

- A. Partnership legislation at such projects as John Day, Cougar, Green Peter, and Pleasant Valley in the Pacific Northwest, and Trinity in California.
- B. Major elements of probable comprehensive legislation to implement Hoover Commission recommendations on water and power policy, and those of the President's Cabinet Committee on Water Resources Policy.
- C. Any legislative or administrative efforts to undermine or weaken the Public Utility Holding Company Act.
- D. Legislation of the type of the Barrett bill of the last Congress establishing rights to the use of water from interstate streams as vested property rights.
- E. Efforts of the oil companies to escape proper Federal regulation by amending the Natural Gas Act.
- F. Downstream benefits legislation.

LEGISLATIVE ANALYSIS MEMORANDUM No. 57-3

JANUARY 9, 1957.

IMPLEMENTATION OF OVERALL RESOURCE POLICY OF NATIONAL FARMERS UNION

The National Farmers Union recommends Federal development of natural geographic areas to promote better use of all existing natural resources of entire river valley basins in order to improve the economic stability of such areas, promote conservation and wise use to prevent erosion and flood. The basins should be organized along completely integrated lines of local control similar to the Tennessee Valley Authority. Such projects should generate maximum amounts of public power with full respect to preference clauses, irrigation improvements aimed to benefit development of family-type farms, and wisest possible wildlife management.

Provision must also be made for continuation and expansion of the small watershed flood prevention and agricultural soil, water, and related resources conservation program both before and after establishment of such valley developments. Such programs of development should include but not be limited to intensification and expansion of existing conservation programs on both private and public land; reforestation and revegetation to protect watersheds and increase timber and forage; increased appropriations for conservational management and development of all resources; and construction and maintenance of timber and stock access roads in national forests. Use must be made of all scientific and technological advancements to increase conservation of all natural resources. Necessary action must be taken to halt the destruction and depletion of our land and our forests.

Enactment of laws is urged making it mandatory for the executive branch to submit to Congress for prior approval any action it intends to take that would sell or grant proprietary privileges in federally owned land or resources to private interests. Approval to make such transactions would be granted only in those cases where it is clearly shown that the general national welfare will be promoted by alienation of title.

IMPLEMENTATION OF ENERGY AND POWER POLICY

Establishment of clear-cut Federal legislation and policies to establish clearly Federal responsibility to produce, regulate, and control public power through programs of area development on the basis of all-inclusive support of a total national program is urged. Federal generation and transmission of the power to meet the present and future needs of nonprofit electric systems and the use of the withdrawal clause to protect the rights of preference customers is required. The Federal Government must assist cooperatives and other nonprofit public power agencies to set up generating and transmission facilities where needed by supplying technical and financial support. The Federal Government must construct and operate the high-voltage transmission facilities necessary to integrate individual hydroelectric projects and to deliver appreciable portions of their output to the load center of preference customers.

The Federal Government must purchase or generate sufficient thermal energy to supplement the hydroelectric capacity of the Federal system so that the maximum amounts of firm power can be made available for the benefit of preference customers.

Any electric or other utility, engaged in interstate commerce and enjoying guaranteed profits without risk while operating as a private monopoly with Government protection, must be prevented from counting as costs in ratemaking the money spent, either directly or indirectly, to influence political action at any level. Amendment of the Internal Revenue Act to preclude charging off such expenditures as those mentioned above as tax deductions is recommended. Legislation requiring that the benefits from accelerated tax amortization be passed on to consumers should be enacted.

We urge establishment of regional development agencies to assure proper use of the Federal hydroelectric power and provide for optimum conservation and development of all values of area-wide projects such as flood control, navigation, irrigation, and recreation. Such development would utilize the highest possible potentials of multipurpose users and benefits including flood control, navigation, recreation, and water for industry, cities, and irrigation.

LEGISLATIVE ANALYSIS MEMORANDUM No. 57-4

JANUARY 11, 1957.

THE DEVELOPMENT OF PUBLIC POWER POLICY

FEDERAL POLICY RECOGNIZES PUBLIC OWNERSHIP AS PART OF AMERICAN WAY

For 50 years congressional legislation and presidential messages have recognized public power as part of the American way of life. During the same half century Federal development of electric power in connection with comprehensive river-basin programs has been recognized as a proper Federal function and a check on the growth of an intolerable private power monopoly.

As far back as 1906 municipal and cooperative electric systems were beginning to buy their power supply under the preference provision of the Reclamation Act from the Federal Minidoka irrigation and power project.

But even earlier than that President Theodore Roosevelt had vetoed a bill authorizing private construction of a power dam at Muscle Shoals in the Tennessee River, stating that "the new conditions caused by the advance in electrical science" which called for comprehensive consideration of "a general policy appropriate" to deal with the newly revealed "element of substantial value in streams" which the Government might develop for navigation. He vetoed the bill pending adoption of a policy to protect the public interest.

Thus the Muscle Shoals issue, which became the TVA issue after 1933, spans a period of more than 50 years of political battle over Federal power policy from "Teddy" to "Ike," with "Teddy" acting to save it for the people and "Ike" acting through Dixon-Yates to give it away to the Power Trust.

In 1908 President Roosevelt vetoed a bill which would have permitted private development of power in the Rainey River, again emphasizing the need for formulation of a general policy to assure "the maximum development of the navigation and power."

In 1909 President Roosevelt vetoed a bill which would have permitted private development of power in the James River, emphasizing the importance of imposing conditions which would prevent increasing control of waterpower by monopolies "controlled from the great financial centers." He said:

"The great corporations are acting with foresight, singleness of purpose, and vigor to control the water powers of the country * * * I esteem it my duty to use every endeavor to prevent this growing (power) monopoly, the most threatening that has ever appeared, from being fastened on the people of this Nation."

In the same year President Theodore Roosevelt transmitted the report of the National Conservation Commission to Congress. This report emphasized, among other things, the need for prompt action to stop waste and monopolization of waterpower. In his message transmitting the report, the President said:

"It is particularly important that the development of waterpower should be guarded with the utmost care both by the National Government and by the States in order to protect the people against the upgrowth of monopoly."

Then, in 1912, 12 Members of Congress, established in 1909 as the National Waterways Commission, reported on the need for a comprehensive storage reservoir system to be utilized simultaneously for flood prevention, navigation, and power development. It said:

"A reservoir system, in order to be utilized simultaneously for flood prevention, aiding navigation, and power development, must be controlled and operated by some public authority."

These statements reflect the thinking of a great Republican President and Congress nearly a quarter of a century before the New Deal began to put the principles of the conservation movement into practice. They show that public power, even Federal development, was in no wise alien to the American tradition and that the present designation of it as "creeping socialism" is solely the creation of hucksters serving the very private power monopolists against whom President Theodore Roosevelt warned the people.

FEDERAL WATERPOWER ACT EMBODIES PREFERENCE FOR PUBLIC POWER.

The Federal Waterpower Act, now part I of the Federal Power Act, enacted in the last year of the administration of President Woodrow Wilson, carried on this recognition of public power as part of the American system.

Although it gave a single body responsibility for permitting private development of waterpower resources involving public lands or streams over which Congress had jurisdiction under its commerce powers, it definitely limited and conditioned the issuance of such licenses and kept the field wide open for Federal or non-Federal public development.

In the first place, section 7 of the act establishes absolute priorities for public development; first priority for the United States itself and second priority for States and municipalities.

Under this section "whenever, in the judgment of the Commission the development of any water resources for public purposes should be undertaken by the United States itself, the Commission shall not approve any application for any project affecting such development, but shall cause to be made such examinations, surveys, reports, plans, and estimates of cost of the proposed development as it may find necessary, and shall submit its findings to Congress with such recommendations as it may find appropriate concerning such development."

This section also provides that, in issuing preliminary permits or licenses "the Commission shall give preference to applications therefor by States and municipalities, provided the plans for the same are deemed by the Commission equally well adapted, or shall within reasonable time be made equally well adapted, to conserve and utilize in the public interest the water resources of the region."

In the second place, section 6 of the act limits the terms of licenses for private development to "a period not exceeding 50 years;" and section 14 gives the United States the right to take over and operate any project or projects on expiration of the license on payment to the licensee of its net investment in the project, plus severance damages if any. In fact, this section gives the Government the right to take over not only the project but also "the right to take over upon mutual agreement with the licensee all property owned and held by the licensee then valuable and serviceable in the development, transmission, or distribution of power, and which is then dependent for its usefulness upon the continuance of the license."

In the third place, this same section expressly reserves "the right of the United States or any State or municipality to take over, maintain, and operate any project licensed under this act at any time by condemnation proceedings upon payment of just compensation."

In the fourth place, section 10 (a) of the act, which requires licensees to pay the United States reasonable annual charges to reimburse the Government for the cost of administering part I of the Federal Power Act and to recompense the Government for use of its lands or other property, specifically provides "that licenses for the development, transmission, or distribution of power by States or municipalities shall be issued and enjoyed without charge to the extent that such power is sold to the public without profit or is used by such State or municipality for State or municipal purposes."

These brief references to the Federal Power Act make it crystal clear that in the years 1918 when Congress was enacting the Federal Worker Power Act of 1920 and again in 1935 when it was reenacted with amendments as part I of the Federal Power Act, Congress did not look upon public power or Federal development, transmission, and distribution of power as "creeping socialism," or "un-American" but accepted Federal, State, or municipal development and marketing of power as a normal part of the American way of conducting this vital public business.

And no Congress has taken a contrary position. Actually, except for the administration of President Hoover and the present administration of President Eisenhower, no administration has fallen in with the propaganda of the Power Trust, that public power is alien to the American way of life.

Furthermore, in upholding the powers of the Federal Power Commission over licensees as "comprehensive and conclusive," the courts have recognized that the development of the water resources of navigable streams is exclusively within the domain of the Federal Government. Thus, in the case of *Alabama Power Company v. Federal Power Commission*, decided by the United States Circuit Court of Appeals for the District of Columbia in 1952 and confirmed by the United States Supreme Court through denial of certiorari, the circuit court said:

"In granting the privilege of exploiting the water resources of navigable streams or the channels of radio communication, the Federal Government is making grant out of its exclusive domain. Aside from statute, there is no right to engage in such activity."

LEGISLATION SINCE 1920 HAS RECOGNIZED PUBLIC RESPONSIBILITY IN ELECTRIC POWER FIELD

In 1922, the Federal Power Commission, after an investigation financed by a \$25,000 appropriation for that purpose, recommended under section 7 of the Federal Power Act that the Government develop the power available at Great Falls of the Potomac River. A bill authorizing such development was before Congress until 1926, but the Potomac Electric Co., with support from New York financial interests, prevented its enactment.

The public power threat, however, produced important benefits for electric consumers in Washington by inducing the company to accept the sliding-scale rate-adjustment plan under which company profits over a fixed return on an actual investment rate base were shared with consumers through rate reductions. As a result, residential electric rates came down to approximately TVA levels and the company prospered.

In 1927, on the basis of a joint report by the Chief of Engineers, and the Secretary of the Federal Power Commission, Congress directed the Corps of Engineers to survey the country's rivers and develop basinwide plans for navigation, flood control, irrigation, and hydroelectric power. The report had classified the streams by degree of Federal participation required. In submitting the report the Secretary of War (serving also as FPC Chairman) foresaw two principal purposes of the investigations: (1) preparation of plans for Federal or Federal-private development; and (2) to provide a basis for judging the suitability of private development within a general plan for full utilization of the water resources of a stream.

In 1928, Congress enacted the Boulder Canyon Act initiating the Federal program for the Colorado River Basin for flood control, municipal water supply, irrigation, and hydroelectric power. It is important to remember that the Boulder Canyon project (now Hoover Dam) was undertaken at the insistence of Los Angeles to provide electric power supply for its municipal electric system and those serving Pasadena and other southern California cities and municipal water supply for the metropolitan water district which also included the municipalities of the Los Angeles area. The Boulder Canyon Act included the preference provisions of the Federal Power Act by reference.

The Boulder Canyon Act also directed the Secretary of the Interior to make investigations and public reports of the feasibility of projects for irrigation, generation of electric power, and other purposes in the States of Arizona, Nevada, Colorado, New Mexico, Utah, and Wyoming for the purpose of * * * formulating a comprehensive scheme of control and improvement and utilization of the water of the Colorado River and its tributaries."

In 1933 Congress established the Tennessee Valley Authority as a public corporation with full responsibility for the comprehensive development of that basin. This climaxed the 12-year battle of Senator George Norris, of Nebraska, to prevent the giveaway of Muscle Shoals power to private corporations. In that fight Norris had the support of an increasing block of progressive Members of Congress. As a result, Congress passed a forerunner of the TVA Act in 1928 and again in 1931, only to have the legislation killed by the Presidential vetoes of Coolidge and Hoover.

The TVA Act embodied clear recognition of Federal responsibility in the field of power supply, including a strong preference in favor of public and cooperative electric systems desiring power supply. The Authority was enabled to build transmission lines so that, in marketing the power, it would not be limited to contracts with the nearest private company but would be able to carry out the entire marketing policy with emphasis on the preference provisions. The act specifically assured public bodies and cooperatives time in which to qualify, both financially and otherwise, as preferred purchasers of Federal power, and provided that contracts with private companies for sale of the power should be cancelable on 5 years' notice if necessary to satisfy the needs of these public and cooperative systems.

As will be noted in connection with the Bonneville and Fort Peck Acts, this Federal power marketing policy was deliberately antimonopoly in purpose.

In 1936 the Rural Electrification Act followed, growing out of the experience with rural electrification in the TVA area. Cooperatives there were already serving farms with TVA electricity in spite of the testimony of Mr. Yates, vice president of the Commonwealth and Southern power system, who had stated in 1933 that with only about 4 percent of the farms in the region electrified, the companies were probably serving all that could be economically provided with this modern blessing. This act is an important extension of Federal responsibility in the electric power field, not only in terms of the financial and technical assistance it provided for farmers establishing their own electric systems, but also in terms of the direct and indirect importance of Federal power supply in assuring the low-cost power which made rural electrification a tremendous success.

In 1937 and 1938 the Bonneville Project Act and the Fort Peck Act were enacted by Congress, with additional definition of the evolving policy of Federal responsibility in the field of electric power supply. These acts make clear an important purpose behind the consistent adoption of the preference provision by Congress, providing in section 4 (e) that: "In order to insure that the facilities for the generation of energy at the * * * project shall be operated for the benefit of the general public, and particularly of domestic and rural consumers, the Administrator shall at all times, in disposing of electric energy generated at said project, give preference and priority to public bodies and cooperatives."

This language of Congress provides a complete answer to the Power Trust propaganda that the preference provision represents discrimination against the customers of the private power companies. Congress established the preference provision "for the benefit of the general public, and particularly domestic and rural consumers." In other words, on the basis of the country's long experience with the effectiveness of public competition as a check on monopoly price fixing by private utilities, Congress knew that the strengthening of public and cooperative electric systems would have far more effect in reducing the rates charged by private companies than would the sale of power from Federal projects to all systems in an area without preference.

The Bonneville Project Act further declares it to be the policy of Congress "to preserve the said preferential status of the public bodies and cooperatives * * * and to give the people of the States within economic transmission distance * * * reasonable opportunity and time to hold any election or elections or to take any action necessary to create such public bodies and cooperatives * * * or to take any action necessary to authorize the issuance of bonds or to arrange other financing necessary to construct or acquire necessary and desirable electric distribution facilities, and in all other respects legally to become qualified purchasers and distributors of electric energy available under this act."

Such language makes it clear that Congress was establishing a power policy which went beyond the mere temporary disposition of a quantity of electric energy which happened to be available from certain river basin projects. It was clearly taking responsibility for a program which would encourage and maintain public competition as a check on the threat of private power monopoly against which President Theodore Roosevelt, Governor Gifford Pinchot, and Senator George W. Norris so vigorously warned.

This antimonopoly purpose is clearly stated in the Bonneville Project Act provision for transmission. Section 2 (b) of the act reads, in part:

"In order to encourage the widest possible use of all electric energy that can be generated and marketed and to provide a reasonable outlet therefor, and to prevent the monopolization thereof by limited groups, the Administrator is authorized and directed to provide, construct, operate, maintain, and improve such electric transmission lines and substations * * * as he finds necessary. * * * [Italic added.]

The Flood Control Act of 1938, the Reclamation Projects Act of 1939, and the Flood Control Act of 1944, all contributed to the rounding out of this Federal recognition of public responsibility in the field of power supply to cover the entire field of Federal river-basin programs.

The 1938 Flood Control Act brought the Federal Power Commission back into the field of planning Corps of Engineers flood-control programs to assure maximum development of power resources as a part of such programs. And the 1944 Flood Control Act placed the marketing of all power from Corps of Engineers projects under the Secretary of the Interior and directed him to market such power in accordance with the same policy as that referred to above as governing the marketing of power by the TVA and the Bonneville Power Administration. United States Attorney General Brownell, in his long-concealed opinion (uncovered by the Subcommittee on Public Works and Resources of the House Government Operations Committee) on the legality of the Georgia Power Co. plan for marketing power from the Corps of Engineers Clark Hill project, so interprets section 5 of the 1944 act.

The 1939 Reclamation Project Act has the same effect on the marketing of power from Bureau of Reclamation projects. So, in the quarter of a century beginning in 1920, Congress rounded out a power policy based on recognition of public power as an essential factor in America's electric service business and of Federal responsibility for the wholesale power supply required by the nonprofit community electric systems.

It is significant that the TWA Act defines "public bodies and cooperatives," to which the preference is given, as including "States, municipalities, and cooperative organizations of citizens or farmers, not organized or doing business for profit, but primarily for the purpose of supplying electricity to its citizens and members."

Public businesses, like water supply, highways, railroads, gas systems, electric systems, postal systems, telegraph systems, and telephone systems, provide services of such a nature that their use in abundance is a public necessity in terms both of a healthy economy and high living standards. Therefore, the yardstick for rates in these public businesses should be nonprofit operation by systems organized primarily for the purpose of supplying electricity to their citizens or members.

Privately owned corporations can only justify their continued operation of these businesses if they can render equally good service at rates comparable with those which public or cooperative systems can offer.

CONSTITUTIONAL BASIS OF FEDERAL WATER AND POWER PROGRAMS

The river-basin and power programs, which have been undertaken under a series of laws since the Reclamation Act of 1902, have meant that the Federal Government was increasingly taking the responsibility for multipurpose development of our rivers for watershed management, conservation storage, navigation, irrigation, hydroelectric power, pollution control, fish and wildlife conservation, and recreation.

This has not resulted from an alien government putting over a dictatorial program on a subservient people. Rather, as conservationists called for the exercise by the Federal Government of broad responsibilities in this field, the people have called upon Congress to use its constitutional powers to see that the programs were initiated and carried out.

The necessary Federal authority for these programs is found in the powers expressly delegated to the Federal Government in the commerce clause, the property clause, the general-welfare clause, and the war-power provisions of the Constitution, as well as in the powers reasonably implied by those specifically granted. And we must not forget that the founders of this Nation also assured Congress authority "to make all laws necessary and proper for carrying into execution all the powers vested in the Federal Government." (See p. 70, Summary on Powers, Water Resources Law, vol. 3 of the Report of the President's Water Resources Policy Commission, 1950.)

These constitutional powers are broad enough to enable the Federal Government to undertake comprehensive river-basin programs, including development of hydroelectric power. They are broad enough to enable the Federal Government, as a part of those programs, to build, or contract for the use of, transmission lines for interconnection of projects and marketing of power; broad enough to enable the Government to build, or contract for, conventional steam or atomic power to firm up its hydro, to provide for defense activities or for other purposes; and broad enough to enable the Government to adopt or give effect to an antimonopoly policy in the marketing of the power.

The commerce power gives Congress jurisdiction over all navigable waters of the United States and over the upper nonnavigable reaches of a navigable waterway as well as over nonnavigable tributaries, if the navigable capacity of the navigable waterway is affected or interstate commerce otherwise affected. It may be employed to authorize construction of navigation and flood-control dams, at the same time providing for Federal generation and sale of power.

The proprietary power gives Congress authority over the use of Federal public lands and the resources associated with them. It provides the foundation for the reclamation acts. It is also important in connection with electric power because the power of falling water at a Federal dam comes into exclusive Federal control, with the right to convert it into electrical energy constituting Federal property which may be sold or leased.

The war power, coupled with the commerce power, provided the basis for construction of Wilson Dam at Muscle Shoals. Although the congressional committee investigating TVA interpreted it as providing very broad powers for regional development, the courts have not been called upon to interpret the full breadth of the authority thereby conferred on Congress.

The general welfare power is a delegation of authority separate from and not restricted by other delegations of power enumerated in the same section of the Constitution. Recently, the Supreme Court said that the only limit to this authority is that the power must be exercised for the common benefit as distinguished from some merely local purpose.

As far back as 1912, the National Waterways Commission reported the need for comprehensive river-basin programs for flood prevention, navigation, and power development. It had previously reviewed numerous Supreme Court decisions and concluded that the constitutional authority of the Federal Government in this field was very broad. After this review it had no hesitation in saying:

"In the nature of the case so comprehensive a policy could be successfully administered only by the Federal Government, and consequently, the eventual desirability of Federal control is easy to predict."

In terms of Federal power activities as a part of these comprehensive river-basin plans, the 1950 report of the President's Water Resources Policy Commis-

sion pointed out that "the Supreme Court has sustained Federal development of power as desirable for utilizing water resources in development for other purposes as navigation and flood control." It cited *United States v. Chandler-Dunbar Co.* (229 U. S. 53, 73 (1913)), and *Ashwander v. Tennessee Valley Authority* (297 U. S. 289, 334-5 (1936)) (*Ibid.* 290).

In the *Ashwander* case, the Supreme Court held concerning the water power created by the construction of a Federal dam that "the right to convert it into electric energy, and electric energy thus produced, constitutes property belonging to the United States." The court then held that "authority to dispose of property constitutionally acquired by the United States is expressly granted to Congress by section 3 of article IV of the Constitution."

The court observed that the property clause is silent as to the method of disposition and then specified that the method employed must "be an appropriate means of disposition according to the nature of the property; it must be one adopted in the public interest as distinguished from private or personal ends, and we may assume that it must be consistent with the foundation principles of our dual system of Government and must not be contrived to govern the concerns reserved to the States."

On this basis the Supreme Court held that the method of disposing of the power established by the TVA Act, including acquisition of transmission lines and fixing the terms of sale, was valid.

Subsequently, when Congress authorized construction of a steam electric plant to assist in the operation of TVA hydroelectric plants, the House committee said the item was justified "if the Government is to make full utilization of the natural resources and of its investment in the area."

Altogether, the status of public service business in the structure of American law and the constitutional powers delegated to the Federal Government by the Nation's Founding Fathers provided a 100-percent American basis for the water resources and power program of which the TVA and Bonneville Power Administration programs are examples. The propaganda characterizing this program as "creeping socialism" has no basis in American law or tradition.

Chairman PATMAN. Thank you, Mr. Baker.

Dr. Talle?

Representative TALLE. I believe the chairman has explained that some of us must leave rather soon. Before departing, I should like to thank Dr. Watkins for his statement about economic statistics. I can report to you that in November of last year, at Bangkok, I presented the need for improving economic statistics at a conference involving 47 nations and, likewise, the preceding year, 1955, and that we are now progressing to a point where I believe on this year's agenda of the Interparliamentary Union, the improvement of economic statistics will be considered. I think that would be all to the good. Most nations are in dire need of such improvement.

Foreign nations are paying attention to what we are doing. This matter has also been discussed in Parliament in London.

We thank you, Mr. Watkins.

I want to express appreciation to everyone who has shown interest in this endeavor in Government and outside of Government, in the professional field and otherwise.

Mr. WATKINS. Thank you very much, Dr. Talle.

Representative TALLE. Mr. Chairman, I should like to ask unanimous consent that a speech delivered by Mr. Raymond T. Bowman, Assistant Director for Statistical Standards, Bureau of the Budget, at the annual dinner meeting of the Washington Statistical Society, on January 28, 1957, be incorporated in the record.

Chairman PATMAN. Without objection it is so ordered.

(The speech referred to follows:)

(Speech by Raymond T. Bowman, Assistant Director for Statistical Standards, Bureau of the Budget, at the annual dinner meeting of the Washington Statistical Society, January 28, 1957:)

IMPROVEMENT OF FEDERAL STATISTICS

I am highly honored that your president, Mr. Homer Jones, invited me to address the Washington chapter of the ASA at its annual dinner meeting. The invitation provides me with an excellent opportunity to "talk shop" with my colleagues in statistics and my remarks this evening are directed to the efforts being made, and the rationale of methods being used, to improve Federal statistics.

In 1848, in his *Principles of Political Economy*, John Stuart Mill, with all the abandon of true genius, wrote:

"Happily, there is nothing in the laws of value which remains for the present or any future writer to clear up; the theory of the subject is complete: the only difficulty to be overcome is that of so stating it as to solve by anticipation the chief perplexities which occur in applying it: and to do this, some minuteness of exposition, and considerable demands on the patience of the reader, are unavoidable."

Unhappily, I find myself unwilling to say about the Federal statistical program in 1957 what Mill said about the theory of value in 1848. I prefer to think that this is not because I do not have a sufficiency of genius. I hope instead that it merely reflects a general understanding that the statistical program of the United States, although it is recognized as outstanding, nevertheless is not good enough for the demands which are being made on it. In fact the process of improvement must be a continuing one, the ideal always a little in advance of achievement.

I am going to assume this evening that it is not necessary to argue before this audience the growing need for organized economic and social data—that is, for statistics. I think we would all agree that appropriate, accurate and prompt intelligence of a quantitative character concerning the way the economy and its social institutions function is necessary in a free society. We must have quantitative intelligence of this kind—what Wesley Mitchell called "analytical description"—to maintain a high level of economic wellbeing without excessive oscillations or unnecessary inequalities, and to reach wise solutions for the social problems of health, of education, and of family living.

We would all agree, too, that our economic and social statistics should be more expertly designed if they are to be adequate in meeting present-day uses—for indications of present positions and past trends, for anticipation of imminent developments, for research in the social sciences, and as a basic tool in determining Government or private business policy.

Starting from these two premises—that statistics are necessary and that improvements are needed—I should like to comment on four factors which I believe must receive major attention in efforts to strengthen the Federal statistical program:

- (1) The need for competent and well-trained personnel;
- (2) The improvement of quality in the whole range of statistical processes;
- (3) The importance of proper presentation or publication of statistical data; and
- (4) The need for greater integration of our statistical program.

I want to comment this evening very briefly on the first three of these factors, and in somewhat more detail on the fourth.

The importance of adequately trained personnel—the first factor I mentioned—cannot be overestimated. Skill and training of an advanced type are necessary for the statistical job that needs to be done, and the statistical agencies must be able to employ and hold competent statisticians. Not enough attention is being given to this problem at the present time, particularly in view of the increasing demand for skilled statisticians in private employment. I hope that the Bureau of the Budget, in cooperation with the agencies, can soon give the problem the special study it needs.

The second factor, concerning quality of the data appropriate for their major uses, requires attention to many elements, such as the training of enumerators, the design of the inquiry, obtaining the cooperation of respondents, the selection of samples, and the speed with which the information becomes available. These problems require and have been receiving considerable attention in the development of the Federal statistical program. Their importance is recognized also at the international level, as I was pleased to note at the meeting of the United Nations Statistical Commission last year.

The United States has been fortunate in the general integrity of the respondents to Government inquiries. Accuracy of information requires much more, however, than the cooperation of respondents. The complexity of the informa-

tion sought, the differing practices of business concerns, the difficulty of communicating questions and answers all require close attention if the information obtained is to be meaningful. Thus new inquiries must be preceded by pilot studies, and older inquiries must inaugurate quality control procedures.

Illustrative of work along these lines is the recent development of a response analysis program by the Bureau of Labor Statistics for its employment statistics series. By meticulous inquiry of a sample of respondents, information is obtained on how well respondents are following instructions and definitions, how well the definitions fit the record-keeping practices of a majority of establishments, and where improvement in practice or changes in definitions and instructions are needed to reduce response errors and make the series more useful for economic analysis. As another example, the Bureau of the Census has been strengthening its program of quality control over the work of the enumerators for the current population survey, scheduling a regular series of reinterviews by supervisors of a sample of each enumerator's work as well as periodic observation of actual enumerations. The Census Bureau is also engaged in experimental work looking toward methods of identifying, controlling and reducing response errors. Programs such as these are particularly important in efforts to improve the quality of statistical data. Response errors must be carefully distinguished from sampling errors, and in many surveys it is more important to reduce response errors than to reduce sampling errors in order to achieve greater accuracy in the results.

I want to mention one other element important to the quality and usefulness of statistical data—the need for greater speed and increased tabulation detail. Fortunately the new electronics computers are making possible great advances in this area, and the statistical agencies are well advanced in adopting these new processes. These new devices not only permit the tabulation of more data faster, but also provide the means whereby many routine clerical operations—coding, editing, typing, charting—can be transferred to machines. For example, one recent development in the mechanical field, the machine known as FOSDIC (film-optical-sensing-device-for-input-to-computers) is obviating the need for manual card punching, thus not only reducing direct costs but also shortening time spent and minimizing opportunities for errors.

The third factor, the proper publication of statistical data, is one of the basic objectives of a good statistical system. It matters little how carefully statistics are prepared unless they are presented in a manner to avoid their misinterpretation and misuse. It goes without saying that all misuses cannot be prevented. But skillful and well-considered presentation can go far toward indicating proper uses of the data, their degree of reliability, their relations to other series, and other factors needed by careful and intelligent users for proper interpretation.

A list of standards for the publication of statistical data, issued almost 10 years ago by the Bureau of the Budget, describes a number of procedures to be followed in order to reduce the areas of misinterpretation of statistical data. Agency practices in this area are generally good—but there is still room for improvement and need for constant vigilance.

The fourth factor I mentioned is the need for greater integration of the elements of information about our economy. In a decentralized statistical system like that of the United States the separate statistical series which together compose the whole originate in many different agencies, frequently as a byproduct of administrative operations. It is generally recognized that in such a decentralized system there has to be an agency whose job it is to see that insofar as possible these separate and independent pieces can be fitted together into a consistent whole. That of course is the job of the Office of Statistical Standards in the Bureau of the Budget, which I have had the honor to head for almost 2 years.

In the remarks which follow I attempt to describe very briefly the rationale being followed by the Office of Statistical Standards in its efforts toward greater integration of the Government's statistical activities.

First, we recognize that an excellent criterion for determining the needs for economic data is found in the development of national accounts. As Edward F. Denison stated in his comments at the annual meeting of the American Statistical Association last September, the national income accounts "provide consistent and integrated estimates for appraising the performance of the economy and studying its operation." Mr. Denison recognized of course that the national accounts do not provide an integrating criterion for all Federal statistics, or even for all Federal economic statistics. They do have implications for almost all, however, including price series and indexes for deflation purposes, employment data for assessing group national product productivity changes, inventory data for measuring capital formation, and a host of others too numerous to mention here.

Use of the national accounting technique as a criterion for organizing basic data must, in our opinion, take into consideration the requirements for the several variant systems of accounts—the national income accounts, national balance sheet accounts, flow of funds accounts, and input-output accounts. At least for the time being, however, our major emphasis has been on the data requirements for the national income accounts. Because of the need for more attention to this criterion, the Bureau of the Budget has recently contracted with the National Bureau of Economic Research for an independent appraisal of the national income and product accounts, directed primarily at determining specific needs for improvement in the underlying statistical series and at investigating means of bringing about future integration of these accounts with the other comprehensive national accounting systems. This appraisal is now underway, and a report is expected in the spring of 1957.

From the same point of view we have taken steps to arrange for speeding up preliminary tabulation, on a sample basis, of certain business indicator information from the income-tax returns, to give a firmer current basis to the national income accounts. Similarly it has encouraged the further development of the SEC-FTC quarterly financial report for manufacturing corporations, and hopes the extension of this report to include trade and mining corporations will be made possible by appropriation requests included in the 1958 budget.

Last year the Office of Statistical Standards completed arrangements for the Board of Governors of the Federal Reserve System to become the focal agency in the field of saving statistics, to take the leadership in developing a well-integrated body of saving statistics and providing appropriate publication and interpretation of data on personal savings. This arrangement also recognizes the needs of national accounts as a general criterion of integration, but with some further recognition of the need for more internal consistency for the various purposes served by statistics of personal and aggregate savings. The focal agency principle does not require that all the data needs be met by collection programs of the focal agency. It does place in one agency responsibility for leadership in formulating a program to meet analytic needs. Designation of a focal agency in the field of saving statistics follows a recommendation made in its 1955 report by the Task Force on Saving Statistics, appointed by Federal Reserve at the request of the Joint Economic Committee.

Thus far I have commented primarily on current series particularly designed for economic analysis. The national income accounts, however, also make considerable use of statistics which are byproducts of administrative programs. One of the most difficult of the tasks of integration is to develop the procedures and techniques for making full use of such relatively inexpensive and complete sources of data, to meet the needs of economic analysis within the framework of the administrative program. The usefulness of the income-tax data in this respect has already been mentioned. The basic records of the Bureau of Old-Age and Survivors Insurance also provide an important source of data, not only for use in estimates of the national income accounts but also in a number of other major statistical programs.

Other criteria than the need of national accounts are, of course, necessary to guide integration, as I shall try to indicate by a few examples.

The United States probably has the best body of labor statistics anywhere in the world. This is true not only because of energetic work in this field by the early development of a Bureau of Labor Statistics, but also because of the emphasis on the importance of the labor factor in the economy. Employment gives the most direct measure of economic activity in real rather than in monetary terms. In this field efforts at integrating statistical programs must recognize the advantages of having more than one approach to the problem of measuring the economic activity of human beings.

A detailed body of information on employment, wages, and hours in nonagricultural industries has been developed by the Bureau of Labor Statistics, with the cooperation of the Bureau of Employment Security, State agencies, and employers. The information is obtained from establishment on a sample basis, and integrated with the comprehensive statistics available as a byproduct from the operations of unemployment compensation agencies. Here we have an integrated body of data providing consistent estimates for States and areas as well as the Nation, and providing needed detail by industry.

But the BLS measures of employment are measures of number of jobs held in nonagricultural industries, not of the number of persons employed. The need for information on the economic activity of the population is met by the Census Bureau's current population survey, a monthly survey of households in which persons of working age are identified as either employed or looking

for work, or as not in the labor force. The BLS measure of number of jobs held, with State and industry detail, is an important measure but it is not and should not be made equivalent to the number of persons employed in any current period. These two series—the BLS count of number of jobs and the Census' series on numbers employed—serve different purposes, and they should not be expected to show exactly the same movements. We should, however, be able to calibrate and explain the general magnitude of the differences between them at different times of the year. Similarly, the unemployment series of the Bureau of Employment Security, based on eligibility for and receipts of unemployment compensation, will never be identical with the Census Bureau's estimates of the number of persons seeking work but not currently working. Here again there is clear need for both approaches, and for knowledge of the general relationship of the two series.

In my remarks this evening I have been talking of integration as the achievement of consistency, the avoidance of contradiction, in the Government's overall statistical program. In this sense of the word I think it is obvious that there can be no major advantage to integration of these various employment and unemployment series, since part of their value stems from the discrepancies revealed by different approaches. Here the concern of the Office of Statistical Standards is with improvement of the basic data in the individual series and with adequate explanation of the differences among them, so that they may be used together to greatest advantage for purposes of economic analysis. A policy committee consisting of myself as chairman, Mr. Burgess, Mr. Clague, and Mr. Wells provides a basis for coordinating the current population survey with general needs for data on the economic participation of the population and gives general focus to the work of the Census Bureau in this important area. In addition, representatives of our office, the Census Bureau, the Bureau of Labor Statistics, and the Bureau of Employment Security each month prepare a press release, issued jointly by the Secretaries of Commerce and Labor, presenting the latest figures on employment and unemployment from all three sources. Certainly in this area we are practicing an art of coordination, not a science.

I will not try to discuss all the fields in which efforts are being made to achieve major improvements and greater integration, but I should like to mention briefly several other areas which are particularly significant at the present time.

In the field of construction statistics some improvements have been made since the war, but there is general agreement that great improvements are still needed. Repeated efforts have been made in the President's budgets for recent years to get the funds needed to expand and improve present estimates of construction activity. Congress has not approved these requests, however, and in view of the common demand for improvements, I have arranged this year for further review of the field and expect to come up with recommendations for a new program.

Also in the field of current economic indicators, need has been expressed for better data on inventories, particularly manufacturers' inventories. In this case we are attempting to reorient the general series on manufacturers' sales, inventories, and new orders along the lines suggested by the Task Force on Inventory Statistics appointed by the Federal Reserve Board at the request of the Joint Economic Committee, and to do this without sacrificing the current simplicity and promptness of the series. This requires some shift in agency responsibility, but we are hopeful that when finally consummated these efforts will bring forth a much better integrated body of information than would be possible by divided efforts.

In the past few years the Department of Agriculture has instituted a program for the improvement of crop and livestock estimates by means of modern sampling methods. The program is still in the early stages, but the results to date are promising. In a way this activity typifies a new era in statistics. It employs modern techniques to produce better results, but beyond that it is creating a statistical framework within which a whole set of integrated agricultural statistics can be developed.

In the field of social statistics there is need for much greater integration. In this area we do not at present have workable criteria to guide the selection of first tasks, and we urgently need to formulate a set of objectives. The new national health survey will provide a base for attacking many problems in this area, and perhaps suggest new needs for related information. In the next few years the Office of Statistical Standards expects to give more attention to this broad field than it has since the outbreak of World War II.

Finally, no discussion of statistical integration can fail to mention the standard classifications developed to provide a comparable basis for the statistical data

collected and compiled by many different agencies. In this area the most important activity at the moment is completion of the revision of the standard industrial classification, undertaken by the Bureau of the Budget with full cooperation of Federal agencies and with the advice and assistance of industry groups, labor organizations, and private research organizations. The revision takes into account technological changes, changes in industry organization and procedures, and the growth of new industries. It will be used by all agencies in presenting data beginning with 1958, and should result in improved usefulness of our industrial statistics.

I have tried this evening to stress the importance of an integrated statistical program, while at the same time noting that the term "integration" cannot have a single operational connotation. It must take on somewhat varying meanings for different purposes. In essence, however, it refers to a statistical program which, as a whole, provides information which is so interrelated as to serve major analytical purposes. In response to the pressures of immediate need, and in the absence of infinite wisdom and resources, new elements will often have to be added, and old elements continued, without sufficient regard to their integration with other parts of the overall statistical program. But recognition that the goal of perfection cannot be attained completely should not curb our efforts at improvement—for we've a long way to go.

Representative TALLE. I want to say to all of you that I regret very much the need for leaving so soon, and that I am grateful for your statements.

Representative KILBURN. I certainly appreciate the witnesses who have come before us, and I am sorry we have this conflict with another important matter.

Chairman PATMAN. Mr. Walter D. Fackler, economist for the Chamber of Commerce of the United States.

STATEMENT OF WALTER D. FACKLER, ECONOMIST FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. FACKLER. My name is Walter D. Fackler, assistant director of economic research for the Chamber of Commerce of the United States. I appear here today at the invitation of the committee to discuss the 1957 economic report and some of the broader issues that it raises.

We have a prepared statement which, I understand, with the permission of the chairman, will be entered into the record. In the time allotted, I will summarize some of the major points which we make in our statement.

In general, the economic report represents competent analysis of the economic trends of the past 4 years and the developments during 1956. Quite properly, we feel, the report does not attempt definite predictions of total output, employment, and, what is more important, the composition of output.

Also, quite properly, we feel, the report does not set specific targets to be achieved by the economy or particular sectors of the economy.

We believe that the administration has been wise in this regard. First, as we know, predictions are, at best, slippery and, at worst, impossible. Secondly, targets are dangerous because they can be easily misunderstood, they create unfortunate political pressures, and they encourage attempts to force the economy into some sort of arbitrary matrix.

In general, we are in sympathy with the tenor of the report, with its emphasis on the public and private responsibilities which attend full employment. However, we do not endorse all the recommenda-

tions of the report, nor do we believe that the report is free from some serious deficiencies.

First, one of the major defects of the report is that it is overloaded with details and proposals for governmental action and governmental activities which are not in any way directly related to the questions of economic stability, and sound economic growth. We think that this practice is misleading and confusing. It diverts attention away from the major issues of balancing the economy to minor problems. We do not think that the economic report is the place to discuss whether or not we should want more automobiles or fewer automobiles, whether we should build more homes or fewer homes, whether there should be Federal aid to education or whether there should be more foreign aid or less foreign aid.

These matters are not directly related to the question of economic stability, although, of course, all Government activities may have an important influence on the economy.

We think that there should be, at least, a clear separation of proposals that are made for social and political reasons, to achieve particular social goals from proposed legislative action that is directed at achieving the goals of the Employment Act: maximum production, employment, and purchasing power.

As far as the economic situation is concerned, it is somewhat strange that this report devotes only two pages to a direct assessment of the current economic outlook. To be sure, there are interlarded throughout the report many observations and facts which bear directly on the current economic situation. But only two pages are addressed directly to this subject. There is no real attempt to analyze the factors which influence the level of investment and saving, and there is no discussion of the possible impact of the Federal budget on the economy.

We feel that a more comprehensive appraisal of the current outlook, with emphasis on the main sources of instability in the system, should be a central feature of the President's Economic Report to the Congress.

As to the question of inflation, the presentation of the inflationary problem we feel is somewhat disappointing in view of the importance of the problem in public debate at this time.

We agree that business, labor, and the public in general have important responsibilities to support general and impartial anti-inflationary controls. But certainly the first line of defense against inflation must be responsible monetary and fiscal management.

Individually, neither businessmen nor labor leaders can effectively fight inflation. The administration should make the issues clear. We cannot control inflation by pointing a finger at the other fellow and saying, "Restrain him."

To help make general monetary and fiscal controls more effective in curbing inflation, we endorse, in particular, four recommendations made in the report: (1) The establishment of a nonpartisan monetary-financial commission to make an exhaustive study of how effectively our money markets work. We feel that there should be much more light thrown on the way the market actually does ration savings and credit among alternative uses.

(2) We support continued vigorous enforcement of antitrust laws to maintain effective competitive discipline in the market place—discipline which will help curb excessive wage or price demands. In this

regard, we feel that the regulation of labor monopoly is certainly just as important as regulation of business in this matter of effective inflation control.

(3) We support the recommendation to eliminate differentials in interest rates between VA and FHA financing of home loans. We would go even further and suggest that the interest rates under these programs should be flexible and vary with market conditions.

(4) We agree heartily with the exhortation in the report that State and local restrictions be removed, which put unnecessary impediments into the flow of funds for private building and public construction of schools and other improvements.

As to the Federal budget: here we find none of the restraint that is urged on others so often throughout the report and in the state of the Union message. We feel that the budget may well be inflationary, even though it is in somewhat tenuous projected balance. Increased Government expenditures, as we know, will add directly to aggregate demand, whereas we are not certain that, even though additional spending is matched by taxes, these taxes will curtail private spending by the same amount.

What happens, of course, whether or not the budget is inflationary, depends largely on private demand.

But every year Government spending rises and the scope of Federal activities is extended in all directions. This means that very much needed tax revision and tax reduction must be expediently postponed year after year.

From the standpoint of balanced economic growth, we suggest that Federal tax reform is far more important than unnecessary preoccupation with State and local issues. The longer the Federal tax revision and tax reform is put off, the more difficult the problems become, because tax-induced distortions work their way more permanently into the fabric of our economic life. What we really need is a very critical reexamination of the role of the Federal Government and serious study as to what the Federal tax structure is doing to our economic growth, to the structure of our industry, the methods of business finance, job opportunity, income distribution, the allocation of resources, and many other like matters.

Here is the really important national issue and a Federal issue, and it bears directly on the question of balanced economic growth and economic stability.

One final remark, in conclusion: The report is cautiously optimistic about 1957. We feel that this is a sound position, that is basically the economy is fairly healthy. The dangers, such as they are, we feel, are still on the inflationary side, not on the deflationary side.

Our economy has shown amazing resiliency since World War II. With enlightened public attitudes and responsible management of our monetary fiscal affairs, we may yet achieve full employment, relative price stability, and reasonable economic growth at the same time. But it is not yet certain that we have learned how to do this.

Thank you very much.

Mr. ENSLEY. Thank you very much.

(Statement referred to follows:)

STATEMENT OF WALTER D. FACKLER, ECONOMIST, OF THE CHAMBER OF COMMERCE
OF THE UNITED STATES

This statement is made on behalf of the Chamber of Commerce of the United States, a federation of over 3,200 State and local chambers of commerce and trade associations with an underlying membership of 2.3 million businesses.

We appreciate the opportunity to review the 1957 Economic Report of the President and to be of possible help to the joint committee as it seeks to discharge its important responsibilities under the Employment Act of 1946.

GENERAL

The report generally presents sound, competent analysis of major economic trends of the past 4 years and the developments of the past year.

Quite properly, we believe, the report avoids predictions for various sectors of the economy and the economy as a whole. We are pleased to note also that specific targets for employment, output, and especially for the composition of output have not been projected. In the nature of the case, neither the Council of Economic Advisers, nor the joint committee, nor any other individual or group can foresee changes in consumer tastes, in supply conditions, in world conditions, and other dynamic developments a year or 18 months ahead. Special targets could be set only within wide limits of tolerance which would be misleading, would accentuate conflicts among different groups in the economy, and would make stabilization policy more difficult. The differences between projected and actual labor force data alone militate against such practice.

Furthermore, setting specific targets is dangerous practice because it would encourage attempts to squeeze the economy into some arbitrary and preconceived matrix, attempts which would be incompatible with free markets for labor and goods. That the administration has wisely declined to establish such a matrix speaks well for the professional competence of its advisers and for its responsibility in accepting the goals of the Employment Act in the terms laid down therein—i. e., "to use all practicable means consistent with its needs and obligations and other essential considerations of national policy * * * in a manner calculated to foster and promote free competitive enterprise and the general welfare * * *," etc.

We are also in sympathy with the general theme of the report which seems to be an emphasis on the responsibilities, public and private, which attend "full employment." To have maximum production and employment, we must deserve them. The important goals of the Employment Act cannot be achieved unless we have the political maturity to seek means of attaining them in a manner consistent with other equally important social objectives. By the same token, we do not deserve our cherished political and economic freedoms unless we have sufficient social discipline to submit conflicting claims of individuals and particular groups to the impersonal arbitration of free markets, unless there are overriding and overwhelming considerations to the contrary.

In commending the 1957 Economic Report for competence in analysis and soundness in approach, we do not endorse all the recommendations of the administration, nor do we believe that the report is free from serious deficiencies. Many of the specific recommendations as to legislation require no comment at this time since they will be considered later by the Congress in other contexts. Absence of specific comment here does not constitute endorsement.

OVERLOAD

One of the major defects of this report, which it shares with previous reports, is its overload of detailed recommendations and specific legislative proposals which have little or no relevance to the main issues of economic stabilization and orderly economic growth. To be sure, all activities and programs of government have economic effects. But to tie so many legislative proposals which have, at most, only minor indirect relationships to the general economic health of the Nation is misleading and confusing. This practice makes the task of the joint committee much more difficult and diverts attention from the more fundamental problems.

There is plenty of room for differences of opinion in and out of the Congress as to the goods and services which should be produced by the Federal Government for collective consumption and as to transfers of income which should be

made, directly or indirectly, to underprivileged groups for what are deemed desirable social reasons. But these matters should be decided on their merits individually and in connection with other governmental priorities and commitments, and not linked with the questions of economic stabilization and balanced economic growth.

The Economic Report should not deal with such questions as whether we should build more or fewer houses next year, whether we should or should not want more automobiles, whether the Federal Government should assume the State and local responsibilities of providing schools, or whether more or less foreign aid is necessary.

When proposals for governmental programs are injected into the Economic Report because they have a significant and direct relationship to economic balance and stability, the nature of the relationship should be made explicit and clear.

Moreover, in making recommendations and legislative proposals, the administration should clearly separate those governmental activities proposed for social and political reasons, which may have a significant incidental economic impact, from specific legislative proposals relating directly to the goals of the Employment Act. The latter proposals should be persuasively justified on grounds of economic necessity.

THE CURRENT ECONOMIC SITUATION

It is somewhat surprising that this report devotes only slightly more than 2 pages (44-46) to a direct and reasoned assessment of the current economic situation and short run outlook. Of course, interlarded through the report there are facts and observations which cast light on the present situation, but we suggest that the report would be improved if a more comprehensive assessment of the general outlook were made a central feature.

Such an appraisal of the current outlook should be presented with primary emphasis on the sources of instability in the system. Particular attention should be given to levels of investment and the possible impact of the administration's proposed budget. It is significant that neither of these important factors receives more than cursory attention.

In spite of the well-meant phrases that "Government must pursue policies that give positive encouragement to the spirit of enterprise and protect the essential incentives to work, to save, and to invest," no analysis is made of the factors which affect the volume and, equally important, the direction of private investment. Nor does the report reflect much concern as to how governmental spending and taxing policies influence the performance of the private sector of the economy.

As the present boom has progressed, it has become abundantly clear that voluntary savings must increase to maintain continued expansion. Extension of commercial bank credit cannot be used as a substitute for new savings without inflation. We feel that the present consumption-saving-investment relationships deserve careful scrutiny. Special attention should be given to the impact of the Federal tax structure on saving and investment and to the institutional rigidities of prices and cost which contribute to instability.

More will be said about the Federal budget, but it is pertinent to remark here that some assessment of the possible economic impact of the proposed budget should be made in the Economic Report, even though a separate budget message is sent by the administration to the Congress.

INFLATION

In view of the stress placed on the problem of inflation in the President's state of the Union message, the importance of this problem in current public debate and the repeated suggestions for voluntary restraints in wage and price determination, we had hoped that a more extended analysis of the inflationary problem would be presented in the report.

Demand has pressed heavily against the limits of physical capacity during the past year. Construction has been carried on at record levels, even though residential building was somewhat lower than during the previous year. Public construction has reached new highs. The investment boom has continued apace, also at a record level. Consumers have had little difficulty in obtaining credit and total consumer debt has increased. In spite of sizable increases in the volume of commercial bank loans, the supply of new savings, which constitute the prime source of new capital for expansion, has not been entirely adequate. As a result there have been continued upward pressures on prices.

The credit stringencies and shortages of new capital in relation to heavy demands have evoked considerable recent outcry that tight money has hurt one group and another. Although the Federal Reserve System has wisely and courageously refused to feed inflation by substituting new credit creation for voluntary savings, there has been a hard core of criticism of tight money which has centered on how effectively the money and capital market allocates available credit and savings among different segments of the market. It is alleged that general monetary and fiscal controls bear too heavily on certain groups—small-business men, builders, and local or State governments.

There is little or no evidence presented to clarify the situation. Because of the tremendous demands for funds for competing uses, all demands, or desires, simply cannot be filled without inflation. We all want to control inflation, but we want the "other fellow" to be restrained. More and more pressures are being brought to bear on Government to replace free market controls with direct controls, subsidies, guaranties, and special credit considerations for preferred groups.

The administration should make the issues clear. Every attempt to circumvent the market to provide extra credit and resources for particular groups denies credit and resources to those who must rely on the market. The system of direct controls and special credit spigots for preferred groups would be not only counter to our basic democratic philosophy, but would likely impose even worse inequities than those which arise from our imperfect market mechanism.

In free markets, the businessman acts as a businessman—he attempts to lower his costs and adjust his prices to competitive market conditions. Unless he does, the market will not allocate resources efficiently. Competitively, no individual businessman can exercise the type of restraints which will control inflation.

On the other hand, no individual labor leader or union can be expected to exercise effective, voluntary, anti-inflationary restraints. Not only has union strength been developed under legal protection, but the individual labor leader must always strive to obtain for his particular constituents as much as the market will bear (or as much as others are getting for their constituents). If he does not, he will soon find himself expendable.

This is not to say that business and labor do not have important responsibilities in this matter of inflation control. All members of the community should vigorously support general monetary and fiscal measures needed to control inflation (and by the same token, avoid deflation). Responsible public officials are faced with an impossible task without this public support. We would deplore attempts by any business or labor groups to undermine the effectiveness of general and impartial anti-inflationary policy. With sufficient enlightenment, good will, and monetary-fiscal responsibility, we may yet prove that high employment and relatively stable prices are not incompatible objectives.

Even though we are disappointed with the presentation or lack of presentation of the inflationary problem in the report, we support certain of its recommendations which will help combat the problem.

1. We endorse the recommendation for a nonpartisan national monetary and financial commission to make an exhaustive study of how the credit-money-capital markets operate. Too much of our current discussion of how the market ration credit is carried on in a vacuum. To use an old cliché, more light and less heat is badly needed.

2. We support vigorous enforcement of antitrust laws as essential to maintaining a competitive economy. One of the important functions of competitive markets is to curb excessive price and wage demands of particular industries or groups. In a competitive environment general monetary and fiscal controls will operate as effective anti-inflationary restraints.

Again this does not mean that we endorse certain proposals in the report. It is vital that these laws be enforced and administered in a spirit and manner consistent with their fundamental purpose. They should not be used simply to extend the power of Government or to harass business. They should be designed and administered to provide for a minimum of direct governmental interference in business transactions.

It is particularly disappointing that emphasis continues to be placed upon new forms of Government regulation of business under the antitrust laws, but abuses of economic power by labor unions are disregarded. Labor monopoly has become an increasingly serious matter of public concern, calling for remedies based on a sound and consistent public policy to preserve competition.

3. We agree that the maximum interest rate on VA-guaranteed home loans should conform to the current rate applicable on FHA-insured home loans. Fur-

thermore the interest rates for those programs should be flexible to meet varying market conditions. The Government-sheltered segment of the housing market shows striking instability when contrasted with housing financed by conventional loans. Here is another example of the distressing results which flow from direct governmental price fixing.

4. We also agree with the administration's exhortation to States that they revise outmoded laws and other legal limitations which restrict the flow of mortgage funds and borrowing for schools and other public improvements.

THE FEDERAL BUDGET

The administration's record peacetime budget shows little of the restraint it urges on the public. The budget is overloaded with proposals to increase spending in all directions. It may well be inflationary, even though estimated receipts put it into a tenuous projected balance.

It is well known that an increase in Government spending, even though matched by increased taxes, may swell aggregate demand. Each dollar of Government spending adds directly to demand, but each dollar of additional tax receipts need not reduce private spending by a full dollar, since some of the increased taxes may merely replace savings. Although there is no proposal to increase tax rates to cover additional Federal spending, under present conditions—with the shortage of savings to finance new construction and capital investments and with great pressure on credit—it is highly probably that the proposed budget will aggravate rather than alleviate inflationary pressures.

In addition, of course, the total impact of Government will actually be much greater than the budget itself indicates. Social security and other programs, such as the new Federal highway program, are not included. The new budget not only reflects increasing expenditures from previous commitments, but also additional proposals to extend the scope of Federal activities—aid to depressed areas, school construction, construction of medical and dental training facilities, etc. These and many other Federal activities taken individually often seem to be laudable undertakings which will fill some real of imagined social need; collectively, they add up to a massive extension of Federal activity into areas of State and local responsibility.

This is not the place to argue the desirability and feasibility of individual proposals and activities, or what certain Federal programs may do to local civic responsibility and control, or how they may aggravate certain problems. But it should be pointed out in passing that what is badly needed is a searching reexamination of the role of the Federal Government. Unless such a reexamination is made, the manifold activities of the Federal Government and proposals to extend these activities cannot be evaluated against a consistent set of principles, and there is little hope for keeping Federal spending and taxation within proper bounds.

It is now proposed that Federal spending be further extended into new areas. Each year new commitments are made which will automatically increase future budgets, and so year after year the long overdue revision and adjustment of our chaotic Federal tax structure is expediently postponed. Instead of the unnecessary preoccupation with local and State problems, we respectfully suggest that, in the interest of balanced, orderly economic growth, it is more important to give immediate and serious study to the effects of our present tax structure on the structure and operation of our economy.

This is a difficult, complex, and uncomfortable problem; and it will become increasingly difficult to cope with as time passes and tax-induced distortions work their way more permanently into the fabric of our economic life. There is need to consider carefully how excise taxes affect the allocation of resources; how excessive and discriminatory personal income tax rates affect the direction of investment, job opportunity, and the structure of industry; how present corporate taxes affect prices, income distribution, methods of business finance, and the structure of industry; and how the combined effects of our present personal and corporate income tax levies distort the pattern of our economic growth.

Only a few of the major tax issues are mentioned here by way of illustration. There are numerous other equally important facets of the tax problem such as the fiscal relationships between Federal, State, and local levels of government. We wish to emphasize here that there is a great danger that preoccupation with the minor problems, however, important at the State and local level, will divert attention from the really important national measures for promoting economic progress.

CONCLUSION

In this review of the 1957 Economic Report of the President we have attempted to be constructive by pointing out where we think the main deficiencies lie. We would not, however, leave the impression that we think it is defective in analysis, perception, or sincerity of purpose. In many respects it is a good report.

We would like to call particular attention to certain innovations which we feel are noteworthy additions to the report. One is appendix C, population changes and prospects. Since our future economic growth and national needs are so closely related in many ways to our changing population trends, the careful survey and analysis in this section is especially timely and useful. Another addition which deserves recognition is appendix D, statistical tables relating to the diffusion of well-being (1946-56). In viewing our economic progress, it is important to look beyond such things as aggregate output per capita income; this section contributes significantly to our understanding of what is behind the oft-used phrase, "our rising scale of living."

Finally, we should like to express our agreement with the cautious optimism reflected in the report. There are still serious inflationary pressures which can be controlled without precipitating depression. Our economy has shown amazing resiliency since the end of World War II. It will provide us with continued growth and prosperity if we learn to keep a firm hand at the monetary and fiscal reins without pulling and hauling, if we take off some of the hobbles, and if we avoid the high pressure of the whip.

Mr. ENSLEY. Our next witness is Mr. Frazar B. Wilde, Chairman of the Research and Policy Committee of the Committee for Economic Development.

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN, RESEARCH AND POLICY COMMITTEE, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. ENSLEY. Mr. Wilde, I am certain that Senator Flanders is very unhappy that he is not able to be here this morning. He has always looked forward to any testimony from the Committee for Economic Development.

Mr. WILDE. Mr. Chairman and members of the panel, I am president of the Connecticut General Life Insurance Co., of Hartford, Conn., and Chairman of the Research and Policy Committee of the Committee for Economic Development. The views expressed here are my own and have not been formally cleared with the Research and Policy Committee of the Committee for Economic Development.

With your permission, I shall file with the committee a somewhat larger brief and condense that brief now. My statement does not discuss details of the economic report, because I am so concerned with two omissions in the report. Those are, in my judgment, inadequate treatment of inflation, and discussion of the tax problem.

It is an excellent report, but those two areas gave me concern.

The American economy has made a tremendous record of growth in recent years. Yet, in spite of high levels of employment and output, it seems to me the American people are trying to get more out of the economy than it is capable of producing today.

This effort shows itself in three major ways:

1. A demand for rapidly increasing Government expenditures, including Federal expenditures, to provide more services and benefits.
2. A demand for more credit than the economy will supply through its savings.

3. A demand for wage-rate increases that appears to exceed the rate of growth in productivity.

If these claims upon the economic system are not restrained or offset the result will be more inflation than we have had in the past year.

The significance of inflation, and the necessity of stopping it now, and of preventing it in the future, is not yet fully appreciated by the American people and their lawmakers. We should realize that a 2 or 3 percent inflation in 1 year is inflation at a rate which, if continued on the average, would double the level of prices in between 23 and 35 years. Realizing this, we can see that we are now faced with the danger of a long-term and persistent inflationary trend. Clearly, the doubling of prices in less than a generation would work serious hardship upon large groups of the population.

In the past 2 years we have had an increase in construction cost of the order of 11 percent, and an increase in equipment cost of 14 percent. When you add such increases to the cost to capital improvements you are burdening the economy—present and future—with a lot of load.

As important as the unfairness of the effects of inflation upon the distribution of the national income are, the effects it would have upon the total size of the real national income. Inflation is a severe tax upon savings in the form in which most of the population must save. And a large flow of savings is the indispensable condition for the rapid growth of productive employment and real national output.

I can see no assurance that a small rate of inflation, once tolerated and accepted by public policy, will remain small. On the contrary, there is every reason to believe that under such conditions the rate of inflation will accelerate.

We must conclude that inflation is an intolerable, unacceptable, and unsustainable way of life and will ultimately lead to full unemployment.

I cannot emphasize too strongly that the first principle of economic policy must be to prevent inflation. We must do this by the best means—those most consistent with freedom and conducive to economic growth.

The President's budget message shows an increase of a little more than \$10 billion in Federal cash expenditures between fiscal 1956 and 1958. The inflationary effects of this large increase, some may think, have been offset or contained because the cash budget has been kept in balance, and even shows a \$3 billion surplus for fiscal 1957-58.

However, even in these overall terms we have not entirely offset the inflationary effects of rising Federal expenditures. The cash surplus will have declined from about \$4½ billion in fiscal 1956 to about \$3 billion in fiscal 1958. Moreover, the 1958 estimate assumes we will get about \$600 million additional from a postal rate increase. In the light of history, we cannot regard this as a firm assumption. Also, some part of the 1958 surplus is the result of inflation and its consequent effect on the levels of income, profits, and sales.

More important, to the extent that we have offset the inflationary effects of rising Government expenditures, we have done so only by keeping in force a level and structure of tax rates that are highly unfair and highly dangerous to the continued growth of our economy.

We cannot look calmly to a continuance of the present tax rate structure. The present system is basically unfair and will have to be

revised. Because of inequities, various classes of exceptions, and loopholes, the tax base has gotten more and more eroded.

The progressive process of tax system deterioration has weakened taxpayer morale. If it continues it will undermine the essentials of a tax system that must pay for the necessary expenditures of Government. The only way to escape this unhappy situation is to return to a much more moderate schedule of tax rates. A somewhat similar situation exists in the schedule of present excise tax rates.

Not only is the present tax system basically unfair but it contains within itself serious dangers to the future growth of our economy. Much of the taxes now collected come from incomes that would normally be invested in productive ventures. The present system encourages financing all kinds of business by incurring debt rather than issuing equity securities. It makes more difficult the obtaining of funds for new and growing enterprises that cannot wholly rely on their own retained earnings.

In the present situation, I see two courses of action. (1) We must reduce Federal expenditures, or at least hold down their rate of growth, so that rising levels of revenue will permit a general tax reduction; and (2) we must seek reform of our tax system by altering its structure without reducing revenue.

In this connection, a first look at the budget impels me to ask some questions. These questions are in this form because I lack the time and information to analyze critically.

I ask: Are we now committed to an annual expenditure of \$5 billion for aids to agriculture? And, if so, why?

That question is posed partly because of its magnitude and partly because of the complex nature of the problem. I have some first-hand experience with the problems of agriculture. In 10 years, from 1930 to 1940, my company had over 1,500 farms and I know the desperate nature of the problem and the great unfairness to farmers. I am sympathetic, but I do not know whether we have a good program now, and my associates here on the panel seem to have some difference of opinion. But if we are going to spend that much money, we ought to be sure that our program is sound.

You probably saw the paper this morning that there is over \$8 billion of farm commodities held by the Commodity Credit Corporation right now, and we lost a billion and a quarter, I understand, on sales last year.

I ask: Why are we planning for the Federal National Mortgage Association to buy \$1.7 billion of mortgages in 1957 and 1958?

It is very doubtful that that much money is needed beyond what the private economy will supply.

Why have public assistance expenditures risen from \$700 million in fiscal 1946 to \$1.7 billion in fiscal 1958 while in the same period social security benefits will have risen from \$0.5 billion to \$7.2 billion?

Certainly we want to be generous and fair to people in trouble, but the rate of increase in those benefits seems quite spectacular. Also, what has happened to the general consensus that State and local governments should assume greater responsibility for financing and administering programs involving local matters? A major new departure from this principle is now proposed for school construction.

The very existence of high Federal tax rates tends to perpetuate high Federal spending, for high Federal taxes make it harder for

States and localities to raise funds to finance their own essential services.

What if we cannot or do not make room for a general tax reduction? Then we should definitely consider something that has never been done in the history of Federal Government—a major tax revision and reform without substantial tax reduction. The following possibility, which has not had prior or present endorsement by the Committee for Economic Development, might serve as a basis for consideration:

1. Reduce the personal income tax across the board by some worthwhile amount.

2. Eliminate the present selective excise taxes except those on alcoholic beverages and tobacco, and the highway taxes.

3. Recoup the revenue lost through the foregoing changes by eliminating some of the many kinds of exclusions and deductions that now reduce income subject to tax and, to the extent necessary, by imposing a general consumption tax. It is to be hoped that some overall expenditure reduction would be available in order to assure that the rate of the general consumption tax would be kept as low as possible.

Mr. ENSLEY. Thank you very much.

(Statement referred to follows:)

STATEMENT BY FRAZAR B. WILDE, CHAIRMAN, RESEARCH AND POLICY COMMITTEE,¹ COMMITTEE FOR ECONOMIC DEVELOPMENT, AND PRESIDENT, CONNECTICUT GENERAL LIFE INSURANCE CO.

I appreciate the invitation of the Joint Economic Committee to appear here today to discuss the Economic Report of the President. Although I am chairman of the research and policy committee of the Committee for Economic Development the views expressed here are my own and have not been formally cleared with the research and policy committee of the CED.

Our country is struggling on three fronts today. The first is the struggle against the worldwide advance of communism. The second is the problem of maintaining high employment and a steady advance in our real standard of living. The third is the struggle to resist a steady deterioration in the buying power of money. These problems are all interrelated. The very real inflationary danger, for example, clearly arises out of the costs of carrying on the fight against communism, while at the same time trying to meet high private investment and consumption demands.

The Economic Report of the President, although properly concerned with inflation, seems to be somewhat inconsistent in dealing with it. Assuming a strong year in 1957, the inflationary forces, which appear to be growing, deserve more concerted attention. What happens to us in 1957 will, in part, determine what happens in future years. Fiscal policy, monetary policy and legislation in the Congress are doubly important this year in the light of this situation.

Anyone who looks at the American economy, either through the Economic Report of the President or directly, cannot fail to be impressed with two facts:

1. The American economy has made a tremendous record of growth in output and employment in recent years.

2. Despite the high levels of production achieved, the American people are trying to get more out of the economy than it is capable of producing at the present time. This is natural and good in one way, but also dangerous.

We have every reason to be proud and pleased with the productive achievements of the American economy. But, it is the less satisfactory aspect of our present situation that I want to discuss briefly now.

The effort to get more out of the American economy than it can produce in the short run is not confined to any particular group, and there is no value in allocat-

¹The Committee for Economic Development is a private, nonpolitical organization of businessmen formed to study and report on the problems of achieving and maintaining a high level of employment and production within a free economy. Its research and policy committee issues from time to time statements on national policy containing recommendations for action which, in the committee's judgment, will contribute to maintaining productive employment and a raising standard of living.

ing blame for this situation. All of us as consumers, businessmen, investors, wage earners, and citizens share in the responsibility.

This effort to extract too much from our economic system in too short a time shows itself in three principal ways:

1. A demand for rapidly increasing government expenditures, especially Federal expenditures, to provide more services and benefits for the population.
2. A demand for more capital and credit than the economy will supply through its savings.
3. A demand for wage and salary rate increases exceeding the rate of growth of productivity.

It is quite clear that the ultimate consequence of these claims upon the economic system, if they are not restrained or offset, may be serious inflation. We have, in fact, had some inflation in the past year. This inflation may be roughly measured by the increase of between 2 and 3 percent of the Consumers' Price Index. Although this is generally characterized as a small or moderate inflation, it may not remain so. I do not know whether inflation will continue this year, but even if it does not, we could not conclude that we had licked inflation as a long-run threat to the American economy. Similar recurring inflations, even at intervals of 3 or 4 years, would add up to a pronounced debasement of the dollar over the next 2 decades.

The rise in consumer prices does not fully reflect the inflationary pressures that may be building up. During the past 2 years, costs of construction, and of capital equipment have risen sharply. In December 1956, the Engineering News-Record index of construction costs was 11 percent higher than in December 1954. During the same period, prices of producer equipment rose 14 percent. These sharp increases in capital costs will be reflected in the future in higher costs of producing consumers' goods and providing Government services.

There has been a great deal of discussion about inflation in recent months—a discussion heightened by the President's concern with the problem as expressed in several recent messages. Despite this discussion, the significance of inflation and the absolute necessity for stopping it and preventing it in the future are not yet fully appreciated by the American people. Perhaps this is because the viewpoints of so many of us about economic problems were formed during the great depression, when the cardinal evil was unemployment, in comparison to which the insidious and creeping danger of inflation seems small. Perhaps it is because the recent rate of inflation is so much smaller than the rate of inflation we experienced in the immediate postwar years.

Appreciation of the full significance and danger of inflation requires a long look. A 2 or 3 percent inflation in 1 year is a rate, which if continued on the average, would double the level of prices in between 23 and 35 years. This would be in addition to the doubling in the level of consumer prices which has taken place in the last 17 years.

We are justified in looking at the problem in this way because we are now face to face with the danger of a long-term persistent trend to inflation. We are experiencing inflation in a period of what we must regard as normal, high-level economic activity. We cannot count on the world situation, insofar as that influences our inflationary problem, radically changing its character in the near future. Nor can we say that we expect or want to eliminate the inflation problem by retreating to a lower level of employment and economic activity.

Clearly another doubling of prices in less than a generation would work serious hardship upon large groups of our population. Those whose incomes are largely fixed in dollar amounts, such as pensioners—and the older-age group is growing—and those whose incomes fail to rise as rapidly as prices, all lose from inflation. Those who own fixed dollar assets—the insurance policyholders, the shareholders in savings and loan associations, the holders of savings accounts in our banks, the owners of E bonds—find their assets no longer buy what they did before inflation.

Just as important as the unfairness of the effects of inflation upon the distribution of the national income are its adverse effects upon the total size of the real national income. Inflation is a severe tax upon savings in the form in which most of the population must, in fact, save. And a large flow of savings is the indispensable condition for the rapid growth of productive employment and real national output.

There is another fact that we should bear in mind when we look at what seems a small or moderate rate of inflation. There is no assurance that a small rate of inflation, once tolerated and accepted by public policy and private thinking,

will remain small. On the contrary, there is every reason to believe that under such conditions the rate of inflation would accelerate. There may have been times in the past when slow inflation could go on for a long period unobserved by the population at large. This is no longer true in the United States. The sight of a continuous even though slow trend of inflation will set in motion efforts on the part of all groups of the economy to protect themselves against it—to make wage rates rise faster and to adjust all kinds of contracts to the estimated future higher level of prices. The consequence of this effort of each to protect himself against the anticipated rates of inflation can only be a still greater rate of inflation.

We must conclude that inflation is an intolerable, unacceptable and unsustainable way of life and will ultimately lead to full unemployment.

Perhaps one must apologize in this sophisticated age for taking a strong position against sin—and inflation is an economic sin. But we have not, I fear, become so intensely aware of the evils of inflation that we can assume that the necessary measures—many of which are hard measures—will be taken to prevent it. So I would say that we cannot emphasize too strongly that the first principle of economic policy today must be to prevent inflation.

Of course we must do more than that. We not only want to restrain inflation; we want to restrain inflation by the best means—by the means that are most nearly fair, most consistent with freedom and most conducive to a rapid rate of economic growth. It is in these terms that I should like briefly to discuss each of the three problems mentioned earlier—the problem of Government spending, the problem of credit policy, and the problem of wage and salary rates and price determination.

THE FEDERAL BUDGET

The President's budget message shows an increase of a little more than \$10 billion in Federal cash expenditures between fiscal year 1956 and fiscal year 1958. It is necessary to look at the cash budget for this purpose because it is only in the cash budget that one can see the influence of some of the most dynamic factors in the Federal expenditure picture—such as the outlays for highways, the secondary mortgage operations of FNMA and the increase of social security trust fund benefits.

It might be said that the inflationary effects of this large increase in Federal spending had been contained or offset because the cash budget has been kept in balance. In fact the cash budget shows a surplus of about \$3 billion for the fiscal year 1957-58. However, even in these overall terms we have not entirely offset the inflationary effects of rising Federal expenditure. The estimated cash surplus will have declined from about \$4½ billion in fiscal 1956 to about \$3 billion in fiscal 1958. Moreover, the 1958 estimate is probably on the high side. It assumes, for example, that we will get about \$600 million of additional receipts from a postal rate increase. In the light of past experience, this assumption cannot be regarded as firm. In addition, some part of the 1958 surplus is the result of the inflation itself and its consequent effects on levels of income, profits and sales. So it is fair to say that we have not been entirely offsetting the effects of rising expenditures upon inflation.

More important, to the extent that we have offset the inflationary effects of rising Government expenditures, we have only done so by retaining a level and structure of tax rates that are highly unfair and highly dangerous to the continued growth of the economy. We did get some tax reduction and reform in 1954, but generally since then we have kept the budget in balance by deferring achievement of the general tax reduction and reform that was expected to occur when the peak of Korean war defense expenditures had been passed, and as the growth of the economy yielded higher tax revenues.

The reason why we have failed, in a period of economic progress, to reach a point where tax reduction and tax reform can be considered is readily apparent. Because we very properly believe in a balanced budget in prosperous years, we have been and are today unable to adopt significant tax-reduction programs, because we have no important surpluses and do not anticipate any now. The lack of important surpluses is due to the fact that while revenue rises in each year by substantial amounts, we parallel the growth in revenue by an increase in expenditures of equal or larger amount. This is the old family phenomenon where a rising income is disbursed in increased spending with no increase—in this case a decrease—in family savings. This can prove dangerous, if Government continues to adopt this practice.

We cannot look forward with equanimity to continued existence of the present structure of tax rates. In the first place the system is basically unfair. Congress

has erected a schedule of very steeply rising individual income-tax rates. It has then built up a long, detailed, and complicated list of circumstances in which particular classes of incomes or particular classes of transactions would not be subjected to those rates. It has done this, because it has been possible in a great many cases to show that the literal and universal application of these rates would have results that Congress did not really desire—results that would either be patently unfair or dangerous for certain kinds of economic activity that are valuable to the country. But every time one class of exceptions is created another class of exceptions is brought close to the borderline where it becomes arbitrary to say that it should be subject to tax. Pressure then arises, with considerable logical foundation, for bringing the new borderline cases within the area of the nontaxed. As this goes on, the tax base becomes more and more eroded, and those who do not get the advantages of the special provisions come to feel more and more discriminated against.

We are embarked on a progressive process of deterioration of the tax system and weakening of taxpayer morale which is already far advanced, and which if long continued will undermine the essentials of a tax system that will pay for the necessary expenditures of Government. This is the inevitable consequence of the schedule of tax rates Congress and the community apparently approve in the abstract, but do not really mean to apply to particular situations when they look at them closely. In my judgment, the only way out of this situation is to get back to a much more moderate schedule of tax rates, a schedule which we are willing to apply with a fair degree of generality.

A somewhat similar problem exists in the schedule of excise-tax rates, where there is no good or logical reason for distinguishing between the items subject to tax and those not subject to tax.

In addition to being basically unfair, the present tax system contains within itself potentially highly dangerous threats to the future growth of our economy. A large part of the tax collected comes from incomes that would normally be saved and invested in productive ventures. The structure of the system provides a strong incentive for financing all kinds of business by incurring debt rather than issuing equity securities. The system greatly increases the difficulty of obtaining funds for new and growing enterprises that need outside money, because they cannot rely heavily on an adequate flow of income after tax for expansion. In addition it diverts a great deal of the attention of a great many imaginative people from productive work to the search for ways to minimize tax liability.

It is fashionable to say that, in view of the rapid growth of the American economy since the end of the war, the present tax system cannot be regarded as inconsistent with economic growth. This seems a shortsighted view. First, there are no advantages in the present tax system which justify us in courting the very real risk that in the long run it will seriously impair our future rate of growth. Second, while we may be pleased with the growth rates of recent years, we have not achieved as rapid a rate of growth as our economy could achieve or indeed as may be necessary for our survival in view of the reported rapid growth rates in the U. S. S. R.

There are, in this situation, two possible courses of action. First, we can try to reduce expenditures, or at least hold down their rate of growth, so that rising levels of revenue will permit a general tax reduction within the confines of which basic reform of the tax system could be accomplished. Second, and more difficult, but necessary if we cannot hold expenditures down, we must seek to reform our tax system by altering its structure without substantially reducing the revenue.

Suggestions to hold down Federal expenditures always run into the question, "Where will you cut?" I recognize that this is a difficult question. CED is only beginning its careful analysis of the 1958 budget, and I am not now in a position to offer specific suggestions for reducing the 1958 budget. However, I am impressed by the tendency for expenditures to rise automatically by amounts sufficient to absorb all the additional revenue that results not only from economic growth, but also from inflation.

I believe that, if the additional revenues had not been so easily forthcoming—had, for example, to be secured by raising tax rates—ways would have been found to restrain expenditures without impairing national security or other vital national objectives. Also, if proper weight had been given to the importance of tax reduction the same result would have followed.

A first look at the budget impels me to ask a number of questions. Are we now committed to an annual expenditure of \$5 billion for aids to agriculture, and, if so, why? Why are we now planning to have FNMA buy \$1.7 billion of mortgages

in the 2 fiscal years, 1957 and 1958? Have plans for making FNMA a private, mutual enterprise been abandoned? What has happened to the theory that as social-insurance benefits increase public-assistance expenditures by the Federal Government will decline? Between fiscal 1948 and fiscal 1958 social-security benefits will have risen from \$500 million to \$7.2 billion, but public-assistance expenditures will have more than doubled, from \$0.7 billion to \$1.7 billion.

What has happened also to the general consensus in this country that the States and local governments should assume greater responsibility for financing and administering programs involving local matters? The present budget indicates that Federal aid to the States will have tripled between fiscal years 1948 and 1958, from \$1.7 billion to \$5.5 billion. On top of this, the budget also projects a 4-year program of grants and loans to the States amounting to \$2 billion for the construction of schools. I do not want to give the impression that a school program is not needed. On the contrary, there is clear evidence of a shortage of classrooms and teachers. But, some method must be found to arrest the growth of Federal-aid programs if we are to succeed in bringing down the high Federal tax rates. Should not the States and localities be capable of helping toward this end by their own school-construction financing? The very existence of the high Federal tax rates tends, however, to perpetuate high Federal spending, for high Federal taxes make it harder for States and localities to raise funds to finance their own essential services.

The Federal Government is now planning a substantial increase in public-works construction in the face of the heavy demands for materials and labor in this industry by the private sector of the economy. The budget indicates that total expenditures for Federal public works are estimated to increase from \$4.1 billion in fiscal year 1956 to \$6.3 billion in 1958. Under present circumstances, it is essential to postpone to future years all but the most vital of projects. The alternative is further increase in construction costs which will reduce what the Government, private individuals, and businesses get for their dollars.

The largest part of the present budget on the disbursement side is for national security. The justification for this rests basically on the uncertain condition of the world and particularly the threat of communism. There is no way in which the figures representing national-defense items can be analyzed competently by an outsider. Even those who are entitled to full information, such as the Armed Services Committees of the Congress, and the civilian and military leaders in the Pentagon would be unable to prove conclusively that the estimates used are the right ones. Military budgets develop largely out of certain assumptions as to the strategy and tactics required to defend the country. These assumptions are always debatable and exceptionally difficult to make today because we are in a period of rapid evolution.

If the present level of national-security expenditures must be accepted as the best judgment that can be applied, one is confronted with a question which we have not been willing to face. This question is: If we must devote such a high proportion of our budget to defense, with the possibility, if not the probability of enlarging it, is it wise and feasible to increase our nondefense expenditures in the short run so far and so fast?

I realize that, with commitments already made, it is going to be difficult to do much about 1958 expenditures. But we should be taking steps now to bring future expenditures under better control. CED has made a number of recommendations for improving budgetary procedures, in the administration and in the Congress, which are more urgently needed now than when they were first offered 2 years ago.

What if we cannot or do not make room for a general tax reduction? Then we should definitely consider something that has never been done in the history of Federal Government—a major tax revision and reform without substantial tax reduction. The following possibility, which has not had prior or present endorsement by the Committee for Economic Development, deserves serious consideration:

1. Reduce the personal income tax across the board by some worthwhile amount.
2. Eliminate the present selective excise taxes except those on alcoholic beverages, tobacco, and the highway taxes.
3. Recoup the revenue lost by eliminating some of the many kinds of exclusions and deductions that now reduce income subject to tax and, to the extent necessary, by imposing a general consumption tax. It is to be hoped that some overall expenditure reduction would be available in order to assure that the rate of the general consumption tax would be kept as low as possible.

Reduction and revision of the personal income tax would do much to restore morale in the country in respect to taxes. It might and probably would increase somewhat the amount of money that was saved and invested. Some of these changes might, in part, reduce slightly consumer spending. In any event, consideration of this line of tax reform would bring squarely before the country the opportunity to debate in the Congress both the inequity of the present personal income-tax structure and the magnitude of our fiscal problems. Certainly we cannot drift along with the present tax system which no one likes but which only survives in the absence of a national consensus on how to change it.

MONEY AND CREDIT POLICY

In the last year the demand for credit of all kinds—from businesses, home buyers and State and local governments—has outrun the supply of funds available from current savings. As a result, credit has become more expensive and harder to get. The Federal Reserve has not generally supplied the increased reserves on which banks could expand credit beyond the amounts that individuals and businesses were willing to save. By following this policy the Federal Reserve prevented the inflation of 1956 from being much worse than it actually was.

While the Federal Reserve was following correct policy, it began to appear as 1956 wore on that the policy did not have the public support and understanding that it deserved and required. It is this fact, more than anything else, that now calls for the establishment of a new National Monetary Commission. We cannot expect a public body like the Federal Reserve to continue to adhere to an anti-inflationary policy if the public actively resents the discipline such a policy imposes.

The subcommittee of the Joint Economic Committee chaired by Senator Douglas and Congressman Patman did valuable work in raising public understanding of our national financial problems. But it is quite clear that the task of study and education in this field is not finished.

The main complaint about monetary policy in the past year has not been that it was too tight in general but that it "discriminated" against certain classes of borrowers—especially home builders, small businesses, and school districts. Of course it is true that the effect of credit shortage will be felt most seriously by those lines of activity that are most dependent upon borrowed funds. Whether this by itself deserves to be called discrimination seems to me questionable. However the validity of these complaints should be the subject of careful study, and further comment here is limited to a few brief observations.

1. The problem of tight money is only likely to arise when the economy is operating near capacity. In such conditions, promoting certain kinds of investment, like housing, necessarily results in less of something else, like factories, or office buildings or even automobiles. In a fully employed economy, we do not get something for nothing.

2. Fixing maximum interest rates for specified purposes does not make money for those purposes cheaply available. It may make money entirely unavailable. We have had an instructive lesson on this point in the mortgage field.

3. We should avoid like the plague any commitment of the Federal Reserve to support the price of any asset. One of the most worrisome aspects of current proposals for influencing interest rates is the superficially logical progression from pegging mortgages at 4 percent to pegging school bonds at 3½ percent to pegging Federal securities at 3 percent. Once we reach this point the inflationary fat is in the fire for sure. On this point, also, we have had sad experience.

4. Whatever discriminations or other difficulties may be found in the operation of a tight-money policy they are small compared to the evils of inflation. We cannot accept inflation, and inflationary policy, as the preferred alternative to monetary restriction.

5. With the possible exception of the labor market, no other market is more important to a free economy than the capital market. If the Government determines who gets capital and on what terms, the Government controls the birth and growth of all businesses. Only the most compelling evidence of necessity should lead the Government to intervene in this market with selective controls or preferences.

THE WAGE-PRICE PROBLEM

The President's Economic Report, and other recent messages, call attention to the basic dilemma of stabilization policy. Suppose that as our economy is now organized high employment and general price stability are incompatible. This would mean that when employment is at a satisfactorily high level, wage rates tend to rise faster than productivity, on the average, and prices on the average also tend to rise, whether because of the higher wage rates or for some other reason. Then a monetary and fiscal policy to prevent inflation would succeed only if it brought about excessive unemployment. And a policy to maintain high employment would inevitably lead to inflation.

This is a problem with which CED has been concerned for some time and which one of our subcommittees is now studying. It is not entirely clear whether the situation I have just described as a hypothesis actually exists in the United States. We know that some wage rates are pushed up faster than productivity, and some prices are raised in periods of high employment. There have been some periods when this seemed to be a general occurrence. But we do not know whether this tends to happen on the average and most of the time if the demand for goods and services is not excessive. We know that there are strong forces tending to make prices and wages rise. But there are also strong forces tending to hold them down. Even in conditions of generally high employment and business activity, workers and management in particular firms and industries must reckon with the danger of pricing themselves out of their markets. If labor unions and business really had the power, singly or together, to raise prices and wages without limitation by the market, we could not explain why prices are not much higher than they are.

In the present state of our knowledge, or lack of knowledge, it would be unwise to base monetary and fiscal policy on the assumption that high employment and general price stability are incompatible. For one thing, this would be too easy an excuse for failure to pursue the most anti-inflationary policy that is consistent with high employment.

Moreover, the surest way to develop the problem would be to act as if it already exists. If we stand ready to inflate the economy to take care of any tendency of wages and prices to rise, wages and prices will certainly behave in the way we fear.

At the same time we must take seriously the possibility that the dilemma does exist now or may arise in the future. We must consider, not how we will choose between high employment and a stable dollar, but how we will make the two compatible.

In addition to monetary and fiscal restraints, there are three general approaches to this problem; direct controls of wages and prices, self-restraint by labor and business, and competition. I assume that we can rule out direct controls. We do not want to solve other problems by giving up freedom. We have every right to expect responsible behavior from labor unions and businesses. But in a matter of such fundamental gravity, we cannot rely exclusively on that. Responsible behavior, while clear enough on the average, is terribly difficult to define in particular cases. If our economy as now organized tends to generate inflation under conditions of high employment, we shall need the most searching reappraisal of our economic organization. We shall have to do everything we can to strengthen the forces of competition in our system that tend to hold prices down.

I hope that before long CED will be issuing a policy statement on the problem of long-run inflation. The problem is one of great difficulty and importance, and must be approached seriously and without premature resignation.

Mr. ENSLEY. Our next witness is Mr. Peter Henle, assistant director, research department, American Federation of Labor and Congress of Industrial Organizations.

STATEMENT OF PETER HENLE, ASSISTANT DIRECTOR, RESEARCH DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. HENLE. Thank you, Mr. Chairman.

We appreciate this opportunity to come before the joint committee to discuss the current economic situation and the President's Economic Report.

President Meany has asked me to convey his regrets that he is unable, because of the meeting of the AFL-CIO executive council, to be present here this morning. He has asked me to submit to the committee for inclusion in this record a statement presenting the AFL-CIO views on current economic problems.

(Statement referred to follows:)

STATEMENT OF GEORGE MEANY, PRESIDENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, ON THE ECONOMIC REPORT AND PROPOSALS OF THE PRESIDENT

I should like to express the appreciation of the AFL-CIO to the committee and its members for the opportunity to present this statement on the President's Economic Report.

Before discussing several specific issues, I should like to make a few general remarks about the report.

1. The report does not comply with the specific requirement of the Employment Act that it set forth the levels of employment, production, and purchasing power needed to provide economic conditions "under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work."

2. There is no analysis of the unbalanced growth of the national economy in 1956—an investment boom, accompanied by drops in home building and automobile output, a decline in farm equipment, and relatively soft markets for many lines of household goods. This lack of balance created some economic difficulties last year, and may have set the basis for a general downturn, if it is not corrected.

3. Although the main theme of the report centers around the danger of inflationary price movements, the report fails to seek out the sources of upward price pressures in the past 18 months. Selective price pressures—from the large price-leading corporations in key basic industries—are incorrectly diagnosed as general inflationary movements. The report proceeds to exhort labor and business to maintain a stable price level, instead of calling public attention to the price-profit investment policies of the dominant corporations in basic industries where price competition is largely absent—and from which much of the recent pressures on prices arise.

4. There is inadequate attention in the report to human values and human needs, especially to the needs of low-income families.

The need to extend the coverage of the Fair Labor Standards Act to millions of low-wage workers who are not protected by the law is lost in rather vague language at the end of a paragraph; and there is no mention of the need to raise the legal minimum wage from the present \$1 an hour to \$1.25.

I can find no mention in the report of the continuing need to extend employment opportunities—and adequate educational and housing opportunities, as well—to racial minority groups.

The report recommends increased interest rates on Government-backed mortgages, which would make homes more expensive. But it indicates no concern about the sharp drop in housing starts in the past 2 years. It fails to mention the need for an improved public-housing program to provide more adequate housing for low-income families. And it contains no suggestion of a program that could help to stimulate private construction of homes and apartments for families whose incomes are in the neighborhood of \$3,000 to \$5,000 per year.

The report describes the administration's tax policy as one that "distributes the tax burden as fairly as possible and imposes the least possible restraint on those incentives—to work, to save, and to invest—that are basic to our system

of competitive enterprise." There is no indication in the report, however, of the Federal tax structure's many loopholes of special privilege for wealthy families and corporations—loopholes that result in an undue tax burden on lower-income groups. Neither is there any recommendation or suggestion that the tax structure be made more equitable by closing those loopholes of special privilege to a tiny minority of upper-income groups and by reducing the tax burden on low- and middle-income families.

While the report speaks of the financial burden on State and local governments—and declares that the administration's policy "leaves no room for operations of the Federal Government that are not truly necessary, or that can be performed better and more economically through private efforts or by State or local governments"—there is no discussion of State and local taxes. The tax structures of most State and local governments place an increasingly unfair share of the burden on low- and middle-income families through sales taxes and other inequitable measures. An administration that shifts many public responsibilities to the States and local governments avoids its own responsibilities when it fails to discuss State and local tax structures and to suggest revisions of those revenue-collecting systems on the basis of fair treatment and ability to pay.

5. National security and international commitments remain issues of prime importance. The report, however, contains no examination of the ability of our economy to meet changing national defense needs and foreign-aid requirements, and the means by which those needs can be fulfilled.

LACK OF ECONOMIC BALANCE IN 1956

Economic developments in 1956 were characterized by a lack of balance. There was a rise in the share of the gross national product that went for business investment—from 7.3 percent in 1955 to 8.5 percent in 1956—while a reduced share went for consumer-related activities—from 69.2 percent in 1955 to 68.1 percent last year. A sharp 21.6-percent increase in business outlays for new plant and equipment was accompanied by a 7.8-percent drop in expenditures for new residential construction, a 4.8-percent decline in consumer spending for hard goods, and a decline in farm-equipment output.

The boom in business investment supplied much of the upward pressure on economic activities in 1956. Despite this investment boom, the rise in the physical volume of all goods and services produced was only about 2.7 percent—below the average yearly rate of national economic growth since 1947.

While consumer-related markets declined or showed only moderate strength, the investment boom created pressures on the available supply of some commodities, such as basic steel, and on the available supply of lendable funds. The Federal Reserve Board responded to this situation by attempting to tighten the supply of money and by making it increasingly expensive to borrow funds. In response to the pressures from the business investment part of the economy, the Federal Reserve Board tightened the money and credit supply generally, without any special relief measures for the soft parts of the economy, such as housing, or for improvements of public facilities, such as schools.

The prime interest rate for top-rated borrowers rose to 4 percent by the fall of 1956. This meant interest rates as high as 5 percent, 6 percent or more, for the consumer and home buyer, the small- or medium-sized businessman or farmer. Frequently, effective interest rates on loans to consumers and smaller businessmen—with interest paid on the declining balance—have been as high as 10 to 12 percent, or more.

The Federal Reserve Board's policy has retarded growth in some sectors of the economy. High interest rates have depressed home building and State and municipal governments have been compelled to delay long-needed improvements of public facilities. The business investment boom, however, continued through 1956. This boom has rested mainly on the expanding outlays of the giant corporations—with their high rates of return on net worth, their 5-year depreciation of Government-certified facilities, their rising depreciation allowances generally, and their ability to borrow funds at relatively low cost. Smaller businesses, however, have been adversely affected by tight money and high interest rates.

The increase in interest rates has brought rising profits to lending institutions, such as banks and insurance companies. The Journal of Commerce of January 3, 1957, stated that early financial reports of the Nation's banks indicate "record earnings for 1956, ranging from 12 to nearly 40 percent greater than reported for 1955."

The investment boom, which created economic difficulties and imbalances in 1956, may create serious problems in the coming year or two. Past investment booms have frequently been followed by declines in business outlays for new plant and equipment, which helped to touch off downward spirals throughout the economy. With vast quantities of new and improved plant and equipment being installed, will the economy's ability to produce a rising volume of goods and services be matched by growing markets? Failure of expanding markets to materialize will undoubtedly result in postponing plans for further investment, in reducing inventories and in cutting back production schedules.

Plant and equipment outlays are now leveling off. There is a danger that these outlays may decline sometime in 1957, if consumer markets are not strong enough.

The state of consumer markets, on which our economy is based, is, therefore, of crucial importance. Last year, however, consumer markets showed weakness or only little strength. The percentage increase in the physical volume of total consumer expenditures for all goods and services was only slightly greater than the increase in the population.

The buying power of per capita after-tax personal income showed hardly any improvement during 1956. Per capita consumer-spending, in constant dollars, was actually lower in the third and fourth quarters of 1956 than in the first half of the year.

Per capita after-tax income and personal consumption expenditures (seasonally adjusted yearly rates)

[In 1956 prices]

	Buying power of per capita after-tax personal income	Real per capita personal consumption expenditures
1956—1st quarter.....	\$1,699	\$1,587
2d quarter.....	1,707	1,580
3d quarter.....	1,696	1,570
4th quarter.....	1,706	1,578

Source: Council of Economic Advisers.

Housing starts dropped 15 percent from 1955; dollar expenditures for home building declined less sharply as the result of the building of more expensive homes. Automobile output fell almost 27 percent. There were declines in demand for many types of consumer electrical goods.

Many consumers, who had built up heavy short-term debts and mortgage-payment commitments in 1955, were apparently concentrating, last year, on repaying at least part of the borrowed funds before buying expensive items. Despite the weakness in most consumer hard-goods markets last year, short-term consumer debt continued to rise, although at a slower pace. The \$3.4 billion increase in short-term consumer debt, between the end of 1955 and the end of 1956, accounted for almost 30 percent of the rise in consumer spending in that same period. Even with the continuing rise in short-term debt, the buying power of most low- and middle-income families was clearly not great enough to strengthen consumer hard-goods and home-building markets last year.

[Billions of dollars]

	Consumer spending for goods and services (annual rates)	Total outstanding short-term consumer credit ¹
1956, 4th quarter.....	271.2	42.0
1955, 4th quarter.....	259.5	38.6
Total.....	+11.7	+3.4

¹ At the end of December.

Source: Federal Reserve Board.

With personal debt as great as it is, the further extension of credit cannot be depended upon to provide a major impetus for growing consumer sales in the months ahead. Neither can liquid family savings be relied on to provide major stimulation to consumer markets. Liquid family savings are relatively low, especially among low- and middle-income families, who make up the bulk of the potential buyers. According to the Federal Reserve Board, 58 percent of spending units (families), with incomes of less than \$1,000, had no liquid savings at all in early 1956; 47 percent of families with incomes between \$1,000 and \$2,999 and 26 percent of families with incomes of \$3,000 to \$4,999—the group that includes the average wage earner—had no liquid savings. It was only among families with incomes of \$5,000 and over that a substantial majority held liquid savings of \$500 or more.

These conditions indicate that the urgently needed growth of consumer markets in the coming months—in the face of a tapering off or possible decline of business investment—requires substantial increases in the buying power of after-tax personal incomes—with emphasis on the buying power of low- and middle-income families.

If we are to avoid increasing reliance on Government expenditures, a balance must be maintained between business investment and consumption. The lack of economic balance of 1956 spells danger for the future, if it continues. A high level of business investment can be sustained only if businessmen expect a rising volume of sales, because the American economy rests on a growing mass consumption base.

High levels of production and employment, in 1957, require substantial improvements in the buying power of after-tax personal incomes and an easing of the tight-money policy—to provide growing markets and available lendable funds.

Although the report speaks of the slowing down of the rate of improvement in output per man-hour of work in 1956, it does not tell us that man-hour output was returning to a more rapid rate of increase in the latter part of the year. The faster rate of improvement of man-hour output is indicated by the available figures on output, employment and hours of work. Let us look at these figures for manufacturing industries, where output per man-hour of work, between the 4th quarter of 1955 and the 4th quarter of 1956, apparently increased by somewhere about 3 to 3.5 percent or better—certainly quite different from the impression one receives from the report.

	Manufacturing production index	Production and maintenance workers in manufacturing	Average work- ing hours
1956, 4th quarter.....	148	13, 379, 000	40.8
1955, 4th quarter.....	145	13, 459, 000	41.2
Percent increase (+) or decrease (-).....	+2.1	-.06	-1

Source: Federal Reserve Board and Bureau of Labor Statistics.

The more rapid rate of improvement in output per man-hour of work in the latter half of 1956 plus the new and improved plant and equipment being installed indicates that productivity will probably rise at a fairly rapid pace in 1957.

THE RISING PRICE LEVEL

In its statement to this committee in February 1956, the AFL-CIO called attention to the dangers of a rising price level which were emanating from industrial goods manufacturers. That statement declared:

"Although the report deals with supposed inflationary demand and anti-inflationary monetary policies in some detail, it sidesteps any discussion of the specific and real 3.5 percent rise in the wholesale prices of industrial goods during the last 6 months of 1955. This significant increase—an average rise of six-tenths of 1 percent per month—is described in the report as "not large for a period of high prosperity."

"This confusion over real and imaginary inflationary pressures * * * requires an examination * * * since it is an issue that is basic to the stability and growth of our economy. Inflationary pressures may be limited to specific markets * * * and they may arise from increasing unit profit margins in administered price markets, rather than from excessive demand."

This year, the President's report centers its main theme around the rising price level. But it fails to point out the major sources or causes of the upward price trend.

The decline of food prices between 1952 and 1955 tended to offset slowly rising prices of other commodities, helping to produce the relative stability of the price level during those years. Food prices have been rising, however, since the beginning of 1956. Price rises for manufactured goods, housing, and medical care, coupled with slowly rising food prices, have meant increases in the overall cost of living.

Wholesale prices of basic industrial goods started to rise rather sharply in mid-1955. These price rises are being passed on through the price pipeline from basic producers to fabricators, wholesalers, retailers, and consumers.

Between June 1955 and the end of last year, wholesale iron and steel prices rose 20 percent, and are still rising. Electrical-machinery prices increased 15 percent and flat glass went up 8 percent. Prices of other basic materials have likewise been moving up, such as fuel, concrete, building-board, and various types of machinery. Wholesale prices of motor vehicles rose 10 percent from mid-1955 to the end of 1956.

Manufacturers of basic industrial goods have tended to take advantage of increasing demands for their products to raise prices, in order to obtain large unit profit margins and to improve the cash flow of their firms. Frequently, prices have been raised, despite soft markets and growing inventories.

Farm-equipment prices, for example, have risen 8 percent since mid-1955 despite large inventories, soft markets, production cutbacks, and layoffs of employees in farm-equipment plants. On the same day that President Eisenhower delivered his state of the Union message, advising workers and unions to moderate their wage demands lest they supposedly create inflationary pressures, the newspapers simultaneously reported gasoline-price increases and sharply rising inventories of gasoline and fuel oils.

The price pressures that have been building up in these past 18 months are clearly from the basic industrial-goods manufacturers, industries in which prices tend to be administered by the dominant corporate giants. The report states: "By December, prices of producer equipment had risen 13 percent above those at mid-1955, intermediate materials for durable-goods manufacturing 10 percent, construction-materials prices 7 percent, consumer durables 6 percent, consumer nondurables 3 percent, and the average of all industrial prices 8 percent."

In attempting to explain these price pressures, the report dodges any meaningful analysis of the price structure and of recent price movements. It speaks in general terms of rising costs.

But it does not tell us anything about costs, prices, and profits in the specific basic industries from which the price pressures have been arising. There is no mention in the report of administered prices in those industries. The report indicates nothing about the high and rising depreciation allowances of those same industries and about their practice of financing the overwhelming portion of new investments from internal sources—high prices, high profits and high depreciation allowances—rather than from new stock issues.

"In some industries," the report declares, "the 1956 rise in prices matched or more than matched advancing costs * * *." But the report does not identify those industries. Is it possible that they are the basic industries from which most of the price pressures have been arising? Is the primary iron and steel industry such an industry, with its 12.9 percent, after-tax rate of return on net worth (stockholders' equity) in the first half of 1955, 14.2 percent rate of return in the second half of 1955, and 14.9 percent rate of return in the first half of 1956?

The report states that "the reduction of profit margins in 1956 was especially noticeable in the motor vehicle, lumber, stone, clay and glass, and electrical-machinery industries." Why does not the report indicate what these profit margins are? Profit margins in these industries were reduced from what level in 1955 to what level in 1956?

Let us look at the after-tax rates of return on stockholders' equity in those industries for which the report sheds tears.

Ratio of profits after Federal taxes to stockholders' equity

[Percent]

	1st half, 1955	2d half, 1955	1st half, 1956
Motor vehicles.....	24.7	18.7	15.0
Stone, clay, and glass.....	15.3	15.9	15.0
Electrical machinery.....	12.2	12.5	11.9
Lumber.....	11.7	10.5	9.0

Source: Federal Trade Commission and Securities and Exchange Commission.

Does the report expect the American people to become agitated over the decline in the rate of return of the motor vehicle industries and of the stone, clay, and glass industry group to 15 percent? Or of the 11.9 percent rate of return in electrical machinery? Or the 9 percent rate of return in lumber?

At the 15 percent rate of return, the cost of an investment can be returned in less than 7 years. If we take account of depreciation allowances—especially the 5-year depreciation of much of the investment in the steel, electrical machinery, and motor-vehicle industries—the return period on investment would be considerably less than 7 years.

Are we to interpret the report as advice to American business that 11.9 percent or 15 percent rates of return on net worth are too low?

These are vital questions concerning the report's comments on the price level. I believe that they deserve careful examination by this committee. Indeed, I think that a study and hearings, by this committee, of the cost-price-profit-investment policies of the dominant price-leading corporations in basic industries is long overdue.

THE OUTLOOK FOR 1957

Most observers expect some moderate growth of economic activities in the first half of 1957. Under such circumstances unemployment would probably be somewhat greater than in the comparable months of last year, as a result of a growing labor force and rising productivity.

The economic outlook for the second half of 1957 is rather clouded with uncertainties. The business investment boom appears to be leveling off and there is a possibility of a downturn in business outlays for new plant and equipment. Construction contract awards have been moving down, as well as new orders for machine tools. In the consumer part of the economy, automobile sales have been running below expectations and below the levels of comparable periods of a year ago. There are reports of large stocks of goods on hand for several lines of household appliances resulting in some inventory shutdowns and layoffs. Unemployment claims, under the unemployment compensation system, in the first half of January rose more than seasonally from December; they were about a quarter of a million greater than in mid-January 1956. There is the possibility, therefore, that national economic activities may taper off or even turn down about midyear.

The level of economic activities in the second half of 1957—and for the year as a whole—will largely depend on consumer spending, on the Government's monetary policy and on whether or not plant and equipment outlays will remain high.

The key question concerning the economic outlook for the months ahead is, Will consumer spending be sufficiently strong to sustain a high level of business investment throughout the year?

Wage increases that will be negotiated in 1957—and those that will be granted during the year under long-term collective-bargaining agreements—will strengthen consumer markets. Government action too, however, is required to contribute to the health of the national economy. Among such required Government actions are:

1. Extension of coverage, under the Federal minimum wage law, to millions of low-wage workers who are not now protected by the law, and an increase in the legal minimum wage to \$1.25 an hour. These actions would broaden the economy's mass consumption base and improve the living conditions of millions of low-income families.

2. Federal Government assistance to communities of chronic economic distress, such as the old textile and coal-mining centers. Despite generally high levels of

employment in the past 2 years, there now are 19 out of 149 major labor market areas and over 50 smaller communities in which unemployment is still a serious problem. A concerted effort by the Federal Government to assist these communities would help to restore them to economic health.

3. Easing of the Government's tight-money policy. This action would relieve restrictions on home building and on other parts of the national economy.

4. Tax relief for low- and middle-income families, coupled with the closing of loopholes of special tax consideration for wealthy families and corporations. Such revision of the tax structure would make it more equitable and strengthen consumer markets, without reducing total Federal revenue.

Mr. HENLE. Anyone reviewing the state of the American economy at the start of 1957 can find some confidence in the fact that the time that has elapsed since the end of World War II is now several months longer than the interval between the end of World War I and the stock market crash of 1929.

While the economy's postwar record for stability and growth may afford some confidence, we must not forget the two recessionary periods in 1949 and 1954, although, on the whole, these proved relatively slight by the standards of the 1930's. One of the major reasons why these declines did not develop into a major depression has been the stronger position of organized labor as well as the various stabilizing elements that have been built into our economy both by union action at the bargaining table and by legislative action in the Halls of Congress.

As we move into 1957, the question arises whether the American economy is once again preparing the way for another recession. There seems to be some evidence of this. The number of layoffs during these winter months is somewhat higher than would normally be expected by seasonal changes. As a result, the number of workers claiming unemployment insurance in late January was 230,000 higher than a year ago. There is some doubt as to whether new car sales are meeting expectations. Awards for construction contracts have been moving down, as well as new orders for machine tools.

On the whole, however, we believe that the momentum engendered by the current high level of output will carry the economy at least through the first 6 months of 1957.

The economic outlook for the second half of the year is clouded with uncertainties and is likely to depend on a number of factors including attitudes of business management, the spending habits of consumers, and the decisions of Government.

Under these circumstances, let me enumerate a few points regarding the President's Economic Report and current economic issues.

1. Economic considerations must not be utilized as an excuse for delaying legislative action to achieve needed reforms in such fields as education, housing, health, aid to depressed communities, and labor standards legislation. We must not fall into the trap of thinking because the economy has been operating at a relatively high level, that no attention need be paid to matters of human welfare.

In fact, just the opposite is the case. Questions of education, housing, health, and persistent unemployment, constitute the very heart of American life and the American economy. Legislative action in these areas is critically needed and must not be postponed on the grounds that the economy cannot bear the added burden. In general, we feel that the President's recommendations are somewhat inade-

quate to deal with a number of these specific questions, particularly with regard to the needs of low-income families.

The health of the economy will not be endangered, as one Cabinet member has suggested, by a slowly rising level of Government expenditures. We very much doubt that this country will find itself in a "depression that will curl your hair," to use Secretary Humphrey's phrase, simply because the Federal Government has been authorized to step up its activities to "provide for the common defense" and "promote the general welfare."

A very pertinent question might well be: Is the Federal Government spending enough, in view of the threat posed by the possibility of Soviet aggression and the needs of our own people?

What are the facts about the budget increase?

The President's 1958 budget calls for a \$2.9 billion increase in Federal expenditures, but it should be remembered, that even with this increase the 1958 budget still shows a larger surplus than that for the current year. Moreover, the actual surplus will be close to \$3 billion according to the "cash budget" which more accurately reflects the impact of the budget on the Nation's economy.

It should also be noted that the increase is concentrated almost exclusively on defense items. In fact, if we have normal growth in the economy, the nondefense portion of the 1958 budget will actually be taking a smaller proportion of the Nation's total output than the 1957 budget.

2. We deplore the fact that the President's Economic Report does not comply with the specific requirement of the Employment Act of 1946 that it set forth the levels of employment, production and purchasing power needed to provide economic conditions "under which there will be afforded useful employment opportunities, including self-employment for those able, willing, and seeking to work" to use the language of the act."

3. The President is particularly concerned about the problem of inflation. He asks specifically that business and labor leadership exercise self-restraint with regard to wage and price determination.

Rather than engage in a lengthy exchange of charges over the President's views and views of others, the AFL-CIO has endorsed the proposal for a full-scale congressional investigation to determine the facts behind the recent upsurge of prices. For our part, we are perfectly willing to throw the whole issue open to the public for a complete examination of the facts regarding the movement of both wages and prices during the past few years.

On the whole, it should be noted that price changes during the post-war period have been caused more by war-induced spurts in demand than by a rising level of costs. While the price level rose during this period, the two chief inflationary periods, 1946-48 and 1950-51, appear to have been triggered by the action of consumers and businessmen bidding against each other for limited quantities of goods. From mid-1951 to mid-1955, prices were relatively stable while real income increased as a result of union-negotiated wage increases.

With regard to the more recent price increases during the past year or year and a half, the President states:

High costs of raw materials and wage increases that tended to outrun the year's small gain in productivity were pervasive factors making for higher prices.

On the wage side, let me make two points: It must be remembered that wages constitute but one part of total cost of goods for any business enterprise. Naturally, the proportion varies from industry to industry but for manufacturing as a whole, figures for leading corporate firms show that total direct wage and salary costs in 1955 accounted for 25.4 percent of total sales. Thus, it is very misleading to translate every wage increase into a comparable increase in business costs.

Secondly, while industrial productivity evidently rose at a slower than average pace during 1956, the figures indicate that in the latter part of the year, to use the language of the Federal Reserve Board, productivity "appeared to be rising more rapidly than for some time." It is thus likely that 1957 will be a year in which productivity will once again rise substantially.

When some business spokesmen attack unions for causing price rises, we think, in reality, they are attacking not just the unions themselves but the entire collective bargaining structure. I suggest that if we are to pass judgment on collective bargaining as an institution, it might be well to consider not just the immediate collective bargaining settlements, but the longer term developments in the use of collective bargaining.

I think that any impartial witness who has had the opportunity to view collective bargaining from close range, for example, mediators, arbitrators, and government labor officials, would generally agree that over the postwar period the American system of collective bargaining is steadily being conducted in a more mature manner, and to a much greater extent is being based on factual material regarding developments affecting the particular bargaining unit. Certainly the system of free collective bargaining by representatives of workers and their employers is the most democratic and at the same time most effective method for determining wages that a free society has ever devised.

Thank you.

Mr. ENSLEY. Thank you, Mr. Henle.

Our concluding witness this morning is Mr. Don Mahon, executive secretary, National Independent Union Council.

STATEMENT OF DON MAHON, EXECUTIVE SECRETARY, NATIONAL INDEPENDENT UNION COUNCIL

Mr. MAHON. Mr. Chairman, I want to thank you for this opportunity to let us present our views here.

My name is Don Mahon. I am appearing here in a representative capacity as executive secretary of the National Independent Union Council and president of the National Brotherhood of Packinghouse Workers. Our national headquarters is here in Washington. My home is in Des Moines, Iowa.

Our interest in the analysis and recommendations contained in the President's Economic Report is based primarily on our estimation of the impact the report would have on our people providing its major conclusions and recommendations are followed. By our people, we refer specifically to the members of organized labor who are represented by the more than 2,500 small independent unions in this country.

These unions constitute an integral part of the labor movement and perform a necessary function. In the field of organized labor, they are comparable to small firms in the field of industry and business.

Big unions and giant corporations are well equipped to slug out their differences in nationwide economic battles by using their almost unlimited resources, controlled by individuals or a small group of union and company board members. However, there are many others in the industrial and economic life of our country who choose to settle their problems locally on a basis of mutual understanding by the individuals or groups involved. Among these are independent unions and small business.

While national patterns lend themselves well to the theories of high finance and industrywide bargaining, they are much too rigid and do not contain the elastic qualities necessary to sustain small business under the local conditions peculiar to a particular locality or individual operation. The same set of facts has proved to be true in the case of small unions which are better suited to local conditions and oftentimes preferred by local union members. Many good examples exist today which illustrates this fact in both business and labor.

We will not attempt to elaborate further with regard to small business because the Congress has seen fit to recognize the requirements of this part of our society. As a result a special committee, the Committee on Small Business, devoted to their future well-being, has been created.

Therefore, we will direct the attention of this committee on the similar requirements of individual workers and small unions. Their interests are primarily of a local nature. Unless Congress gives specialized consideration to their requirements, they are in no position to forever withstand the ever-increasing pressure from the giant organizations of labor and industry. In fact, some now seek to exterminate the local independent union and thus subject their members to the nationwide patterns of bargaining that lends itself better to the one big union theory that they desire.

Monopoly of labor and business in this country could not result in any lasting benefits, a principle reason being that there is never room for two governments in the same country. The record will prove this statement by simply reviewing the struggle for power and domination now taking place through the current mergers of big unions and big corporations.

We would recommend to this joint committee, and through you to all Members of the Congress of the United States, that legislation be passed that will give further study and consideration to the future problems posed by this trend we have cited.

We are pleased to note that this problem has already been recognized and some initial action taken in the House of Representatives. We refer specifically to House Resolution No. 118, submitted by Congressman Cunningham of Iowa, which was referred to the Committee on Rules. This resolution calls for the establishment of a Committee on Independent Unions and unrecognized groups. We feel that similar consideration in the Senate would likewise provide the necessary means of giving unbiased attention to this important matter.

We feel that more consideration should be given to the constantly increasing problems resulting from industrial automation. For that

reason and purpose, our most precious natural resources, in the form of our students, should be given greatest opportunities for their development. This can only be provided whenever opportunities for free college and technical school training are made available to all our young citizens, with qualifying ability, regardless of the financial status of their families. This extension of the theory of our free public-school system, to the college and university level, is long past due. Now in the face of the promising economic picture, as presented by the President, is the logical time to make these future plans. Not after a decline has started.

We are becoming increasingly alarmed about the institution and application of certain tariff and foreign-trade policies. We are particularly concerned about the rising volume of imports of equipment and control instruments which are directly or indirectly essential to our national defense. We recognize that there is some merit and logical argument for more freedom of trade between the nations, but we feel that some control and restrictions must be placed on imports of those items utilized by the industries which are fundamental to the protection of our country.

The structure of our economy and our defense, for example, is dependent upon energy, particularly electrical energy. Electrical energy cannot be produced and distributed without turbines and transformers and other related equipment. Such equipment is produced by experienced workers who have acquired special skills through long experience. In fact, a large part of the cost of such equipment consist of the labor of such people. It is not likely that automation will soon replace the skills of these workers.

We find, however, that present tariff and foreign trade policies are encouraging foreign manufacturers to sell such equipment in this country at prices considerably below American manufacturing costs. Even the much greater efficiency of the American workman does not make it possible for the American manufacturers to compete with foreign manufacturers who pay their workmen labor rates that range from 59 cents per hour on an hourly basis to \$17 per month on that basis.

Federal purchase of heavy electrical equipment and controls for the various Federal power projects is a very substantial part of the total purchases of such equipment. In fact, surveys indicate that if all of the heavy transformers bought by the Federal agencies in 1956 had been made by American manufacturers there would have been 20 per cent more work for the highly skilled workers in this industry. These workers are people who have become qualified for their jobs by many years of apprenticeship, training, and experience. Every heavy transformer, every turbine and many other large equipment items are custom made, and therefore, become a new experience which adds to the store of knowledge and technical skill of the workmen.

Therefore, when such equipment is manufactured in a foreign country this knowledge and skill is a gain to that country, and is definitely lost by us. We feel that it would be a national tragedy to allow the foreign manufacturers to take over such a large segment of our electrical equipment industry, and permit the skills of our own workmen to be lost. Electric energy is too vital to the economy and defense of our country.

We urge that the tariff and foreign-trade policies be reviewed immediately and amended to encourage an electrical equipment indus-

try, located in the United States, strong enough to supply our electrical energy requirements.

In concluding, we refer to the Economic Report statement that—while policies that strengthen competitive forces and foster stable economic growth are the surest means for improving the opportunities of small business in a free economy, specific measures are needed to deal with problems of special importance to this sector of the economy.

Accordingly, several Government programs have been developed to meet this problem. If this theory is logical and sound for business, and we certainly believe it is, then at least comparable consideration should be given to the rights of the individual and small labor organizations. For that reason, we again recommend that positive action be taken with respect to House Resolution No. 118 to provide a Committee on Independent Unions and unrecognized groups in the House of Representatives. Similar action should also be taken in the Senate.

Thank you, Mr. Chairman.

Mr. ENSLEY. Thank you.

Senator Goldwater, would you start off the questions?

Senator GOLDWATER. Gentlemen, I want to apologize for having been late. The Senate seemingly never gets to work until about the end of the session, but I can assure you that there are committees meeting regularly.

Mr. Wilde, I have some questions here that are inspired by your statement. I am sorry I was not here to hear it read, but I have read it since I have been here. You say on your first page:

The American economy has made a tremendous record of growth in recent years. Yet in spite of high levels of employment and output, it seems to me the American people are trying to get more out of the economy than it is capable of producing today.

I would like to ask you to comment on an observation that I suggested in that field. You say that the American people are trying to get more out of the economy. I question that. I wonder if this concept of the full employment might not be inspiring that more than the American people themselves.

Mr. WILDE. I would not know, on an analytical basis, what the total forces were. I think part of it is the very commendable American ambition and enthusiasm to improve all of our material things and a good many of our cultural things. We want to have an automobile for everyone, and a second one, if possible. We want to have roads. We want to have better public buildings. We want to have both a public and private increase in the material standard of living. We would like to improve our school systems and our other cultural advantages. We want to help people who are below standard. At the same time, we have to dedicate a tremendous portion of our productivity to national defense and security which does not directly contribute very much to the standard of living.

I just think we are trying to do too much too fast. I do not criticize us for trying to do it. I merely say we cannot do it overnight, because we are running into shortages of capital, shortages of technical labor, engineering, and human resources.

Senator GOLDWATER. The thought was prompted by the words which follow that first statement, when you say

This effort shows itself in three major ways: One, a demand for rapidly increasing Government expenditures, including Federal expenditures, to provide more services and benefits.

Do you tie that into the assumption that the American people—I am talking about the American people as a whole—are trying to get Government increases in expenditures, trying to get more services and benefits out of the Federal Government?

Mr. WILDE. Yes, I do. But it is done by individual groups, each of whom feels it has a very worthy case, and collectively the burden is more than we can meet at the present time.

Senator GOLDWATER. That is the point of my question. I was going to come to that. I am glad you beat me to it. Is it not rather than the American people as a whole, the groups that are seeking power amongst our American people who profess to represent these people as a whole who are causing more and more public expenditures that, mind you, and you know this as well as I, are being paid for by the very people that these groups claim to represent as they seek to spend more and more of their earned dollar?

Mr. WILDE. Senator, certainly, the groups who are interested in advancing their causes, which may be good ones, seem to use frequently a special means to increase their pressure. But, after all, in a free democratic society, they have the right to do that, if they want to—to press their case as long as it is lawful and aboveboard. But there is no doubt in my mind, and you know it better than I, that some groups have been so resourceful and so powerful that they have overwhelmed legislation, both in the States and in the Federal Government, to go farther and faster than is fair to the economy as a whole.

Senator GOLDWATER. I wanted to bring that out, because I would not like it said about the American people as a whole that they subscribe to the idea that the Federal Government can support them from the cradle to the grave and can prevent the economy from collapsing, and can do all of these things without it costing them money.

Mr. WILDE. I am glad you make that point. I do not want that implication. It is the composite forces that do it, and not the American people as a whole.

Senator GOLDWATER. I think you hit the nail on the head on the third page, where you say:

The progressive process of tax system deterioration has already weakened taxpayer morale.

I am glad you brought that out.

I do not think anybody has said it as flatly or as bluntly as that. But across the length and breadth of this country, I think that is the greatest threat we have to our future, the acceptance of this idea that the Federal Government can be father and mother and grandfather and grandmother to everybody in this country.

Mr. Henle, did you have a comment to make on that?

Mr. HENLE. Senator, I could not help but feel, as I listened to you and Mr. Wilde, that perhaps one of the groups you had in mind was the group I represent, the labor unions.

Senator GOLDWATER. Not particularly. But certainly in general, yes. I would say the group that I am a member of is guilty of it, too.

Mr. HENLE. I am certainly not going to say that every little particular piece of legislation that the unions may at one time or other favored, automatically would benefit every person in the country. Yet at the same time I would like to point out that insofar as we are concerned, we have tried to develop a legislative program that would be a benefit not just to our members, but to all working people in the United States. There are bound to arise some differences over the program.

In effect, it seemed to me that in raising questions about the Government's role and the goal of full employment—it is not really full employment, as the word "full" does not appear in the Employment Act of 1946—your quarrel, really, is with the Congress itself, because whatever appropriations have been voted have to be voted by Congress.

I assure you that from our point of view, we do not consider that the Congress of today, or at any time since the Employment Act or at the time of the Employment Act, is a Congress that was friendly to labor.

As you know, the unions have been trying for some time to obtain some changes in something called the Taft-Hartley Act. This is just about item No. 1 on our legislative program.

If our record on the Taft-Hartley Act is a measure of the unions power to enact legislation, certainly we rank rather low.

Senator GOLDWATER. I certainly would not want to single out your organization of unions nor any organization of unions as being singularly guilty of the charges that I feel could be leveled against all groups in this country. I did not have that in mind, although I did say that in a general way, yes, it could be applied, as it could be applied to all groups.

I agree with you that Congress is probably the guilty person here. But just to carry on this argument, we are all concerned today, and we heard during the election talk after talk, speech after speech, about the poor small-business man and what we could do about him. We come back and assemble in Congress, and I have not heard yet from the Congress as a whole an expression in the fields that would really help small business. When we help small business, we help labor, we help management, we help everybody in the country. This idea that we should help business alone or help labor alone is a ridiculous thing.

If you help one you help the other. You know that as well as I do. My solution in this field is just one, that we reduce taxes, and if we reduce taxes across the board in this country, but particularly in the fields of small business, you are going to have more people employed from your unions, and business is going to pay more taxes instead of less taxes as a result of doing more business.

But I have not heard yet any discussion directed at the heart of this whole problem of business in this country which is, frankly, a stifling tax load. I think you recognize that as being important to your membership, just as I recognize it as being important to the business fraternity. That is the whole nut of what I am trying to get across. We are all in favor of economy in the Federal budget, as long as it is happening in the other fellow's backyard. When the time comes that your organization of labor and the other organ-

izations of labor, and the farm organizations and the business organizations, can come down here to Congress with their arms around each other's shoulders and say "Now, look here, gentlemen. You have gone far enough in taxing the people of this country," then I think each one of you will be doing more for your organizations than by coming in here and asking for special tax benefits or special this or special that.

That is the whole substance of my argument.

Mr. HENLE. I do not want to take up any more time, but on the specific question of helping small business through changes in the tax laws, I thought you might be interested in knowing that there is a specific provision in the statement on taxes that was recently adopted by our executive council calling for a change in the corporate income tax to benefit small business.

Senator GOLDWATER. Good. But we cannot reduce those taxes if all of our groups, including the ones that I am a member of, continue to come to Washington and say "Well, we are going to cut taxes, but we cannot cut the budget."

That just does not add up. Somebody wrote a song recently about the money tree. I think they have the idea that it grows someplace around this Capitol Hill. I have never seen one. The money tree is the 165 million people of this country. All I am asking the groups of this country, including yours and including all of ours, that we lay off the demands on the Federal Government and let this free enterprise of ours run in a freer way, let the people retain more of the money they earn, not only the small-business man and the big-business man, but the consumer, who, today, is tapped for pretty close to 30 percent of what he earns.

Mr. HENLE. We have to remember, though, that when we talk about the Federal budget, that something like 80 percent of that Federal budget is defense or defense related.

Senator GOLDWATER. That is true.

Mr. HENLE. The future of the whole free world is at stake, and certainly recent developments have shown that the United States has had to step into places where, only a few years ago, we considered such action unthinkable. Naturally, that means we are going to have to spend more money on our military forces, on certain amounts of economic aid, and on military assistance. That is a major item in this increase.

Senator GOLDWATER. Yes; but the domestic portion of our budget has increased rather surprisingly in the last 5 or 6 years, while the military budget has actually decreased a little bit. I do not accept the idea that a budget cannot be balanced. I wish my banker would accept that. I would be a little better off once in awhile.

Mr. FACKLER. Senator Goldwater, could I speak to the point you made on the question of taxes?

Senator GOLDWATER. Yes, sir.

Mr. FACKLER. I would like to point out again, as has been pointed out many times before, that the large majority of small businesses are not incorporated. Since they are not incorporated, changes in the corporate tax law are not going to help them a bit. It seems to me it is kind of ridiculous, on one hand, to have the very high progressive personal income tax rates, which really break the small-business man's

back, and then, on the other hand, say "we are so sorry for him" that we must devise means to help him out of a situation that we helped put him into. By "we," I mean the American people and the Congress.

Also, this question of aid to depressed areas and other proposals for Federal intervention are directed at situations which would be much more self-corrective if we had a general, overall revision of our personal income-tax rates. Taxes are tied directly to the problem of job opportunity. But the moment anyone says we should reduce progressive tax rates, it is said, "So, you are in favor of reducing the taxes for the wealthy."

It is not a question of favoring anyone. It is a question of job opportunity investment incentives and diversification of investment which is the very important issue.

Senator GOLDWATER. I agree with you entirely. When I say reduce taxes, I mean reduce taxes, not just corporate taxes but personal income taxes. The whole problem that a businessman faces today is no different than what a housewife or an individual faces.

How much can they retain out of their earnings?

We have been in an accelerated period of inflation since World War II. We have checked it some. There is a question as to whether we can continue to check it effectively. But a man earns money, whether it is earned in the form of a salary or profit or dividend, or whatever it is, he should be allowed to retain a sufficient portion of that to enable him to expand, to buy new equipment when it is needed, just the same as the housewife should be able to save enough to take care of a rainy day.

That, to me, is a sensible approach to helping the businessman and the people of this country. But, let us look at what has been recommended. Instead of cutting taxes, we hear "Let's increase the amount of money that the Government can make available to small business by some \$80 million." That is \$80 million. Where is it coming from?

Right out of that poor fellow's pocket that you are going to give it back to, only he is going to get about 50 cents of it back, and that 50 cents today is worth about 25 cents.

I think we are on very sound ground, the whole economic family in America, labor and management alike, when we come down to Washington and to our legislative body in the States, and say "Now, gentlemen, enough is enough. Let us cut this budget. Let us cut taxes. Let us decrease the deficit. Let us get back on a sound footing."

Mr. FACKLER. Senator, I was not disagreeing with you. I meant to reinforce your remarks. I support your position.

Senator GOLDWATER. I am glad you brought up the matter of personal income taxes as it relates to the unincorporated small-business man. To me, there is such a simple answer to this thing. Why we have to get complicated about it through suggesting more money to be spent by the Federal Government when we do not have it is beyond me. Yet getting back to the statement that Mr. Wilde made, in effect saying that the pressure groups of America are responsible for this, I hope the pressure groups realize that they have caused this. When I say pressure groups, I am talking about the people that represent every segment of this population, because they are all in here.

Ask them to lay off for awhile and let us take another look at our hole card, which is the free-enterprise system, and see if by laying off this incessant demand on the Federal Government we might not actually increase the business of this country faster than we are doing it today.

Do any of you gentlemen have any comments on that?

Mr. FACKLER. All I want to say, Senator, is that I agree wholeheartedly.

Mr. NEWSON. I would like to comment to the effect that basically I think there is no disagreement with what you have said in our attack here on our particular problem. But I want to take temporary exception to the broad and wholesale application of that philosophy to our agricultural situation under present circumstances.

In doing it, I want to call your attention to the fact that some of us have been making a diligent effort to try to relate agricultural credit to the total business community, and have this become somewhat in conformity with nonagricultural credit. We are getting into a dangerous situation, because the earning power on agricultural investment just will not sustain that sort of a thing.

To be specific, as you perhaps know, most of the Federal land bank long-term paper is out at a fixed 4 percent interest rate. When we talk about just simply depending on normal competitive and market operations, we come head on into a situation such as this: We have recently sold \$72 million worth of debenture certificates of the Federal land bank at $4\frac{1}{8}$ percent. That is a 15-year debenture. At the same time, we sold about \$130 million of 1-year certificates at $3\frac{7}{8}$ percent. This particular sale brought the average rate on Federal land bank paper up to 2.98 percent, according to the figures that I have before me now.

On December 31, that average rate was 2.83. You know as well as we know that it takes something more than one percent to operate this system. As a matter of fact, I think the figures run about 1.4 percent.

I am only citing this situation to say that there is something basically wrong with the system insofar as agriculture is concerned, and we are going to have to call upon the Congress to take cognizance of that fact.

I am not presuming that this is the place to go into details of a farm program. I am only saying to you that there is something wrong, something bad, with the present program, even though we cannot, and even though we are trying to do it, become a reasonable part of the sound fiscal and economic policy of this country and yet survive.

Senator GOLDWATER. I could not agree with you more. I think agriculture, probably more than any other field that we are in today, points up the damage that can ultimately be done to the whole economy, by a Government trying to inject itself constantly into the operation of that segment.

I recognize, as do all people, that in times of war, in times of heavy demand, we have to go to the farm industry, as they did in my State during the war, and say "We want you to produce cotton, short staple," which we had never produced. The Government then has to offer some bonus, or inducement to do this.

But to have continued that inducement or bonus past the years of critical demand has resulted, in my mind, in the situation which

the farmer finds himself in today, not only from the standpoint of the unbalance of credit but from the imbalance in the markets.

I realize, too, that we have gotten ourselves into the position where it cannot be chopped off, as you would cut off a chicken's head.

Getting back to my State of Arizona, I can cite an instance that happened this year, in long-staple cotton, where the producers of long staple asked for a doubling of the acreage and at the same time cutting the parity to 75 percent. The Secretary never heard of a request like that. It rather shocked him to find a group of farmers who actually wanted parity reduced.

But the free system that we operate under is beginning to operate in that area again, and I think within a few years they can successfully get out of it.

I think the whole Congress is beginning to recognize that the meddling of Congress in any section of our economy can only result in chaos, if we do it too long.

Mr. NEWSON. I reiterate, I have no fundamental fault to find in what I think your basic statement implied, except that I do want it clearly understood that we think we are going to have to make some temporary exceptions here and there. In saying that, Senator, I do not want to imply that we subscribe to an affirmative answer to the question raised by one of our colleagues here on the panel, that we are permanently and over a long period of time committed to any \$5.5 billion agricultural budget. But unless or until we can succeed in modifying the program, either after our own pattern or after some pattern that somebody else can propose, then we are just going to have to insist on that kind of money.

As indicated in our statement which you did not get in in time to hear, we are face to face with the probable necessity of having to ask for a substantially higher appropriation for extension of Public Law 480, than the administration is or the President's report indicates, simply because of these facts.

Senator GOLDWATER. Have any of you gentlemen any comments on this general topic or anything you want to bring up?

Dr. Talle is here, and maybe he has something, and Congressman Kilburn is also here.

Representative TALLE. I do have one statement, which will be brief. This is directed to Mr. Hamilton. It is merely to say thank you for underwriting the President's proposal for a monetary and financial commission.

I introduced the administration bills.

Mr. HAMILTON. I think such a commission would be very helpful, and that there is no need to have a conflict over whether you should have a study by a commission or a congressional study. Congressional committees are always free to make studies. This committee has made a number of studies of monetary matters. You have had subcommittees. I would assume that this committee would continue to study the question and would study any report by the proposed Commission. By having a commission such as has been suggested, you would get an additional study and you would not deprive Congress of its authority to pass on whether any action should be taken.

Representative TALLE. As a matter of fact, the Joint Economic Committee has worked in the field a good deal, and has jurisdiction to carry on a study.

Mr. HAMILTON. That is correct.

Representative TALLE. I want to thank you for underwriting the proposal to set up a commission. It does not evade or violate the Constitution at all, because the proposal has to do with a study. When the time comes to legislate—the Congress will do that work.

It has been suggested that I serve as acting chairman in the absence of the regular chairman.

Mr. WILDE. I would like to endorse my colleague's statement about the Monetary Commission. It has been the policy of CED since 1948, and we certainly think that in view of the complex situation there is a need to reassess our credit-capital institution, and that it should be authorized by the Congress and set to work.

Representative TALLE (presiding). I think it would be very helpful if we could poll the entire panel on that.

How many are in favor of the President's proposal to establish a national monetary commission in its revised form?

The first bill was introduced on the 14th of January, and the second one 10 days later. In its revised form, the bill provides for the original 9 members outside of Congress and, in addition, 4 other members, and those 4 would be the chairmen and ranking members of the two Banking and Currency Committees of the Congress, or their designees, which would make a group of 13, and thus in this Commission the outside world would be represented by 9 and Congress would be represented by 4.

The purpose is to inquire into the nature, the performance, and the adequacy of our financial institutions.

How many of the panel are in favor of such a commission?

Mr. WILDE. I would not hold a definite position, Mr. Chairman, as to the number or distribution of membership. I think the overall idea of having objective students on the outside as well as members of the legislature is desirable.

Representative TALLE. That was actually what I had in mind in asking for a poll of the panel.

I think I would like to see a show of hands. How many do favor the idea?

How many are opposed to the idea?

It is 6 to 2 in favor of the idea.

Mr. HENLE. Let me make clear that to my knowledge, at least, the organization of the AFL-CIO has taken no specific position one way or another on this question, Mr. Talle. But I certainly think in view of the present stringency of credit and some of the issues that have arisen, that this is certainly an appropriate time for a thorough study of the whole problem. I myself, am not in a position really to judge whether this is a study that should be done purely as a legislative matter or as a Presidential commission.

If it is going to be a commission with representatives from outside of Congress, I would feel that it would be appropriate to include, as members of such a commission, people from all walks of economic life who are affected by the credit problems: business, bankers, agriculture, labor and so forth.

Representative TALLE. I fully agree. Mr. Hamilton made that point. He says in his statement:

"The membership of the commission should include individuals with broad experience in business, labor, agriculture, finance, and government, but the members should not be chosen in such a way as to cause them to feel that it is their duty to represent the views of any particular group or organization. The views of such groups should be sought through hearings or informal conferences.

Mr. HENLE. I would agree with that, if a Commission is to be created.

Representative TALLE. Then the poll count is 7 to 1.

Mr. Baker, would you like to make a statement?

Mr. BAKER. Mr. Chairman, it is my feeling that the committees of Congress are quite well qualified by long experience, including the temporary chairman of this joint committee this morning, to conduct through technical staffs and whatever hearings are necessary the study that needs to be made. You are undoubtedly aware that there is a subcommittee of the Senate Banking and Currency Committee currently at work studying a bill called Financial Institutions Act of 1957. The permanent chairman of this committee is one of the world's outstanding experts in this subject. I have absolutely no reason to expect that a study headed up by Congressman Patman, either as a subcommittee of the Joint Economic Committee, or as a special joint committee for this purpose, made up of members of the House and Senate would not make a completely unbiased study and a completely and fully qualified and competent study of the subject.

We do not have the faintest idea who is the appointing authority or who these nine members might be. They would be people not responsible to the electorate of the United States, somebody set off in an ivy-covered tower, away from the democratic processes of the American system of Government.

Once they had reported and outvoted the Members of Congress 9 to 4, they would be given a special position of prestige in the light of United States public opinion and it might take generations to overcome the ill effects of that.

I would recall also that this has been one of the major dichotomies in American economic and political history. It began many, many years ago with the ultimately successful fight of Andrew Jackson in trying to maintain control of the financial institutions of America, the credit and monetary system, for the people of the country, instead of turning it over to small, power-hungry groups.

I would, therefore, urge, instead of going this route of setting up a special select group not responsible to the American constitutional and political system in making such decisions, that you retain that power to make this study among the Members of the House and Senate.

Representative TALLE. Are there any further comments on that point?

Mr. HENLE. I just wanted to make it clear, Congressman, that as far as I personally am concerned, I have not looked into the question of who should conduct the study. I would be perfectly willing to leave that to the Congress.

Representative TALLE. Mr. Kilburn.

Representative KILBURN. I would like to say one thing, if I may.

I did not hear all the statements, but I did want to say to Mr. Newson and Mr. Hamilton that I thought their statements were very good and I agree with them. I am sorry I did not hear the others. I do think it was very helpful for you people to show up here. It is too bad we do not have more of the committee.

Representative TALLE. I had the pleasure of hearing those two statements, too. I thank you for them.

Did you have anything further, Mr. Kilburn?

Representative KILBURN. No, Mr. Chairman.

Representative TALLE. Mr. Ensley.

Mr. ENSLEY. Dr. Watkins, 10 years ago, in 1947, when this committee was organized under the chairmanship of Senator Taft, the president of your organization met with the committee, I recall, in executive session, and devised a survey of businessmen's expectations. You have been conducting that survey quarterly, I believe, ever since, with a considerable degree of success. Could you tell us in a few words what the latest survey shows with respect to businessmen's expectations?

My second question is: Could you tell us something more about the Federal Statistical Users Conference; who makes it up, what its purposes are, what it hopes to achieve?

Mr. WATKINS. Thank you, Mr. Ensley.

You will note that I wear two hats here. I speak first in my Dun & Bradstreet capacity. Here is a brief summary of our most recent survey of businessmen's expectations. The interviewing was conducted throughout the country, with a representative sample of large- and medium-size business concerns totaling somewhat over 1,500, over the period January 2-11, 1957; and it related to their expectations for the second calendar quarter of 1957 in comparison with the second quarter a year earlier.

Sixty-three percent of our respondents expected increased sales. Only 5 percent expected decreased sales. Thirty-two percent expected about the same volume of sales.

That, again, is in comparison with the same quarter a year earlier.

With respect to net profit expectations, 44 percent expected to do better than in the second quarter of 1956, only 6 percent expected to do worse, and the balance—50 percent—expected about the same profits.

With respect to inventories, 30 percent expected higher inventories, 12 percent expected lower inventories, and 58 percent about the same.

For employment, the number of employees, 16 percent expected an increase in their employment rolls, 3 percent expected a decrease, and 81 percent expected about the same.

For manufacturers expectations as to new orders, 57 percent expected higher new orders over the same quarter a year ago; 4 percent expected less, and 39 percent expected about the same.

Remember that we asked these respondents what their expectations were with respect to their own companies, not general business expectations.

We have found from experience that businessmen err in the same way that a general group will err, or would reflect the same points of view, let us say, with respect to general business. But if you ask them about their expectations for their own businesses, that is a question they know something about specifically. For that question, they are in a unique position.

I have left one item for the last, and that is expectations with respect to their own selling prices. I have left it for the last because, in my judgment, it represents the most significant aspect of the survey, this current survey, and for the past several surveys.

Forty-one percent of our respondents expected their selling prices for the second quarter of 1957 to be higher than they were for the second quarter of 1956. Only 3 percent anticipated lower selling prices. Fifty-six percent expected about the same level of prices.

We also asked the same respondents what their outturn had been for the quarter just ended, which was the fourth quarter of 1956, compared with the fourth quarter a year earlier. Fifty-four percent of our respondents reported that their selling prices for the quarter just closed were higher than for the quarter a year earlier. Five percent said their prices were lower. Forty-one percent said they were about the same.

Mr. Chairman, I emphasize this point because these figures are extraordinary. That is to say, they reflect an extraordinary degree of diffusion of a price movement, an upward price movement, throughout the business structure. The only comparable price situation we have found over the past decade was that accompanying the Korean war inflationary rise in the latter part of 1950 and the early part of 1951. Only during that Korean war inflationary rise have we found anything like this high or a higher percentage of concerns either reporting higher prices or anticipating higher prices.

That you may appraise the figures I have reported to you on price expectations, may I cite the figures on selling price expectations I gave before this committee just exactly 3 years ago? At that time, I reported on our survey of expectations for the second quarter of 1954, which you will remember was a time of mild recession.

Of our respondents then interviewed, in January 1954, 13 percent expected higher prices, 19 percent expected lower prices, for the second quarter 1954 compared with the second quarter 1953, and 68 percent expected no change.

That is the nature of the shift, and it does, I think, point out the extent to which price inflation has become diffused through the business structure. I am not concerned here with discussing the causes; I merely report the facts of this diffusion.

Mr. Chairman, may I shift now to my other hat, as chairman of the Board of Trustees of the Federal Statistics Users' Conference. Mr. Ensley asked if I would explain a little more about the organization, its inception, and the like. I will give you as brief a response as I can make it.

Over the years I have been called on many times to appear before committees of the Senate and of the House, and before this committee, and, specifically, Congressman Talle, before the Subcommittee on Economic Statistics of the Joint Economic Committee, to speak as the representative of a business concern as to the interest of business concerns in the statistical programs before these committees, the statistical programs of the several departments of the executive branch of the Government.

In general, I have been asked a question as to whether business sees any need for the statistical programs of the executive branch of the Government. I have had to explain, sometimes somewhat laboriously, as to the nature of the uses of Federal statistical programs by business

concerns. Let me hasten to add, of course, that I was speaking as just one representative of business. Many representatives of business have been called before these committees and many business organizations, such as the Chamber of Commerce of the United States, CED, NAM, and so forth.

Likewise, I have had to participate in a good many fire brigades, I will call them. That is to say I have been called on to express, on an emergency basis, the views of my organization, or, insofar as I could speak for other business users, the needs of business generally for these statistical programs.

Let me mention specifically two or three of these. Several years ago, the Bureau of Labor Statistics of the Department of Labor was confronted with a crisis in terms of its statistical programs. Many people over the country were asked by business organizations of one sort or another to explore their organizations and see to what extent there was a reliance on these figures, to what extent they did meet a need. Many of us participated in that program.

Shortly thereafter the General Motors-United Automobile Workers labor contract made the BLS consumer price index one of the criteria for the determination of wage rates. I think it was that action that dramatized the practical needs met by the Bureau of Labor Statistics, and since that time I think its program has had better recognition.

Secretary Weeks, in 1953, called on me to serve as chairman of the Intensive Review Committee, to make an emergency appraisal of the programs of the Bureau of the Census. That was done in a publication called Appraisal of the Census Programs, which the committee got out early in 1954. In that work, there were nine of us on the committee, all from outside the Government. Seven of us were from business concerns, 1 member was from the labor field and 1 member was from the field of agriculture.

We had to survey, on an emergency basis, the opinion of business, labor, agriculture, and the professions as to the needs being met by Bureau of the Census programs. We were almost overwhelmed with the nature of the evidence that came in to us as to the basic practical needs that were being met by these programs.

I think it is fair to say that partly as a result of that work, the census programs were put on a better, more regular and more efficient basis. May I add that the members of the Intensive Review Committee, as well as Secretary Weeks, were deeply grateful for the splendid reception given our report by the appropriate committees of the Congress and the Congress itself.

Congressman Talle, let me recall that you and Congressman Bolling, the two ranking members of the joint committee's Subcommittee on Economic Statistics, asked me about 4 or 5 years ago if I would call together a group of people through which your committee could ascertain the statistical needs of the business community, and the extent of our interest in the Federal statistical programs.

I did that, and we had several meetings with your subcommittee and the staff.

The statement was made that we really ought to have some sort of a continuing organization through which this more or less representative group, at that time with respect to business, could be consulted by your committee.

In our further discussions with you, it became clear that the group needed to be more broadly based.

We have, as a result of these developments I have tried to outline to you, formed this organization called the Federal Statistics Users' Conference, and it is quadri-partite in its makeup. That is to say it consists of organizations representing agriculture, business, labor and the professions and nonprofit research organizations.

It is our hope, as I have tried to outline in the statement to you, that we can exercise a constructive influence in the development of statistical programs which will meet the management needs of the American economy.

I am talking about both public management and private management of the American economy and of American society generally, to make a contribution toward these twin objectives we all subscribe to, namely, reasonable economic stability and dynamic growth of this American economy. We take the position that these programs will not take care of themselves, that they do need the constant scrutiny of the user interest. We are a nonprofit organization. We are seeking to serve the broad national interest. We have a board of directors that ultimately will be representative of four groups I have named.

I am afraid I have taken more time than I should have; but if I have not responded to all your questions, I will try again.

Representative TALLE. You look good in both hats, Dr. Watkins. We are ready to put a feather in each one.

Mr. WATKINS. Thank you, Congressman Talle.

I would like to say that Mr. Henle, here on my left, is vice chairman of the Conference. Dr. Gerhard Colm is secretary, and Mr. Rodney W. Markley, of Ford Motor Co., is treasurer.

Representative TALLE. Dr. Colm has been very helpful to the committee. All of your officers have been helpful.

Mr. ENSLEY. Mr. Chairman, I think our record, before closing, should show that we invited a representative from the United Mine Workers, but since Mr. Lewis has accepted the President's invitation to be a member of the Commission to Study Foreign Aid Abroad, his office feels that he would not think it appropriate to testify before the committee until and after the Commission has reported to the President.

The committee also invited a representative from the National Association of Manufacturers to be here this morning. They are unable to do so, but they have filed a statement, and with your permission it will be inserted into the record.

Representative TALLE. It is so ordered.

(Statement referred to follows:)

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

This statement on the Economic Report of the President is respectfully submitted to the joint committee in behalf of the more than 21,500 member firms of the National Association of Manufacturers.

We are grateful to the committee for this opportunity to contribute to the general economic discussion of the President's report by submitting a prepared statement for the record.

ECONOMIC RESPONSIBILITY

One of the highly significant aspects of the President's report is the discussion of responsibilities, and the distinction between public and private responsibilities and policies. This is emphasized especially in the general approach to the economic analysis.

For nearly a generation, and certainly since the Employment Act of 1946, the Federal Government has been widely regarded as the wellspring of the Nation's prosperity and progress, and the guarantor against depression. This has been, and still is, one of the excuses for big government, for huge spending budgets, and for Federal paternalism extending into areas and functions which properly belong to State or local agencies.

Therefore it might be well to underscore one of the President's thoughtful observations about responsibility, where he said: "But Government cannot assume exclusive responsibility for the smooth functioning of our enterprise system, nor can it guarantee sustained economic growth."

The President went on to point out that even an attempt by Government to so guarantee, and to assume such exclusive responsibility "would involve intervention on a scale incompatible with the fundamental character of our enterprise system. * * *" He emphasized the loss of freedom and the loss of competitive vitality that would follow.

Industry concurs in this basic thinking and fully accepts its own share of economic responsibility. However, industry's responsibility has certain realistic limitations, too, some of which we would like to explain, particularly in connection with the wage-price spiral which now confronts the Nation.

WAGE-PRICE SPIRAL

The President's report analyzes the upward trends of prices, wages and productivity and admonishes business and labor leaders as follows:

"Both management and labor should remove restrictions on the operation of competitive markets and enhance the economy's adaptability to change. Of particular importance in a prosperous economy is the responsibility of leaders of business and labor to reach agreements on wages and other labor benefits that are consistent with productivity prospects and with the maintenance of a stable dollar."

This admonition fails to come to grips with the question of whether the responsibility for the current inflation lies with the leaders of business or labor. However, the factual data given in the body of the report (notably pp. 32-34), point the way to the answer.

The factual data show that there has been a general rise in costs of raw materials and labor. Productivity in industry has not kept pace with wage increases, and consequently unit labor costs have gone up. Prices, in turn, have gone up—but not enough to avoid a squeeze on profit margins.

This information clearly indicates that rising costs are at the root of the price rise. Manufacturers spent about \$15 billions last year for new plant and equipment, which contributes importantly to productivity gains, but wage rises consistently exceed productivity gains, and prices are forced up.

Nevertheless, in the face of this pressure, industrial prices have been so restrained by both self-discipline and stiff competition that profit margins have declined, as shown in the report.

MONOPOLY POWERS

In an economic study issued in the spring of 1956, entitled "A New Force for Inflation," this association pointed out that the fiscal policies of the Government had brought inflation under control, but that the monopolistic powers possessed by unions in the mass-production industries threatened this stability. These unions were demanding and getting increases in wages and fringe benefits far beyond any gains they were entitled to by reason of increased productivity. Inevitably, the study showed, such increases in the cost of production per unit of goods must lead to higher prices and further inflation.

We now see it happening. This new force for inflation is not abstract economic theory. It is proven fact, and is shown in the President's report. In the past year the price level advanced, but the wages of industrial workers advanced even more. Furthermore, by virtue of the escalator clauses in many labor contracts in the big mass-production industries, the workers in these industries received still further wage increases. Thus, every rise in the Consumer Price Index stokes the inflationary fires still higher.

This association believes in the right of workers to organize and bargain collectively. But we also know that monopoly is wrong—economically, socially and morally. It is just as antisocial and harmful to the national interest for monopoly power to be exercised by an industrywide union as it is for the same power to be exercised by a company or group of companies.

CAUSE AND CURE

The fact is that unions in some of our basic industries do have monopoly powers. They can and do engage in virtually all the practices ordinarily associated with monopolies—they restrain trade and fix prices; they allocate territories and keep out competition; they limit output; they ban new products and processes when it suits them to do so; they keep the supply of some types of skilled manpower artificially short; employers often must do business on union terms or not at all. Court cases and judicial decisions in abundance attest to the prevalence of all of these practices.

Self-discipline is not likely to halt such practices. The welfare of the Nation, the stability of the economy and the interests of union members themselves require that the monopolistic powers in the hands of union leadership be curbed in three ways:

(1) By a nationwide ban on compulsory unionism, which is the cornerstone on which these monopolistic powers rest.

(2) By making it impossible for union leaders to compel compliance with their demands by the use of boycotts, jurisdictional strikes, and other forms of coercion.

(3) By prohibiting the use of union dues money for political purposes.

Good unions, which exist only to serve the interests of their members, do not need any of these arbitrary and dictatorial powers. Unions which are being used primarily as tools to advance the personal power or political ambitions of their leaders cannot be allowed to have them.

TAX AND SPEND

The President's report dwells rather briefly upon taxation, although taxes as an economic force can hardly be rivalled in importance.

In his letter of transmittal, the President states that—

“Government can strengthen the enterprise system at this time by preserving a balanced budget. Accordingly, the Congress should continue tax rates at their present levels, and Federal expenditures should be strictly limited.”

And for small business—“such tax adjustments as can be made with a minimum loss of revenue.”

The Federal budget for fiscal 1958 is astonishing in its sheer magnitude of taxing and spending. It is the largest in peacetime history, and the proposed spending is about \$7.3 billion higher than actual expenditures in fiscal 1955. Only \$2.7 billion of this increase is for national security.

Such gigantic spending, especially at a time when the economy is operating close to current capacity, seems sure to contribute to inflationary pressures. Such spending pours out money without creating an equivalent amount of goods on which the money may be spent.

Once again the Nation is confronted with a fiscal policy of “tax and spend, tax and spend”—but with the significant difference that deficit spending is not anticipated.

However, the budget for 1958 is balanced only by applying a number of assumptions, such as no substantial reductions in tax rates. For example, it is assumed that the scheduled 5-percent reduction of the corporate tax rate on April 1, 1957, and the excise-tax reductions, will again be postponed by the Congress. This assumption alone is more than enough to account for the indicated budgetary “surplus” for 1958.

This association is preparing an analysis of the Budget which will show how billions of dollars can be saved on the spending side, leaving ample room for vital tax-rate reductions. Moreover, many of the recommendations of the Hoover Commission, which would save billions of dollars, have yet to be put into effect.

FACING THE ISSUE

The economic impact of taxation is by no means confined to the question of sheer magnitude of the tax burden. Income-tax discrimination has a vital and destructive economic impact. Yet the President's report does not face this fundamental issue.

The unfair discrimination of the steeply graduated personal income-tax rates is a matter of profound economic significance. That is why we feel it is not inappropriate to raise this problem in addressing the Joint Committee on the Economic Report. We have, of course, spelled out the full details repeatedly

before the congressional committees more directly concerned with taxation as such.

It may suffice to say here that the present rate structure of the income taxes places a heavy roadblock in the way of capital formation and economic progress. There is a rapidly growing recognition that such discriminatory taxation is the most powerful of all instruments for socialism and is a punitive instrument—the archenemy of a dynamic and free capitalistic system.

SMALL BUSINESS

A good deal of concern for small business is found in the President's report. The encouragement and nourishment of small business is a tradition in American life. This association derives much of its strength from the fact that its membership is overwhelmingly "small business" as that term is officially defined for manufacturing. Over 83 percent of its membership have fewer than 500 employees, and 47 percent have less than 100.

The foremost need of small business has always been and will always be venture capital, which comes from the savings of individuals and the retained earnings of business. It takes venture capital to start a new business and it takes more venture capital to make it grow.

In years gone by, an important source of such capital was the savings of the successful person, who found pride and satisfaction—and who could take the risks in the hope of profits—from giving a financial lift to a budding enterprise. This source has been fairly well choked off by the extremes of tax-rate progression, both as regards the capacity to save and the incentive to use such savings as are accumulated. Today, the small entrepreneur has to look first to his own resources, and then to bank financing.

BANK FINANCING

Bank financing cannot make up for the shortage of venture capital. In the first place, the basic need is for long-term capital to share both the risks and the prospects for profit. By and large, bank loans must avoid this kind of risk, and, the greater the possible risk, the shorter will be the loan period. In the second place, the function of bank or debt financing is to supplement, not to replace venture capital. Both from the standpoint of the enterprise and of the lender, an adequate proportion of venture capital makes supplementary debt more feasible. In other words, equity financing is the key to debt financing; when more money is risked, more money may be borrowed on sound and reasonable terms. The two in balanced combination make for maximum development and growth of business.

Under these conditions, it is not surprising to find the recurring interest in doing something special for small business in the way of so-called tax incentives. The surprising points are that most of the proposals are more concerned with the corporate than with the individual tax, and that those on the corporate tax are more concerned with the normal than the surtax.

This is the case, for example, in the No. 1 recommendation of the 1956 Progress Report by the Cabinet Committee on Small Business—which is referred to in the President's report.

Of the over 4 million active business firms in the Nation, some 84 percent are not incorporated, and therefore would gain nothing from a reduction of corporate tax rates. Moreover, the ultimate interest of the owners of small incorporated firms is exactly the same as that of the unincorporated businesses, namely, the tax impact on their individual income.

A MEASURE OF PROGRESS

The current struggle to prevent continuous price inflation is one of our most important economic objectives today.

The utility and harmfulness of inflation in the past decade can be seen at a glance in the President's Economic Report in terms of the changes in real income per capita, after taxes. This indicator of individual progress in terms of the buying power of personal income has gone up only 10 percent in 10 years. (Data on p. 105, table D-5, col. 4.)

This entire 10-percent gain, however, was achieved during the past 4 years of relative price stability.

We are now confronted with a creeping inflation which in 8 months has exceeded an annual rate of 4 percent at the retail consumer level. If this rate

is permitted to continue indefinitely, it can compound into a doubling of the price level by 1975 and cut the buying power of today's dollar in half.

On the other hand, if this inflation is stopped, the buying power of the dollar can be sustained and the individual's real buying power of income can be compounded and increased in line with the gains in productivity.

This is a worthy objective for the entire American people.

MONEY SUPPLY, GOODS, AND SERVICES—A NEW FORCE FOR INFLATION, 1950-55

(National Association of Manufacturers, 2 East 48th Street, New York 17, N. Y.
May 1956)

Throughout the free world, economists and economic bodies have been expressing growing concern in recent months over an inflationary force, more insidious than any they have faced before.

By definition, inflation is an increase in the money supply of an economy out of proportion to the amount of goods and services available for purchase. When more monetary units than normal are available to buy the goods and services being produced, prices rise.

In the past, inflation has stemmed from two sources:

1. The creation of artificial money through the payment of government obligations by means of the printing press or through the sale of government debt to banks.

2. Unsound credit policies by central banks—in the case of the United States the Federal Reserve—which lead to excessive credit extension by the private banking system.

In recent years, a new force for inflation has appeared in nearly all the industrialized nations of Western Europe and also in the United States. It stems from a characteristic of a free modern industrial society—the tendency for wage rates to grow without any definite or normal relationship to market conditions.

The problem is most acute in those countries in which trade unions are most powerful and unified.

Rising wage rates in excess of productivity increases, forced on an economy by union economic or political power, cause prices to rise generally; to sustain activity and employment, an increased supply of money is required to handle this larger monetary volume of business transactions; and government or the banking system must either supply this inflationary volume of money or face the harsh alternative of curtailed activity and increased unemployment.

The latter course not only is socially and economically undesirable, but politically unrealistic in free nations today. On the other hand, the former course—endless inflation—will lead ultimately to disaster and economic collapse. Inflation is an evil from which few escape, whether they are employers or wage earners. Values which have been built up over a lifetime or over generations are reduced or wiped out. Savings accounts shrink in value; life insurance policies, pension funds and other forms of savings to which people have contributed lose purchasing powers; bonds, mortgages, and other evidences of value become little more than pieces of paper; the wage earner is caught in a treadmill of spiraling costs; those on fixed incomes or whose incomes are slow to rise suffer sharply decreased living standards.

THE BASIC PROBLEM

The problem which today confronts free industrial nations, therefore, is how to maintain economic growth and full employment and at the same time avoid forced additions to the money supply beyond the normal requirements of economic expansion. This is the problem which is causing concern in Western Europe, Great Britain, and the United States.

Late in March of this year, the British Government issued a white paper which discussed the basic problem of keeping prices stable while maintaining full employment.

The Government noted that the experience of the past 10 years has shown that the more nearly the goal of full employment is approached, the more likely prices are to rise. The only way out, the white paper advised, was self-restraint on the part of unions in making wage demands and on the part of employers in fixing profit margins and prices, so that total money income would not rise faster than output.

"In the absence of such self-restraint," the white paper said, "it may seem that the country can make a choice—albeit a painful one—between full employment and continually rising prices, or price stability secured with some danger to the level of employment that might otherwise have been achieved."

PRODUCTIVITY IS KEY

The white paper then proceeded to demolish the first alternative as a possibility. It pointed out that continually rising prices would have an adverse effect on exports and that with declining exports Britain soon would have to cut the imports which are essential to maintain full employment and the present standard of living.

The Government recommended that management of British industry make every effort to increase individual productivity by utilizing the most modern plants and most efficient techniques and that it eliminate all practices which curtail output. It said labor also will have to cooperate in adopting new methods and by dropping its own limitations on work performed and other restrictive practices.

The white paper said that British production costs per unit for the average article increased when wages, salaries and profits rose faster than output. From 1946 to 1955, it pointed out, income from these 3 sources rose 90 percent while the country's output rose only 30 percent. As a result, prices are now about 50 percent higher than they were in 1946. About one-seventh of this price rise is attributable to changes in taxes and subsidies, and about one-fifth to rising import costs, leaving about two-thirds due to changes in home costs. What this means is that British prices have risen about 33½ percent in 10 years because of increases in the cost of production alone.

SITUATION ON THE CONTINENT

On the Continent of Europe, the situation is reported in the New York Times of Monday, March 26, 1956, by Michael L. Hoffman, the economic correspondent of that paper in Geneva, Mr. Hoffman writes as follows:

"The Economic Commission for Europe has made an attempt to prod Western European governments into frank consideration of their most vexing and politically touchy problem of economic policy: wages.

"The present form of the problem is characteristic of the 1950's. It arises from the attempt of governments to regulate their national economies so that three things can be accomplished simultaneously; the maintenance of full employment, the avoidance of inflation, and a satisfactory rate of economic growth.

"Economists of the United Nations group have produced, in this year's survey of the European economy and in previous studies, ample evidence that the only country that can be said to have succeeded in all three is Switzerland. Elsewhere there has been either inflation or too slow a rate of growth in investment, or both, when full employment of labor has been achieved.

"It would be unavailing to advise other governments to study the Swiss example. Few Western European countries are in a position to meet the inflation problem by admitting foreign workers when the demand for labor expands and expelling them when it contracts. Were it not for this factor, it is probable that a serious upward pressure on wages would have given Switzerland inflationary problems like those of her neighbors.

"INADEQUATE GROWTH

"This year's survey concentrates attention on the rate of growth of productive capacity and fixed capital generally in Europe. It finds that the older industrial countries have a perilously low rate of investment compared with the newer industrial countries of Scandinavia and, even more so, compared with the Soviet Union.

"The reason is that not enough of the national product is left over for investment when the claims of current consumption have been met. As these claims are being constantly expanded by the granting of increases in money wages, the countries of Western Europe are eating up their substance and making wholly inadequate provision for their industrial future.

"The countries with the strongest and most unified trade unions are those in which the problem appears in its most acute form. In those countries wage rates largely cease to be related in any traceable fashion to market forces and become increasingly determined by what are essentially political decisions."

American economic observers recognize a close parallel in many particulars between the situation abroad, as described above, and that prevailing here. Unwarranted wage increases, exceeding labor's reasonable share in the gains of productivity, are forced on industry year after year by union power. Such wage increases are possible without slowing down the economy only in a strongly inflationary situation where the money supply exceeds that normally required by economic growth.

The situation was described as follows by the United States Steel Corporation in its annual report for 1955:

"Of great importance to industry and hence to United States Steel is the development of what appears to be a permanent and alarming peacetime trend of cost and price inflation. During the war period, 1940-45, United States Steel's employment costs per employee-hour increased at a rapid rate. But in the 10 years since 1945 there has been an uninterrupted and even greater rate of inflation in this cost. Over the whole period, 1940-55, the average annual increase is 8 percent compounded.

"A paralleling employment cost inflation has been general throughout industry and Government. This has been reflected in greater taxes and mounting prices of things purchased by United States Steel. Thus, United States Steel's costs other than employment costs have risen in step with its employment cost inflation. During the 15 years since 1940, United States Steel's total of all costs per employee-hour has increased an average of 8.7 percent per annum compounded.

"Since it is impossible for output per employee-hour to be increased at anything like these rates, it has been necessary from time to time—as competition permitted—to raise steel prices and thereby pass on to buyers of steel part of the underlying cost inflation. According to the Bureau of Labor Statistics, the prices of steel mill products increased from 1940 to 1955 by 119 percent. None of that increase has resulted in widening the percentage spread between costs and sales prices since United States Steel's income as a percent of sales was less in 1955 than in 1940, despite 1955's higher operating rate."

ROOTS OF INFLATION

In describing how prices receded sharply from their wartime peaks immediately following the War of 1812, the Civil War, and World War I, while they continued to rise even more sharply after World War II ended, United States Steel says "something new has appeared in the American economy."

In describing this "something new," the report states as follows:

"Two basic roots of the inflationary tendency are discernible. The first one is the institution of industrywide labor unions, headed by leaders who, with power to bring about industrywide strikes, seek always to outdo each other in elevating employment costs in their respective industries. The legislative and social framework within which they function compels them to compete in elevating this basic cost.

"The other root is the Government's 'full employment' policy under which the money supply must be inflated fast enough to accommodate the inflating employment cost, lest that mounting cost bring about its natural result of pricing some people out of their jobs, even though only temporarily. It takes even more dollars to cover ever-rising costs and prices if industry's full output is to be purchased. The money supply—people's bank deposits subject to check plus their pocket money—was in 1955, on a per capita basis, 2.7 times what it was in 1940. This is equivalent to 6.8 percent per annum compounded.

"The abuse of labor monopoly privilege and the monetary policy that transfers to the public in higher prices the penalty of that abuse appear to be the main elements of institutionalized inflation. It would be most helpful in this regard if those responsible for determining wage costs and fiscal policies were constantly aware of the inflationary potentials of their decisions."

DEFICIT FINANCING

In recent years this Nation has experienced an inflation of the traditional type resulting from Government deficits. From 1931 to 1955, Federal Government expenditures exceeded receipts by \$250.5 billion. The effect of this vast deficit financing was mitigated to a great extent by the fact that many of the billions needed to pay the Government's obligations during these years came from the sale of bonds directly to individuals and nonbanking institutions, and to the various United States Government agencies and trust funds.

Nevertheless, much of the Government's debt entered the commercial banking system, where it became the basis for an increase in the money supply. In the period 1939-55, the actual expansion in the money supply amounted to a 280 percent increase.

Thus a vast reservoir of money was available which permitted a growing volume of business transactions to be handled at higher prices. In this inflationary situation the unions representing the employees of industry were able to demand increases in money wages, far exceeding increases in productivity, without causing an economic downturn.

In a similar period (1939-53, the latest period covered by the figures of the Bureau of Labor Statistics), physical output per man-hour in manufacturing increased by 28 percent. However, during the same interval, the pay received by employees in manufacturing plants for each man-hour of their work increased by 180 percent. This does not include the cost of the numerous and steadily mounting fringe benefits which have been granted to industrial workers. Thus, the indicated percentage gain in labor costs in industry greatly exceeded the percentage gain in labor productivity.

As a result prices rose generally, but unevenly, all along the line. The index of industrial prices increased by 100 percent during the 1939-55 period. The Consumers Price Index advanced by 93 percent, thus cutting labor's gain in real wages to 60 percent. The balance of labor's wage gains in excess of the increase in productivity was absorbed by decreases in the shares of the gross proceeds of private business going to other segments of the economy. The percentage share of the gross proceeds of private business going to rent, interest, and dividend receivers showed a sharp decrease. The shares going to unincorporated business, professional people, and farmers also decreased.

BUDGET NOW BALANCED

The reservoir of excess money supply which permitted these gains by labor and the resultant price increases now has been absorbed. At the present time, the administration has succeeded, after diligent effort, in balancing expenditures with receipts. Furthermore, the banking system of the Nation is benefiting from sound, conservative leadership. However, unwarranted wage increases, exceeding labor's reasonable share in the gains of productivity will necessarily destroy this stability, and through forcing a further increase in the money supply beyond that required by normal economic growth, will start us again on the road of inflation.

If this danger is to be avoided wage increases, at the maximum, must be restricted company by company, to increases in productivity, and, in the general public interest, the wage increase should be held to an even smaller figure. This is because gains in productivity should not all go to labor but rather should be divided three ways—to labor for its increased efficiency, to investors for the more effective tools and machines their savings provide, and to consumers through price reductions of the products which are being produced with these improved tools.

RESULT OF UNION PRESSURES

When an industrywide union, exercising monopoly control over the labor supply of an industry, demands wage increases which discount productivity gains far in advance, possible price reductions of mass-produced products are prevented and buying power is shifted unfairly from the public as a whole to the favored few who happen to work in the industry in question.

Furthermore, competition cannot act to restore the proper balance. Any new concern, attracted to the industry by growing demand, would have to submit to dictation by the same union and would not be permitted to establish labor costs which would reflect the true value of the services rendered in the economic situation then prevailing.

Thus, union monopoly power distorts economic rewards in favor of those who are under the umbrella of the monopoly, to the detriment of all other economic interests. In the situation which prevails today, where monopoly power over the labor supply is a reality in most of the Nation's basic raw materials, manufacturing, transportation, and communications industries, persistent inflation is a constant threat.

Even though the effect of union wage demands may not show up immediately in significant or important changes in overall prices at the consumer level, concealed within this apparent stability is a shift in buying power from other economic interests to those employees of business and industry who are getting the unwarranted wage increase. Also, the consuming public is not benefiting as it should from scientific and technological advances, which should have the effect of increasing everyone's buying power.

Under present conditions, monopolistic power is wielded by small groups at the head of international unions in mass-production industries. The practice is to set adamant terms and, with little or no regard to local conditions or the competitive situation of an individual employer, impose these terms on an industrywide basis. Employers must submit or face long and bitter strikes which are costly to the Nation, to communities, to employees, and stockholders.

THE SOLUTION

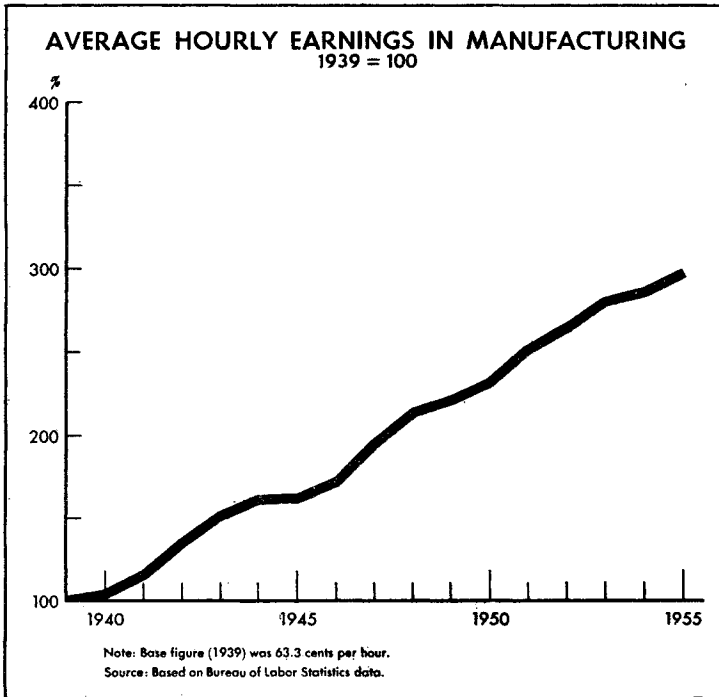
The obvious remedy in the situation is to curtail the power of industrywide unions to engage in monopolistic practices and restore bargaining to the local level. There is nothing harsh or disconcerting about this suggested solution. With the rapid strides of science and engineering, and with the adoption of automation in those mass-production industries in which it is feasible, the American workingman can look forward to a steadily advancing standard of living and a steady increase in personal security and well-being.

The great danger to the future of the American people, including particularly those who work in industry, is that by grabbing for too much now, we will jeopardize what is sure to come and perhaps lose our liberties and free way of life in the process.

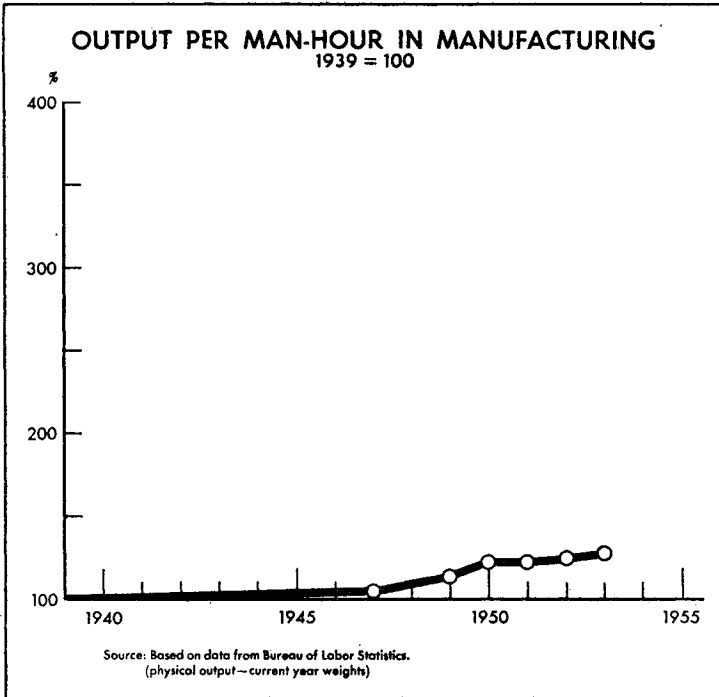
America's road is the road of orderly economic growth, which avoids the perils of inflation on the one hand and the evil of unemployment on the other. The only way to stay on this road is to share the benefits of economic growth fairly by means of lower prices to consumers, better wages to labor, and increased returns to investors. As long as unions are permitted by law to exercise monopoly powers, this sane course is unavailable.

A NEW FORCE FOR INFLATION

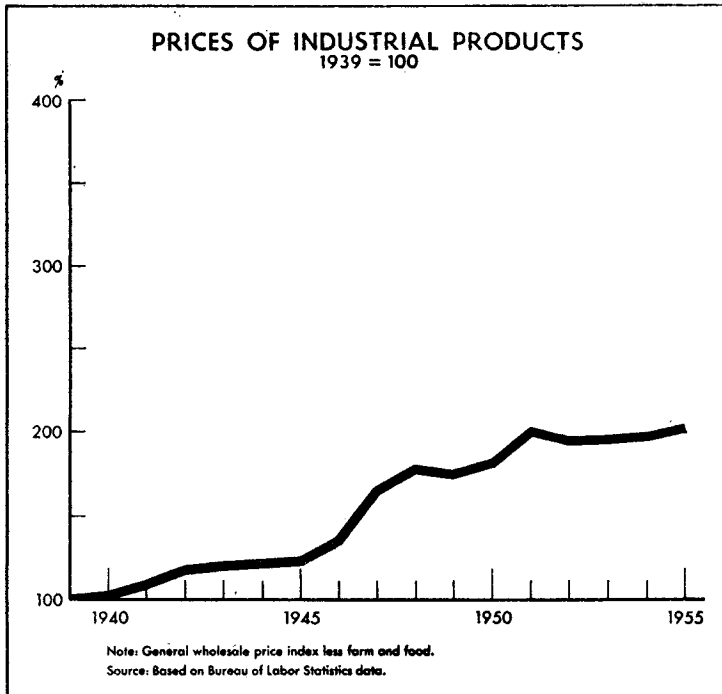
1. During the period 1939-55, the hourly earnings of factory workers, exclusive of the cost of fringe benefits, almost tripled.



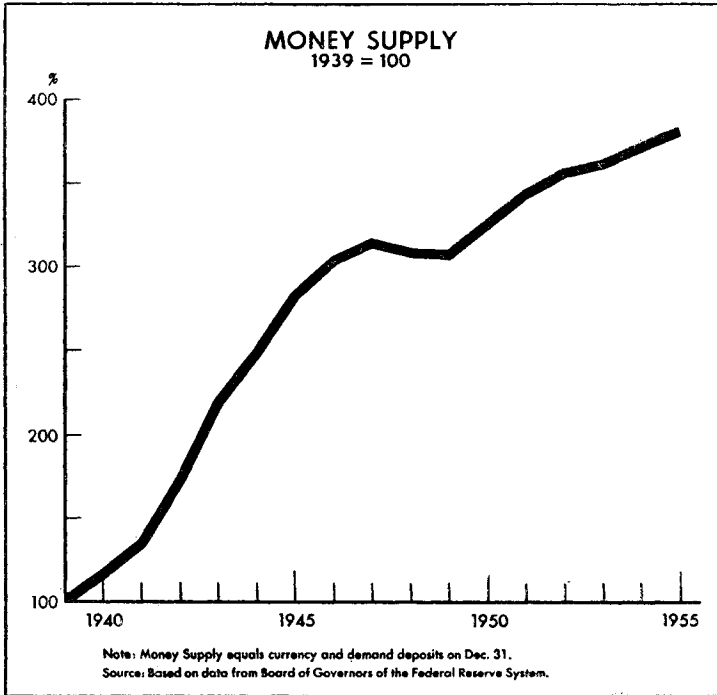
2. In a similar period 1939-53 (the latest year covered by the figures of the Bureau of Labor Statistics), output per man-hour in manufacturing rose by 28 percent.



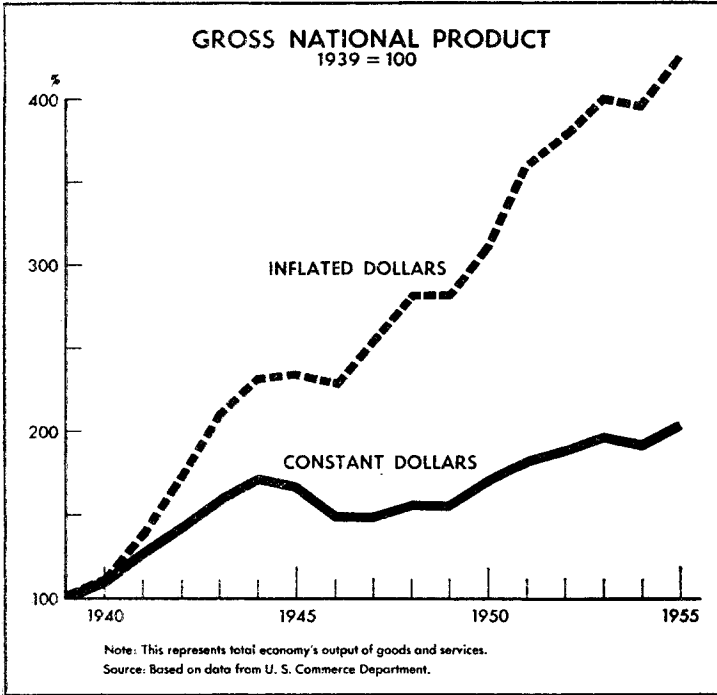
3. The net result was that the prices of the products turned out by industrial workers doubled.



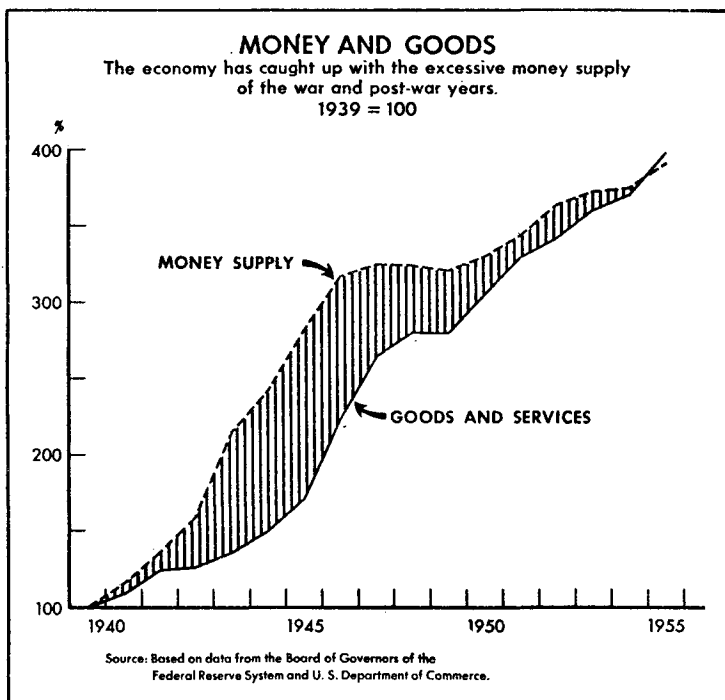
4. A quadrupling of the money supply made it possible to handle the increased output of industry at these higher prices. Without the monetary inflation, the growing cost of production would have priced one line of goods after another out of the market.



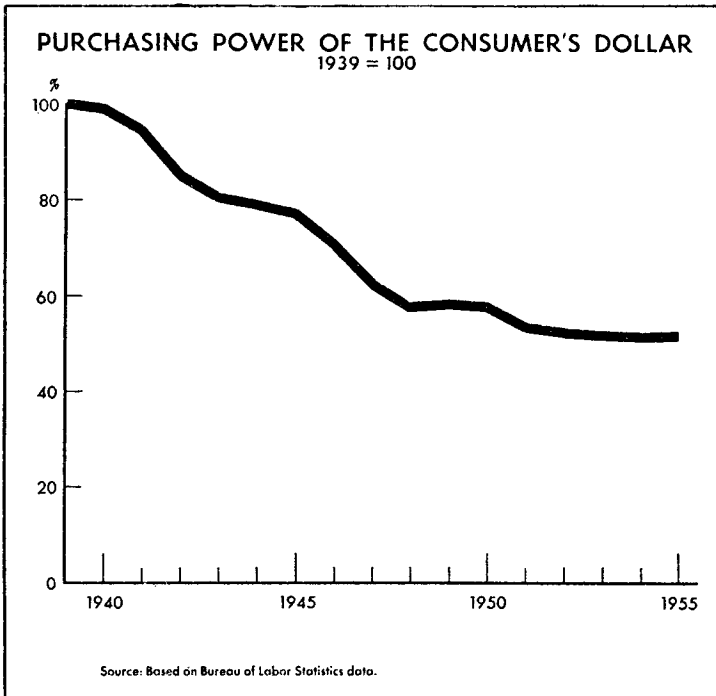
5. While gross national product figured in constant dollars doubled over the 1939-55 period, it quadrupled in inflation dollars.



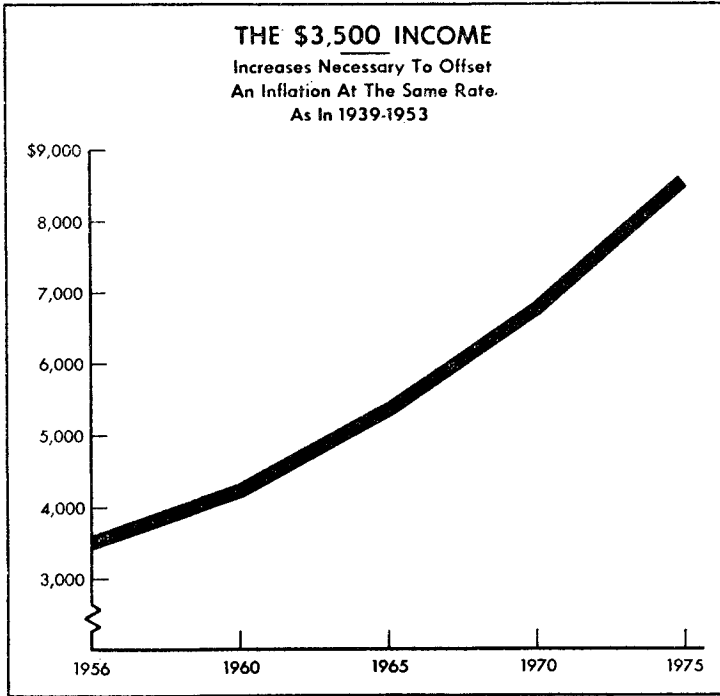
6. The economy now has built up to the inflated money supply as a result of increased volume at higher prices. There is no further room for higher labor costs per unit of production to be absorbed. If labor costs are increased beyond productivity, goods will not be able to find a market unless the Nation again embarks on the road of monetary inflation.



7. Inflation already has cut the purchasing power of the consumer's dollar in half during the 1939-55 period. This means that savings accounts, Government bonds, building and loan shares, life insurance proceeds and all other forms of savings redeemable in dollars have lost nearly half their values.



8. If inflation of the money supply is resumed for any reason, the value of the consumer's dollar and his savings will continue to decline. Future inflation at the same rate as in the period under discussion would make it necessary for the income earner—whether he works in a factory, an office, in public employment, or teaches school—to advance his earnings an average of 4.8 percent each year in order to stay even.



Representative TALLE. Do you have an additional statement, Mr. Henle?

Mr. HENLE. There was one other matter. If there is time, I would like to make a brief statement with regard to it.

Representative TALLE. That will be quite all right.

Mr. HENLE. More or less taking up where Mr. Watkins left off in his Dun & Bradstreet that, discussing the question of prices, I wanted to assure the committee that we, on our part, are very much concerned with this problem. We are concerned with the fact that prices have increased and the fact that some people feel that we have inflationary tendencies in the economy today. We are also concerned with what that means to our members, so many of whom are in the position to receive social-security benefits and who find that their social-security benefits are not paying off in terms of a stable dollar. This is one instance of our direct concern.

We, of course, are particularly concerned because so many people feel that it is the pressure from unions in terms of wage increases that have helped to cause some of these price increases. Of course I want to make clear that as far as our collective bargaining efforts are concerned, we feel that they bring results and we feel that they are of benefit not just to our members but to the whole economy, by strengthening its mass consumption base.

We feel that the way a number of people have discussed the problem, in their minds a simple wage increase of, say, 2, 3, 5 or 10 percent more or less means pressure on business to raise their prices by the equivalent amount. We think this is the type of impression that many people have gotten from the discussion of this problem as appearing in the public press. We do not pretend to know all the answers, and this is why we have called for a congressional investigation.

But, recently, in order to try and get some more information on this question, we in our office made a brief comparison of the wage and price increases during the past year in a number of industries, increases in hourly earnings, and increases in prices. We had the feeling that if this were true, what they say about wages and prices, that we would find by using the Labor Department's hourly earnings figures as a rough, a very rough, index of labor cost, that those industries where the increases have been the largest in terms of hourly earnings, would also be the industries in which prices have gone up the most.

I have a little table here, and if it interests the committee I can submit it for the record.

I wanted to just explain some of the figures we came up against, some of the figures that were revealed. We took the latest yearly period for which there was full information, October 1955 to October 1956. We found, for example, that the industries which had the largest percentage increase in hourly earnings were some of the industries that had the smallest increases in prices. For example, in textiles average hourly earnings went up 5.7 percent, but prices, judging by the BLS wholesale price index over this period, actually declined 0.6 percent.

The apparel industry, all types of clothing, had the largest percentage increase in hourly earnings, almost 9 percent, but only 1 percent increase in prices.

I do not want to burden the record, and I do not say that this brief table that I have here gives the conclusive answer at all. I simply am using this as an illustration to show that the problem of wages and prices is a lot more complicated than some people believe, and more complicated than has so far been revealed in the public press. I cite this as an additional reason why we feel that some committee, preferably this Joint Economic Committee, should delve more behind these actual figures and bring out a more closely reasoned study of the recent trend in prices.

Mr. BAKER. Mr. Chairman, could I make a statement at this point?

Representative TALLE. First, would you like to have that inserted in the record, Mr. Henle?

Mr. HENLE. If the committee is interested, I will be glad to.

Representative TALLE. It is so ordered.

(Document referred to follows:)

Comparison of increase in average hourly earnings and wholesale prices, selected manufacturing industries, October 1955 to October 1956

Average hourly earnings	Percent increase	Wholesale prices	Percent increase
Industry:		Industry:	
Food and kindred products.....	5.1	Processed foods.....	3.4
Dairy products.....	5.4	Dairy products and ice cream.....	5.6
Distilled, rectified, and blended liquors.....	5.4	Alcoholic beverages.....	2.1
Tobacco.....	4.8	Tobacco.....	0
Cigarettes.....	4.8	Cigarettes.....	-0.6
Textile mill products.....	5.7	Textile products.....	2.4
Carpets, rugs, other floor coverings	2.8	Floor coverings.....	1.0
Apparel and other finished textile products.....	8.8	Apparel.....	-2.7
Lumber and wood products.....	3.5	Lumber and wood products.....	4.6
Furniture and fixtures.....	3.2	Furniture and other household durables.....	7.1
Household furniture.....	5.5	Household furniture.....	4.2
Office, public building, and professional furniture.....	5.9	Commercial furniture.....	1.1
Paper and allied products.....	5.5	Pulp, paper and allied products.....	-4
Chemicals and allied products.....	4.8	Chemicals and allied products.....	6.6
Drugs and medicines.....	4.0	Drugs and pharmaceutical.....	9
Paints, varnishes, lacquers and enamel.....	5.9	Prepared paint.....	6.6
Fertilizers.....	7.6	Mixed fertilizer.....	3.6
Products of petroleum and coal.....	4.2	Fuel, power and lighting materials.....	-1.4
Petroleum refining.....	3.6	Petroleum and products.....	4.2
Rubber products.....	4.2	Rubber and rubber products.....	6.3
Tires and inner tubes.....	3.6	Tires and tubes.....	3.7
Leather and leather products.....	8.1	Hides, skins, leather and leather products.....	2.0
Footwear (except rubbers).....	5.3	Footwear.....	4.0
Stone, clay, and glass products.....	-0.4	Nonmetallic minerals structural.....	10.6
Flat glass.....	5.2	Flat glass.....	5.6
Structural clay products.....	5.7	Structural clay products.....	7.6
Primary metal industries.....	6.4	Metals and metal products.....	1.4
Blast furnaces, steel workers, and rolling mills.....	4.8	Iron and steel.....	9.2
Fabricated metal products.....	3.8	Metals and metal products.....	9.6
Hardware.....	7.0	Hardware.....	4.8
Fabricated structural metal products.....	6.3	Fabricated structural metal products.....	2.5
Machinery (except electrical).....	5.1	Machinery and motive products.....	
Agricultural machinery and tractors.....	5.9	Agricultural machinery and equipment.....	9.2
Metalworking machinery.....	7.0	Metalworking machinery and equipment.....	9.6
Electrical machinery.....	6.3	Electrical machinery and equipment.....	4.8
Transportation equipment.....	5.1	Machinery and motive parts.....	
Automobiles.....	5.1	Motor vehicles.....	4.8
Miscellaneous manufacturing.....	5.9	Miscellaneous products.....	
Toys and sporting goods.....	5.9	Toys, sporting goods, small arms, ammunition.....	2.5

Source: Bureau of Labor Statistics, U. S. Department of Labor.

Mr. BAKER. Mr. Chairman, I wish farmers were able to sit up at this table and discuss in a learned fashion how and to what extent increased farm income resulted from what. Farmers have seen their prices drop 30 percent in the last 4 or 5 years, as you know, and this discussion around the table interests us a great deal. I wonder how these people get increased prices. We would be interested in your finding out.

Representative TALLE. Your statement will be incorporated in the record, Mr. Baker.

Mr. Hamilton?

Mr. HAMILTON. I would like to make a comment there, too. I think Mr. Henle has made a very good point, that this subject is complicated. I agree that it is complicated, but I would put in an additional factor or two. I would certainly agree that many wage increases can and are absorbed within the price structure. But one of the things that concerns us is the fact that in some industries there seems to be an ability for labor and management to divide up the gains of increased productivity, or even to anticipate them through a division that results in higher prices to consumers, with the result that none of the gains of increased productivity are passed on the consumers in the form of lower prices.

Mr. Henle cited a case or two where some benefits were passed on to consumers. Wages went up and prices went down. Presumably, at least labor and the consumers shared in the benefits. But, as Mr. Baker says, we have had a bad situation in agriculture, and one of the things that concerns farmers is the fact that despite the intervention of price supports we still have a pretty competitive economy in agriculture where the gains in productivity tend to be passed on in the form of lower prices. Our situation, regardless of what has caused it, has been, in recent years, that farm prices have tended downward, while our costs have been stable to higher.

If you take the overall figures on it, you find that net farm income declined \$5.9 billion, from 1947 to 1955, but only 19 percent of this decline resulted from a reduction in cash farm sales. Eighty-one percent was the result of increased farm production costs. So we are interested in seeing some of the gains in productivity passed around in the form of lower prices, as well as in higher wages and higher profits.

Mr. BAKER. Mr. Chairman, let us get some facts in this record now on this subject. Mr. Henle could have used family-farm operators as his example, as the extreme example, of management that ought to be patted on the back for raising wages paid to hired labor and reducing its prices. The farm operators of the United States have raised the wages that they have paid to their hired laborers, and I wish they could raised it even more, since 1949, the average, cash wage rates for hired farm labor. They are up 28 percent.

That is larger, Mr. Henle, than the 9 or 10 that you mentioned for some of the other industries.

At the same time, the prices that farmers have been able to obtain are down, since that period, about 31 percent.

At the same time prices farmers have had to pay for things that they buy from nonfarmers were up in December 15, 1956 compared with the average of 1947-49, as follows: Interest is up 92 percent, interest paid by farmers; taxes paid per acre up 56 percent; the per unit

price of motor supplies up 20 percent; motor vehicles used to draw plows, up 36 percent; farm machinery generally up 41 percent; farm supplies, staples, hammers, up 17 percent; and for buildings and fencing supplies, the cost to farmers is up 28 percent. Fertilizer is up 6 percent.

There is an average for those 6 items up 29 percent.

They are paying their hired labor 28 percent more out of an income that dropped the \$5.9 million that Mr. Hamilton mentioned.

The point of this is not that this is anybody's special fault, any of these groups. The point is that the economy is seriously out of joint and out of balance, and you are allowing it to be used, the hard-money policy, for example, and various other policies, as a club to beat over the head the people with the lowest bargaining power in the commodity and money markets of the United States.

The thing Mr. Newson mentioned a while ago about the land banks having to go hat in hand and pay a higher interest rate on very secure debentures, and a farmer cannot even afford to pay that rate much less the service charges that go on top of it, is another point.

Again let me say, we would sure like to be here discussing with you how we divide up increased profits for farmers, but we haven't had any in so long that it kind of makes us feel bad to hear the discussion taking this turn.

Representative TALLE. Thank you.

I believe I saw Mr. Fackler's hand up.

Mr. FACKLER. I would like to comment on this wage-price question, the issue that has been raised by Mr. Henle and other gentlemen here at the table.

I agree that this is a very complex subject—this question of the relationship between wages and prices and how wages work themselves into the cost structure. But I feel that other statements of Mr. Henle's are also misleading. He says in his testimony that only 25.4 percent of sales represents direct labor cost in manufacturing. That is true for one individual firm, but not for all manufacturing taken together. This is a statement that has been made time and time again in AFL-CIO publication, and again and again it has been exposed as misleading and nonsensical. He forgets the very thing that Mr. Newson so eloquently spoke about this morning, when he said one man's prices were another man's costs. So if wages go up in one industry, they spread as cost of materials to other industries.

Further, they always overlook the fact that when wage increases are granted in one industry, workers in other industries press to get equally good wage increases. The indirect ways by which wage costs spread are very important.

We agree it is complex, but it is not made less so by this type of statement. I do not want to comment on his figures, because I have not had a chance to look at them to see what they mean. He pointed out a few minutes ago cases in which, as I recall, wages were going up and they were not necessarily connected with the price increases which occurred. This is perfectly reasonable economic behavior, but not necessarily relevant.

He mentioned textiles. Demand also might be falling. There are all sorts of variables at work in a particular situation.

I do not want to comment on his specific statement, except to say that it still does not add very much light. We would be very pleased to see a much greater public debate and inquiry into this whole subject. I believe that your very capable staff had some tentative plans earlier this past year to investigate this particular problem. We would very much like to see the findings if they are able to pursue the project.

True, this is a complex subject. But to say that rising wages do not contribute to costs and do not contribute to rising prices is, I think, nonsense. If you take the figures from the Economic Report, the appendix of the report, for the gross private product, (this excludes the part of the product produced in Government) from 1950 to 1956, there was an increase of \$112 billion, in current dollars. Employee compensation went from \$153 billion to \$239 billion, an increase of \$86 billion, in the same period, over that span of time.

Corporate profits before taxes went from \$40 billion to \$43 billion, and after taxes from \$22.1 billion to \$21.5 billion. With this great increase in gross private product, the profit-after-taxes component is actually lower than it was in 1950. Certainly the great increase in wages could not have come out of profits.

I am not saying this in defense of particular pricing policies of particular businesses. I merely point out that wages have something very important to do with this question of cost and price increases. Saying that they only constitute 25 percent of direct manufacturing costs in a particular firm does not add to our understanding of the problem for the economy as a whole.

Representative TALLE. Do you desire to comment, Mr. Newsom?

Mr. NEWSOM. I do not want to engage in this particular controversy. I simply want to point out that regardless of the probability that there is merit on both sides of this particular argument, the fundamental fact still remains that even though we were not aware of the particular figures that Mr. Watkins put out on the table a moment ago, we were aware of the trend. We were keenly aware that there was an upward movement in prices.

The point that I want to make now is that this fact is the very reason that we subscribe fully to this matter of having a financial study of the monetary functions and policies of this country, because we firmly believe that there is already a good little bit of evidence that the effect of change in this policy is pretty slow.

In other words, in spite of our confidence in the soundness of the direction of these policies that have been pursued in most recent years, we still are confronted with this very substantial forecast, or a forecast of a very substantial upward moment in prices. Is it possible that we are going to have to place a great deal more dependence on some other mechanisms other than monetary and fiscal policy manipulation to prevent this squeeze that is increasingly catching our particular segment tighter and tighter?

Representative TALLE. Mr. Wilde.

Mr. WILDE. I do not want to get into a controversy, but may I make an observation on the interest rate problem, because that is my business in part? Interest rates today are the only large item in the cost of doing business that are lower than they were historically. Money before the great depression of the 1930's averaged 4 to 6 percent and higher. If you went back, particularly in agriculture, farm-

ers were charged what were exorbitant rates, 7 and 8 percent, and then a discount and a commission to a broker.

Today, the rates, after being subnormal because of special factors, have returned to merely an average price of 4 to 6 percent. The land bank bonds are a great tribute to the soundness of agriculture, its fundamental soundness, because 4 percent is a very low rate in today's market.

A short-term rate, approximating a long-term rate, is, again, a common phenomenon. You can have short-term rates higher than long-term rates. I submit that our problems today are not the rates, but the possible inadequacy of funds in some areas.

Representative TALLE. Mr. Newsom?

Mr. NEWSOM. On this particular subject, Mr. Wilde is not accurately informed or up to date. The only 4 percent money is the money that is already loaned, a lot of it for 30 or 33 years. This constitutes the greater portion of the assets of the Federal Land Bank which I mentioned awhile ago. Actually, there is no more 4 percent, not even $4\frac{1}{2}$ percent, money available in very many of these institutions. Most of the PCA's, for example, have gone up somewhere in the neighborhood of 7 or $7\frac{1}{2}$ percent.

But that does not solve the problem that during the next year our Federal Land Bank will have to refinance something in the neighborhood of \$650 million to \$750 million of certificates that are going to come due just in this next year.

Assuming that we have to go ahead and pay somewhere in the neighborhood of 4 percent on that paper, and there is about a billion dollars worth of those certificates coming due in the next year, as I remember the figures, this is the reason that I am saying that you are not completely in possession of all of the current facts in this picture.

Mr. WILDE. I guess I misunderstood you. The bond rate is around 4 percent. You are talking about the individual loans?

Mr. NEWSOM. Yes. But you mentioned the interest charges of a few years ago to farmers being exorbitant at 6 or 7 or 8 percent. Actually, that is where they have already gone to again now.

Mr. WILDE. I am not familiar with such high rates. I know we have been loaning money at $4\frac{3}{4}$ and 5 percent on agricultural loans, Mr. Newsom. And many other companies have been, too. So you must be dealing with special situations. I do not think we are in controversy. We are just talking about different areas, perhaps, or different kinds of credit.

Representative TALLE. Dr. Watkins?

Mr. WATKINS. May I supplement very briefly my statement about the Federal Statistics Users' Conference?

First I want to make clear that the fact the organization is concerned only with Federal statistics does not mean its members believe that only the Federal Government can produce statistics. The Federal Government does not and cannot do the whole job. We do believe the basic statistical contribution must come from the Federal Government because only the Federal Government has the requisite authority. And it is in this area of Federal statistics the Conference seeks to further the common and joint interests of business, farm, labor, and research organizations.

I felt it was particularly important to make this supplementary point because my other hat, my Dun & Bradstreet hat. My company

is probably the world's largest private generator of statistics in our primary job of reporting on 3 million American business concerns and in the various other things we do. As this committee knows, some of our statistical contributions are contained in the Economic Report of the President, in the Statistical Abstract of the United States, and in the Government publication entitled "Historical Statistics of the United States."

Second, I want to make clear that the Federal Statistics Users' Conference is not plugging for more and more statistics. Moreover, we are not interested in statistics for statistics' sake. We are concerned only with purposeful statistics, the statistics we believe are essential to the public and private management of the American economy.

In many situations, we believe the Conference will be able to exercise its influence in the direction of lower costs rather than higher costs for statistics, as was true of the report on the census program that I mentioned to you earlier.

Thank you, Mr. Chairman.

Representative TALLE. Thank you, again.

I believe Mr. Ensley has another item.

Mr. ENSLEY. On page 4 of Mr. Fackler's statement, he is critical of the President's Economic Report for devoting only slightly more than two pages on the short-run outlook. I want to call attention of the panel and the general public to the volume of the hearings on the President's Economic Report, which will contain a panel session with the Council of Economic Advisers. We also had other sessions where Government technicians came in and spelled out in considerable detail their views for 1957, including targets, for labor force, productivity, and all the other factors that have to be considered in order to construct the Nation's budget for 1957, which is, of course, not a prediction or forecast, but merely a set of assumptions on which the Federal Government proceeds.

Mr. FACKLER. Thank you, Mr. Ensley. I assure you that there was no intent on our part to mislead the public or to question thoroughness and competence of the Council of Advisers. It does seem strange, however, that here is the Economic Report from the President to the Congress and it contains such a skimpy assessment of the current economic situation and short-run outlook. After all, the report does have wide distribution outside of Government.

We are also very much aware that this committee takes its responsibilities very seriously. It conducts these extended hearings after receiving the report, augments the report, and does a fine job.

We commend and compliment the committee on its work.

Mr. HENLE. Since Mr. Fackler and I have not always agreed this morning, let me say at this point that I fully agree with the point he just made. It seems to me that one of the things that we on the outside of Government need is a fairly responsible discussion of the short-term trends. For that reason, I certainly am glad that the joint committee staff has gone into this question.

Representative TALLE. You gentlemen will never know how much we who serve in the Joint Economic Committee of the Congress really appreciate your service to us, by coming here to give us your views in written statements and to participate in panel discussions.

Apparently it falls upon me as acting chairman to pronounce a sort of benediction. I want to say that it is really with considerable regret that I do so, because these hearings have been so informative and so stimulating. But the hour has come for me to say that this concludes the hearings of the Joint Economic Committee on the 1957 Economic Report of the President.

On behalf of the entire committee, I want to say "Thank you" to all of the witnesses who have prepared statements and who have participated in the various sessions. We welcome additional written statements from other groups in the interest of preparing the committee better for discharging its responsibility in advising the Congress with respect to the main recommendations contained in the President's Economic Report.

As the chairman stated on the opening day, we hope and expect that the committee's report will be submitted to the House and the Senate before the statutory deadline of March 1, 1957.

Now I ask unanimous consent to insert into this record additional pertinent information which has a bearing on the subjects under discussion, and it is so ordered.

(The materials referred to follow:)

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

JULY 20, 1956.

MEMORANDUM

To: All members, Joint Economic Committee.
From: Senator Paul H. Douglas, chairman.
Subject: Budget estimates for fiscal 1956.

At my request, the committee staff has prepared a memorandum which shows the forecasts of budget receipts and expenditures for fiscal 1956 as they have been previously estimated by the Treasury Department, the staff of the Joint Committee on Internal Revenue Taxation and the staff of the Joint Economic Committee.

The record, as presented in this memorandum, demonstrates that the staff of the Joint Economic Committee has been more timely and more accurate in estimating budget results for fiscal 1956 than the Treasury Department and the Bureau of the Budget. This may be seen by comparing the administration's August 1955 budget review predicting a deficit of \$1.7 billion for fiscal 1956, with the estimate by the committee staff in October 1955 of a balanced budget for 1956.

More recently, the Joint Economic Committee staff on April 18 of this year estimated a \$2 billion surplus for fiscal 1956. As widely reported in the press on April 25, Secretary Humphrey told Republican congressional leaders that the staff's estimate was wrong and reaffirmed his January estimate of a \$200 million surplus. Less than a month later, on May 17, however, the Secretary issued a joint statement with the Bureau of the Budget estimating a \$1.8 billion surplus for fiscal 1956.

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

JULY 20, 1956.

MEMORANDUM

To: Senator Paul H. Douglas, chairman.
From: Grover W. Ensley, executive director.
Subject: Chronology of budget estimates for fiscal 1956.

Pursuant to your request, the staff has prepared the attached memorandum on budget estimates for fiscal 1956. The memorandum traces the changes in the various estimates prepared by the Treasury Department, the Joint Economic Committee staff, and the staff of the Joint Committee on Internal Revenue Taxation.

In its release of July 19, 1956, the Treasury Department announced the budget results for the fiscal year 1956. Net budget receipts were \$68.1 billion, net budget expenditures amounted to \$66.4 billion, resulting in a budget surplus of \$1.8 billion.

These budget results show a marked increase over earlier Treasury Department estimates. In the budget message for fiscal 1956 (presented January 17, 1955), receipts were estimated at \$60 billion and expenditures at \$62.4 billion, leaving an estimated deficit of \$2.4 billion. In the budget review of August 1955, the fiscal 1956 estimates were revised upward to show anticipated receipts of \$62.1 billion and expenditures of \$63.8 billion, resulting in a deficit of \$1.7 billion. The budget message for 1957 (January 16, 1956) presented a further upward revision in receipts for fiscal 1956 to \$64.5 billion and in expenditures to \$64.3 billion, producing an estimated surplus of \$200 million. Finally, in a statement issued on May 17, 1956, the Secretary of the Treasury and the Director of the Bureau of the Budget estimated fiscal 1956 budget results at \$67.7 billion of receipts (an increase of \$3.2 billion over the January estimate) and \$65.9 billion of expenditures (\$1.6 billion over the January figure), yielding an estimated surplus of \$1.8 billion.

In October 1955, the executive director of the Joint Economic Committee staff stated in an address to the National Tax Association that the administrative budget would be about balanced in fiscal 1956. A staff memorandum, *The Economic Situation and Outlook*, dated April 18, 1956, stated that the Federal budget would show an administrative surplus of about \$2 billion for the fiscal year 1956. A statement issued May 16, 1956, by the staff of the Joint Committee on Internal Revenue Taxation estimated the administrative budget surplus at \$2.3 billion for fiscal 1956.

These estimates are summarized in the following table:

[Billions of dollars]

	Receipts	Expenditures	Surplus (+) or deficit (-)
Budget message for fiscal 1956 (Jan. 17, 1955):			
Fiscal 1955, estimated.....	59.0	63.5	-4.5
Fiscal 1956, estimated.....	60.0	62.4	-2.4
August budget review:			
Fiscal 1955, actual.....	60.3	64.5	-4.2
Fiscal 1956, estimated.....	62.1	63.8	-1.7
Statement by Grover W. Ensley to National Tax Association (October 1955): Fiscal 1956, estimated.....	63.8	63.8	-----
Budget Message for fiscal 1957 (Jan. 16, 1956):			
Fiscal 1955, actual.....	60.4	64.6	-4.2
Fiscal 1956, estimated.....	64.5	64.3	+2
Fiscal 1957, estimated.....	66.3	65.9	+4
Joint Economic Committee staff memorandum (April 18, 1956): Fiscal 1956, estimated.....	67.3-68.7	65.3-66.7	+2.0
Joint Committee on Internal Revenue Taxation staff (May 16, 1956): Fiscal 1956, estimated.....	68.1	65.8	+2.3
Treasury-Budget Bureau statement (May 17, 1956): Fiscal 1956, estimate.....	67.7	65.9	+1.8
Treasury statement (July 19, 1956): Fiscal 1956, actual.....	68.1	66.4	+1.8

According to the statement by Marion B. Folsom, former Under Secretary of the Treasury, in a letter dated January 25, 1955, addressed to the chairman of the Joint Economic Committee, the two most important basic assumptions used by the Treasury in estimating tax revenues are personal income and corporate profits. The January 1955 estimate of budget receipts for the fiscal year 1956, according to Mr. Folsom, were based on the assumption that personal income in calendar 1955 would amount to \$298.5 billion, a \$12 billion increase over the then estimated total for 1954 and \$9.5 billion over the then estimated fourth quarter 1954 rate. Corporate profits for calendar 1955 were estimated to total \$38.5 billion, a \$2.5 billion increase over the total of the preceding year and about a \$2 billion decrease from the implied fourth quarter 1954 rate. Subsequent data for 1955 show that personal income for the year was \$306.1 billion, an increase of \$19.2 billion over the preceding year's total, while corporate profits aggregated \$42.7 billion, a \$9.5 billion increase over calendar 1954. Successive upward revisions in estimates of tax receipts in fiscal 1956, accordingly, reflect the impact of the rapid rise in income during 1955, at a rate greater than estimated by the Treasury Department in January 1955.

The Treasury Department's estimates of personal income and corporate profits for calendar 1956 were presented to the Joint Economic Committee by Secretary Humphrey in a letter addressed to the chairman and dated January 18, 1956. The Treasury estimated that personal income would total \$312.5 billion for calendar 1956, an increase of \$10 billion over the total for 1955, as then estimated by the Treasury, and \$300 million over the Council of Economic Advisers' estimate of the fourth quarter 1955 rate. Corporate profits, as estimated by the Treasury, would aggregate \$43 billion in calendar 1956, representing no change from the total for the preceding year, as estimated by the Treasury, but a decrease of \$1.5 billion from the Council of Economic Advisers' estimate of the fourth quarter 1955 rate.

[For release: Friday a. m., June 1, 1956]

CONGRESS OF THE UNITED STATES
JOINT COMMITTEE ON THE ECONOMIC REPORT

MAY 29, 1956.

MEMORANDUM

To: Members, Joint Economic Committee.
From: Senator Paul H. Douglas, chairman.
Subject: Staff memorandum on implications of recent expansion of special amortization program.

Pursuant to my instructions the committee staff has prepared the attached memorandum on the amortization program. They have completed this study and I am sending it to members of the committee. I recognize that it does not necessarily represent the views of the committee or of the individual members, although I understand that the staff consulted with some of the members in its preparation.

Because of its timely interest and factual character, I am releasing it to the public.

CONGRESS OF THE UNITED STATES
JOINT COMMITTEE ON THE ECONOMIC REPORT

MAY 28, 1956.

MEMORANDUM

To: Senator Paul H. Douglas, chairman.
From: Grover W. Ensley, executive director.
Subject: Implications of recent expansion of special amortization program.

There has been a sharp rise during the past 6 months in issuance of certificates of necessity, authorizing 5-year tax amortization of "emergency facilities." The program was initiated in 1950, following the outbreak of aggression in Korea. Its purpose was to encourage a rapid expansion of productive facilities required for national defense by private rather than public funds.

Continuation of the special amortization program may have significantly adverse effects on balanced growth of the economy and efficient use of resources. The benefits of special amortization invest the recipient with relatively greater command over available resources than companies not so favored. Because of the discretionary control over the distribution of the benefits, the usual market tests for assuring maximum effectiveness in use of resources may be, in part, avoided.

Other factors suggesting the need for reappraising the justification of continuing the program under the present circumstances are:

(1) Since the inception of this program in November 1950, 20,916 certificates of necessity have been issued covering private capital outlays totaling \$36.3 billion. Of this amount, \$21.3 billion, or 58.6 percent, has been certified for tax writeoff over 5 years instead of over the ordinary useful lives of the facilities.

During the first quarter of 1956, certificates for \$2 billion of proposed investment were issued, the highest quarterly rate since the second quarter of 1952. Of this amount, \$1.4 billion, or 70 percent, was certified for 5-year writeoff. This is the highest quarterly certification percentage since November-December of 1950.

Over the full period since the inception of the special amortization program, certifications have been concentrated in primary metal manufacturing, power utilities, railroad transportation, chemicals and allied products, and petroleum and coal products. Over one-third of the \$2 billion investment covered by certificates issued in the first quarter of 1956 were in electric power facilities; 29 percent were in railroad transportation facilities; 25 percent were in oil and gas refining, storage, and transporting facilities.

(2) Taxpayers receiving certificates of necessity may obtain substantial financial benefits not generally available to others engaged in the same kinds of economic activity and using noncertified facilities. Since the allocation of these benefits is highly selective and dependent on the action of the certifying authority, continued expansion of the program may have serious consequences for the fairness of tax burden distribution.

(3) Continuation of the special amortization program at first quarter 1956 levels may involve a substantial revenue loss to the Federal Government. As of mid-1955, the Treasury Department estimated the cost of the amortization program in fiscal 1956 at \$880 million. In view of the sharp increase in certification since that date, estimates for subsequent years must be revised upward by a significant amount.

The attached committee staff report examines the current special amortization program since its inception in November 1950. It presents (1) the statutory authority for issuance of certificates of necessity, (2) a description of the size and scope of the present special amortization program, (3) an analysis of the benefits provided taxpayers with facilities entitled to 5-year amortization, (4) estimates of the revenue loss involved, and (5) economic implications of continuing the special amortization program in a peacetime economy.

A draft of this report was submitted to the Treasury Department and the Office of Defense Mobilization. Technical suggestions from the Treasury Department have been incorporated. The comments of Mr. Arthur S. Flemming, Director of the Office of Defense Mobilization, are attached.

IMPLICATIONS OF RECENT EXPANSION OF SPECIAL AMORTIZATION PROGRAM

*Provisions for special amortization*¹

The outbreak of aggression in Korea in 1950 emphasized the need for rapid expansion of productive facilities required for national defense. As a means of encouraging the diversion of resources to defense production by private rather than public funds during a period of prosperity and high civilian demand, the Revenue Act of 1950 amended the Internal Revenue Code of 1939 to provide 5-year amortization, for tax purposes, of emergency facilities. This provision was reenacted in the Internal Revenue Code of 1954 (sec. 168).

Emergency facilities are defined as including "any facility, land, building, machinery or equipment" completed after December 31, 1949, with respect to which a certificate of necessity has been issued. The certificate of necessity authorizes the taxpayer to write off the certified portion of the facility's cost over a period of 60 months instead of over the longer period generally applicable

¹ See par. 3 of Mr. Flemming's letter.

to the facility under the ordinary depreciation provisions of the income-tax law (sec. 167, Internal Revenue Code of 1954).

The Office of Defense Mobilization, rather than the Treasury Department, has been invested with authority to issue certificates of necessity. ODM, upon the advice of delegate agencies, has the responsibility for determining the necessity of various types of facilities to meet the defense production goals set up by ODM and further to determine the essentiality of the specific facilities proposed in individual applications. Moreover, ODM, upon the advice of delegate agencies, is responsible for determining that portion of the facility's cost to which the special 5-year writeoff privilege is applicable.

The criteria, as set forth in ODM regulations, for determining the necessity of facilities are the extent to which the products of the proposed facilities are directly required in defense and defense-related activities in the emergency period, and the extent of any shortage, either current or for standby purposes, of such facilities. Consideration is also to be given to such other factors as new and improved technology, assurance of fair opportunity for participation by small business, the promotion of competitive enterprise, the competence and performance record of the applicant, and the location of the facility with due regard to military security and dispersion criteria.²

In determining the percentage of the facility's cost to be certified for special amortization, the certifying agencies are instructed by regulations to base the certification percentage on the probable economic usefulness of the facility after 5 years and the "additional incentives to the minimum amount deemed necessary to secure the expansion of industrial capacity in the interest of national defense during the emergency period."³ The percentage certified is also to be closely related to such other financial incentives as may be afforded by the Government.

Defense Mobilization Order No. 11 provided that "for purposes of effective administration the Defense Production Administration may establish percentage certification patterns for individual industries. These shall provide a basis from which adjustments upward or downward shall be made * * *. A major objective of the procedure will be to insure that individual firms will not be unduly benefited or prejudiced, as they would be by the flat application of industrywide percentages."⁴

In theory, the objective of special amortization allowances is to overcome the deterrent to private investment in emergency facilities resulting from an anticipated foreshortening of the ordinary useful lives of such facilities. It is maintained that the economically useful life of an emergency facility, particularly if it is highly specialized to the production of defense output, may well be limited to the period required to fulfill a defense contract. Where this limited useful life is anticipated, the taxpayer will be reluctant to acquire the facility if allowed only ordinary depreciation allowances based on the assumption of a longer useful life.

This justification for 5-year amortization was expressed in connection with the adoption of special amortization in World War II.⁵ The (then) observed reluctance by industry to expand capacity was attributed to the general assumption, in the light of the preceding decade of depression, that postemergency demand would not be adequate to sustain, on a profitable basis, the additional industrial capacity required to meet defense needs. Accordingly, * * * some assurance was needed that, in computing income, special allowance would be made for the possibility that war facilities would become useless before the expiration of their normal useful life. In view of the probability that earnings would be high for a brief period, and then might drop, it seemed only fair to permit the cost of the facilities to be taken out of the high income during the period in which it was earned."⁶

² ODM Regulation 1: Issuance of Necessity Certificates Under Sec. 124A (sec. 168, Internal Revenue Code 1954) of the Internal Revenue Code, sec. 2, Code of Federal Regulations, title 32A, revised 1954, pp. 71-72.

³ ODM Regulation 1: Issuance of Necessity Certificates Under Sec. 124A (sec. 168, Internal Revenue Code 1954) of the Internal Revenue Code, sec. 3, Code of Federal Regulations, title 32A, revised 1954.

⁴ Office of Defense Mobilization, Defense Mobilization Order No. 11, 16 F. R. 8098, August 15, 1951.

⁵ Cf. statement by Secretary of War Stimson, joint hearings, before Committee on Ways and Means and Committee on Finance, on excess profits taxation, amortization, and suspension of Vinson-Trammell Act, 76th Cong. (1940), p. 23.

⁶ Robert P. Patterson, Under Secretary of War, A Report to the Secretary of War on the Administration of Section 124 of the Internal Revenue Law Relating to the Issue of Necessary Certificates, March 24, 1945, p. 1.

It was recognized that providing capital cost recovery allowances for tax purposes on this basis might well convey special benefits to taxpayers whose facilities in fact remained economically useful after the emergency. This possibility was considered of secondary importance to the objective of securing the desired expansion of defense capacity.⁷

The same objective, presumably, underlies the enactment of provision for special amortization following the outbreak of hostilities in Korea in 1950. The provision was added by the Senate Finance Committee to the House version of the Revenue Act of 1950 and passed by the Senate with little debate as to the specific occasion or objectives of the provision. However, the regulations adopted by the Office of Defense Mobilization in stipulating that the percentage of the facility's cost to be certified for 5-year writeoff is to be based on estimated post-5-year usefulness, apparently reflect the assumption that industrial capacity acquired for defense purposes will become excessive, in varying degree, after 5 years, thereby requiring special capital recovery allowances.

Size and scope of accelerated amortization program

Between November 1950 and April 18, 1956, 20,916 certificates of necessity were issued. These covered facilities representing \$36.3 billion of total investment, an average of about \$1.7 million per certificate. Of the total investment covered by certificates, \$21.3 billion, or 58.6 percent is eligible for 5-year writeoff.

Table 1 presents certification actions on a quarterly and cumulative basis through April 18, 1956. These data show the rapid growth of the certification program in the first three quarters following its start in November 1950. This expansion evidently exceeded expectations of the ODM and a general moratorium on further issues of certificates was made effective on August 18, 1951. In explaining the purpose of the moratorium, the Defense Production Administration stated that "The moratorium will afford an opportunity for a complete review of administrative procedures and of the criteria on which certificates should be granted and percentages determined. During the early stages of the mobilization program, it was essential to get the expansion of facilities underway as rapidly as possible and the present material shortages were not a factor. As the program moves closer to the realization of expansion goals within specific categories, standards should tighten and adhere to specific rules whenever possible. *This should result in generally lower percentages of amortization although there will be certain instances which will not fit the established pattern.*"⁸

Both the volume of certificates and the amount of proposed investment covered fell off temporarily following this moratorium which was lifted in October 1951. Issues of certificates reached a new peak, however, in the first quarter of 1952, decreasing markedly thereafter through the third quarter of 1955. In the last quarter of 1955, certifications began to increase very sharply, particularly in terms of the total cost of facilities covered.

A further substantial increase in the volume of certifications occurred during the first quarter of 1956. The 364 certificates issued in this period cover facilities with a total cost of \$2 billion, the largest quarterly total since the second quarter of 1952. The average investment per certificate in the period is \$5.6 million, a higher average than in any preceding quarter except the fourth quarter of 1955 and November-December 1950.⁹

In addition, certification percentages were sharply increased in the first quarter of 1956. Between the first quarter of 1952 and the third quarter of 1955, the average certification percentage on quarterly issues ranged from 48 to 63 percent. In the first quarter of 1956, however, the average certification percentage on new certificates was raised to 70 percent. With the exception of certificates issued in November and December 1950, this is the highest certification percentage on quarterly issues since the inception of the current amortization program. If the first-quarter rate of certification were continued through 1956, it would bring the year-end total of covered investment to about \$42 billion, about 61 percent of which would be subject to 5-year writeoff for tax purposes.

⁷ Assistant Secretary of the Treasury John L. Sullivan stated: "I couldn't say to this committee that it is reasonable to except that an ultramodern factory that is to be constructed in the latter part of 1940 or the first part of 1941 * * * is going to be absolutely useless in 1946. I don't think that is 'reasonable,' and yet I believe it is desirable and prudent to grant this amortization to these companies that are putting up new facilities." Hearings before the Committee on Finance, U. S. Senate, 76th Cong., on H. R. 10413, p. 125.

⁸ Defense Production Administration, Defense Programs, Supplement, Federal Aids for Facilities Expansion, September 10, 1951, p. 3. [Italics added.]

⁹ No data are available to indicate in what way, if any, the rate of certification of emergency facilities is related to aggregate plant and equipment outlay plans, and therefore, the extent to which such plans have been affected by changes in certification policy.

TABLE 1.—*Certificates of necessity outstanding: Cumulative and quarterly actions, 1950-56*

[Dollar amounts in millions]

Year and quarter	Quarterly actions				Cumulative total			
	Number of certificates	Cost of facilities ¹	Certified for fast writeoff		Number of certificates	Cost of facilities ¹	Certified for fast writeoff	
			Amount	Percent of cost			Amount	Percent of cost
1950—November to December.....	149	\$1,401	\$1,004	71.7	149	\$1,401	\$1,004	71.7
1951—								
January to March.....	788	3,211	2,232	69.5	937	4,612	3,236	70.2
April to June.....	1,385	3,206	2,091	64.0	2,322	7,878	5,327	67.6
July to September.....	1,767	1,933	1,244	64.4	4,089	9,811	6,571	67.0
October to December.....	1,382	2,160	1,214	56.2	5,471	11,971	7,785	65.0
1952—								
January to March.....	3,524	5,975	3,099	51.9	8,995	17,946	10,884	60.6
April to June.....	3,019	3,951	1,977	50.0	12,014	21,897	12,861	58.7
July to September.....	1,934	1,984	990	49.9	13,948	23,881	13,851	58.0
October to December.....	1,051	1,368	700	51.2	14,999	25,249	14,551	57.6
1953—								
January to March.....	1,214	1,555	874	56.2	16,213	26,804	15,425	57.5
April to June.....	1,267	1,558	769	49.4	17,480	28,362	16,194	57.1
July to September.....	751	1,014	507	50.0	18,231	29,376	16,701	56.9
October to December.....	524	890	456	51.8	18,755	30,256	17,157	56.7
1954—								
January to March.....	377	527	285	54.1	19,132	30,783	17,442	56.7
April to June.....	425	678	381	56.2	19,557	31,461	17,823	58.7
July to September.....	339	457	279	61.1	19,896	31,918	18,102	56.7
October to December.....	264	233	116	49.8	20,160	32,151	18,218	56.7
1955—								
January to March.....	265	465	292	62.8	20,425	32,616	18,510	56.8
April to June.....	390	589	296	50.3	20,815	33,205	18,806	56.6
July to September.....	224	812	388	47.8	21,039	34,017	19,194	56.4
October to December.....	314	1,812	1,095	60.4	21,353	35,829	20,289	56.6
Less: Net adjustment not allocable to periods.....					874	1,748	526	
Subtotal (November 1950 to December 1955).....					20,479	34,081	19,763	58.0
1956—								
January to March.....	364	2,047	1,432	70.0	20,843	36,128	21,195	58.7
April 5 to April 18, 1956.....	73	217	108	49.8	20,916	36,345	21,303	58.6

¹ Estimated total cost of projects as shown on applications.

Source: Office of Defense Mobilization.

According to advice from the Office of Defense Mobilization, much of the increase in certification during the last quarter of 1955 and the first quarter of 1956 reflects a cleanup of pending applications, following the closing off of a number of expansion goals at the end of 1955. On August 11, 1955, ODM issued DMO-6, Supplement 1, closing 19 expansion goals and suspending 38 others. The Defense Mobilization Director announced, in connection with this action, that sufficient facilities or capacity to meet defense needs were available in the areas of the closed goals and that all pending applications falling within these closed goals were to be denied. The 38 suspended goals, it was announced, were to be reviewed "to determine whether adequate productive capacity exists to meet defense mobilization needs." Until such determination was made, there was to be no further processing of pending applications nor receipt of new applications.¹⁰

On September 29, 1955, ODM announced the results of its review of the suspended goals. Of the 38 suspended goals, 11 were reopened, 25 were closed, 1 remained suspended, and the last was closed September 22, 1955. Ten of the reopened goals were revised, in most cases upward, while five of the goals which had remained open on August 11 were revised, primarily to extend the target date.

¹⁰ Office of Defense Mobilization, DMO-6, Supplement 1, August 11, 1955, and ODM Release No. 416, August 11, 1955.

These actions on September 29, 1955, are summarized as follows:¹¹

"The commercial carrier aircraft goal was increased to 900 aircraft for which firm orders must be placed by December 31, 1955. The original goal was for 600 aircraft on which production was to begin before June 30, 1955.

"The domestic petroleum goal which called for refining capacity of 8,750,000 barrels a day by January 1, 1956, was increased to 9 million barrels a day by January 1, 1957.

"Applications for necessity certificates on the electric power, high voltage switchgear, and power and distribution transformer expansion goals must be filed by the close of business December 31, 1955, to be eligible for consideration.

"The freight-car goal will cover those cars for which construction is authorized or firm orders placed by December 31, 1955.

"The target date for the expansion goal of manganese ore of battery and chemical grades was extended to December 31, 1955.

"The expansion goal for domestic production of synthetic glycerin was increased 57 million pounds to 185 million pounds of annual capacity for which applications for necessity certificates must be filed by June 30, 1956. No change was made in the natural glycerin segment of the goal.

"The expansion goal for the supply of chemical grade chromite for chemical use was set at 225,000 long tons of annual production to be reached by December 31, 1956.

"The rutile expansion goal was raised 10,000 tons to 35,000 tons to be achieved by December 31, 1955.

"Five goals on the open list were revised as follows:

"The alkylate goal was revised to provide 55,000 barrels of productive capacity a day by January 1, 1957 an increase of 25,000 barrels a day.

"The research and development laboratory expansion goal was confined to cover only those laboratories having contracts directly relating to defense research and development. The construction of such laboratories must be completed by December 31, 1956.

"The target date for the supply of mercury was advanced to December 31, 1957.

"The selenium-expansion goal was confined to primary domestic sources of supply and the target date advanced to June 30, 1958.

"The target date for the supply of copper was extended to December 31, 1955."

In its September 29 release, ODM also announced that applications received after August 11 on any of the goals closed on September 29 would be denied. Those pending on August 11 were to be denied unless qualifying under the following rules.¹²

"(a). Any application filed more than 60 calendar days prior to the date of suspension or closing of the applicable goal, whichever is earlier, shall be considered for certification under the terms and conditions of the expansion goal involved.

"This means that applications will be eligible for certification on the basis of priority of filing and other factors to the extent of the unfilled portion of the goal at the time of suspension.

"(b) Any application filed within 60 calendar days prior to the date of suspension or closing of the applicable expansion goal, whichever is earlier, shall be considered for certification only when it is determined by the Government that an application covering similar facilities, filed on the same or a later date, was certified."

On April 3, 1956, ODM announced that applications on file when the 25 expansion goals were closed September 29, 1955, would now be considered for certification within the terms of the goals involved. It was stated that "the retroactive feature contained in the September 29 rule was rescinded because it created inequities and did not conform to past administrative practices under which were processed all applications pending when an expansion goal was closed."¹³ This action was expected to involve 85 applications covering proposed investments totaling \$139 million.¹⁴

¹¹ Office of Defense Mobilization, Release No. 439, September 29, 1955.

¹² Office of Defense Mobilization, Release No. 439, September 29, 1955.

¹³ Office of Defense Mobilization, Release No. 488, April 3, 1956.

¹⁴ *Ibid.*

The Office of Defense Mobilization claims that as a result of the changes in expansion goals and recent certification, further consideration may be expected to fall off markedly.¹⁵ However, between April 5 and May 9, 1956, about \$500 million in additional facilities have been certified.

Table 2 shows the distribution of certificates of necessity, as of December 28, 1955, by broad industry groups. Of the \$34.1 billion of total investment covered by certificates outstanding at the end of 1955, about \$17.6 billion were in nonmanufacturing industries. Public utilities and sanitary services accounted for about \$6.4 billion, and railroads about \$5.0 billion. In manufacturing industries, about \$5.7 billion of certified investment were in the primary metals industries, about \$3.0 billion in chemicals and allied products, and about \$2.7 billion in petroleum and coal products.

Average certification percentages ranged from 26 percent in the case of pipeline transportation facilities to 79 percent in the case of air transportation facilities. Certificates issued with respect to facilities in primary metal manufacturing, mining, and ordnance have averaged 69.3 percent, 66.9 percent, and 66.0 percent, respectively.

TABLE 2.—*Distribution of outstanding certificates of necessity by industry group, as of Dec. 28, 1955*

[Dollar amounts in millions]

Major industries	Number of certificates outstanding	Cost of facilities ¹	Certified for fast writeoff	
			Amount	Percent of cost of facilities
Total, all industries.....	20,479	\$34,081	\$19,763	58.0
Total, manufacturing industries.....	13,477	16,487	10,174	61.7
Primary metal industries.....	1,715	5,654	3,921	69.3
Chemical and allied products.....	1,060	2,989	1,597	53.4
Products of petroleum and coal.....	621	2,715	1,658	61.1
Transportation equipment.....	2,423	1,266	815	64.4
Machinery (except electrical).....	3,160	866	515	59.5
Pulp, paper and board mills.....	117	812	419	51.7
Electrical machinery, equipment and supplies.....	1,211	550	322	58.6
Ordnance and accessories.....	1,116	347	229	66.0
Other manufacturing industries.....	2,064	1,288	697	54.1
Total nonmanufacturing industries.....	7,002	17,594	9,589	54.5
Utilities and sanitary services.....	920	6,417	2,834	44.2
Railroads.....	2,114	5,042	3,262	64.7
Mining.....	609	2,316	1,550	66.9
Pipeline transportation.....	235	1,263	329	26.0
Water transportation.....	745	897	533	59.4
Air transportation.....	43	560	443	79.1
Other nonmanufacturing industries.....	2,336	1,098	640	58.2

¹ Estimated total cost of projects as shown on applications.

Source: Office of Defense Mobilization.

The certification actions in the first quarter of 1956 show a sharp increase in the proportion of certificates issued for electric power, railroad transportation, air transportation, and petroleum and gas products refining, transporting, and storage facilities. These four classes of facilities account for over \$1.9 billion of the total \$2 billion of proposed investment covered by certificates issued during the first 3 months of 1956. Electric power facilities account for \$753 million or about 37 percent, railroad facilities amount to \$576 million or about 29 percent, air transportation facilities total \$510 million or 25 percent, and oil and gas facilities \$112 million or about 6 percent.¹⁶

No official data covering the entire period of the current amortization program are available to show the distribution of certificates of necessity between

¹⁵ See pars. 4, 5, and 6 of Mr. Flemming's letter.

¹⁶ It would be helpful, in evaluating the amortization program, to be able to relate the type of facilities certified to Government expenditures for defense purposes. Unfortunately, the industry classifications of certifications are too broad to be of use in this connection.

small and large companies. It has been unofficially estimated, however, that roughly 32 percent of the certificates issued in 1954 went to small business, all of the certificates issued, accounting for only 8 percent of covered investment, covered by certificates issued that year. In 1955, it is estimated that 19 percent of the certificates issued, accounting for only 8 percent of covered investment, went to small companies.

Taxpayer benefits from special amortization

A certificate of necessity authorizes the taxpayer to write off the certified portion of the facility's cost over 5 years instead of over the ordinary useful life of the asset. By virtue of the excess of special amortization allowances over ordinary depreciation allowances during the 5-year amortization period, the taxpayer's taxable income with respect to any given amount of gross income during this period is reduced. After the 5-year period, of course, taxable income is greater than it would have been had ordinary depreciation allowances been claimed throughout. Accordingly, special amortization allowances permit the taxpayer to postpone the payment of part of the taxes otherwise due on the income produced by the certified facility for a period of 5 years. This postponement is sometimes characterized as an interest-free loan by the Government to the taxpayer claiming amortization allowances. In the event that tax rates are lower in the period following the 5-year amortization period, the loaned tax funds will not be fully repaid.¹⁷ If tax rates rise in the period of economic usefulness of the asset after the 5-year amortization period, of course, the loaned tax funds may be more than repaid.

The value of the interest-free loan provided by special amortization to the taxpayer at the time the acquisition of an amortizable facility is being considered depends on (1) the useful life of the facility for ordinary depreciation purposes; (2) the marginal tax rates applicable during the 5-year amortization period and afterward; and (3) the cost, actual or imputed, to the taxpayer for investable funds. This may be illustrated by reference to a taxpayer who, at the beginning of 1951, acquired an emergency facility with a normal useful life of, say, 20 years. If the taxpayer was subject to the excess profits tax, the applicable marginal tax rate during the first 3 years of the amortization period (1951-53) was 82 percent and during the last 2 years of the period (1954-55), 52 percent. Assuming a marginal tax rate of 52 percent for 1956 and afterward and a cost of 6 percent for investable funds, the present value, at the time the facility was acquired, of net benefits to the taxpayer would be \$260,157, or 26 percent of each \$1 million of amortizable investment. Had the facility had an ordinary useful life of 30 years, the net benefits would have been \$333,154 or 33 percent for each \$1 million of amortizable investment.¹⁸

Ordinary depreciation allowances on new facilities acquired after December 31, 1953, may be computed by use of the sum-of-the-years digits method or the declining-balance method, instead of the straight-line method. The former types of depreciation allowances provide some acceleration of writeoff compared with straight-line depreciation. The benefits provided by 5-year amortization of facilities eligible for sum-of-the-years digits or declining-balance depreciation, therefore, are somewhat less than those in the case of facilities on which ordinary depreciation would be computed by the straight-line method. For example, on 20- and 30-year facilities currently being certified for special amortization, the benefits for each \$1 million of amortizable investment would be, respectively, \$86,049 and \$135,484, assuming a marginal tax rate of 52 percent throughout the life of the facilities, compared with \$139,872 and \$199,504, if ordinary depreciation were computed under the straight-line method.

¹⁷ See par. 7 of Mr. Fleming's letter.

¹⁸ In computing these benefits, it is assumed that ordinary depreciation allowances would be computed by use of the straight-line method. If the sum-of-the-years digits method, first provided in the Revenue Code of 1954 for new assets acquired after December 31, 1953, had been available and in use in the earlier period, the benefits would have been \$173,850 and \$245,801, respectively, for each \$1 million amortizable investment in a 20-year and a 30-year asset.

The prospective character of these benefits should be emphasized. As stated above, they measure the difference in the present value of future tax deductions under special amortization and under ordinary depreciation. Alternatively, these benefits may be expressed retrospectively, that is, what they will have amounted to at the end of the facility's useful life. For example, in 1981 the taxpayer who acquired the 30-year asset in 1951 will have accrued, under the stated assumptions, net benefits of \$1.9 million with respect to each \$1 million of amortizable investments.

These benefits assume that the facility will remain economically useful to the taxpayer for its full ordinary useful life. If the taxpayer expects the facility to be economically useful for a somewhat shorter period, some portion of the benefits received from 5-year amortization may be regarded as necessary to offset the resulting deterrent to acquisition of the facility. Since the benefits from 5-year amortization depend in part on the percentage of the facility's cost certified for accelerated writeoff, the difference between the percentage actually certified and the percentage which reflects the expected reduced period of usefulness provides additional benefits to the minimum amount deemed necessary to secure the needed expansion.¹⁹ For example, in the case of a \$1 million facility expected to remain economically useful for the full 30 years of its ordinary useful life, all of the \$88,065 benefits afforded by a 65 percent certificate would represent such additional benefits. On the other hand, if this facility were expected to remain economically useful only for 20 years of its 30-year ordinary useful life, the \$88,065 benefits afforded by a 65 percent certificate would fall short of the amount necessary fully to offset the resulting deterrent to its acquisition. Or if the facility were expected to remain economically in use for 25 years, \$38,342 of the \$88,065 benefits would represent additional benefits.²⁰ Accordingly, differences in expectations among applicants for certificates of necessity involve corresponding differences in the amount of incentive afforded by any given certification percentage in excess of that required to offset the deterrent to investment resulting from an expected reduction in the useful life of the facility below ordinary. Failure to take due account in certification actions of such differences, therefore, may result in some taxpayers receiving substantially more benefits than others with respect to virtually identical investments.

If the certification percentage were in fact an accurate reflection of the certifying authority's estimate of the post-5-year usefulness of the facility, the recent high rate of certification percentages would indicate an extremely bearish outlook with respect to the economy's growth prospects. A very large proportion of recent certifications involved such basic industrial resources as electric power generating and transmission facilities and railroad facilities, with respect to which the average useful life for ordinary depreciation purposes is about 30 years. Recent certification percentages have ranged from 35 to 65 percent on electric power facilities and up to 85 percent on railroad facilities, implying anticipation of a substantial foreshortening of their ordinary useful lives.

According to advice from the Office of Defense Mobilization, however, no attempt is made with respect to each application, as required by regulations still in force, to adduce expected post-5-year usefulness in determining the percentage of proposed investment to be certified for accelerated writeoff. Certification percentages, apparently, are set for types of facilities without reference to the particular circumstances of the applicant, on the basis of predetermined expansion goals. Should it develop that the percentage set with respect to a given type of facility is too low to bring forth the expansion necessary to meet this predetermined goal, the percentage is raised for future certification. Too high an initial percentage results in an earlier meeting of goals than anticipated and a consequent shutting off at an earlier date than anticipated of further certifications for the type of facility involved.

It may well be argued that, despite specific requirements in the regulations, certifying authorities cannot be expected to estimate post-5-year usefulness with respect to each application because of the lack of adequate data upon which to base such estimates. So long, however, as the certification percentages do not accurately measure post-5-year usefulness, wide disparities may be expected in the amount of benefits derived by different taxpayers from the 5-year writeoff privilege with respect to identical facilities.

*Revenue effects of special amortization allowances*²¹

As indicated previously, special amortization allowances result in a deferral of tax liability with respect to income produced during the 5-year amortization period. By virtue of the decrease in depreciation deductions in the post-5-year period, taxable income, hence tax liabilities, are greater than would have resulted had ordinary depreciation been claimed in the first 5 years. The deferred taxes

¹⁹ ODM, Defense Mobilization Order No. 11.

²⁰ These calculations assume a 6-percent cost of investable funds, use of the sum-of-the-years digits method for ordinary depreciation purposes, and a 52 percent marginal tax rate throughout.

²¹ See par. 8 of Mr. Flemming's letter.

are, therefore, repaid over the period from the sixth to the last year of the facility's useful life. In the case of a 30-year facility, for example, the reduction in tax liabilities afforded by special amortization during the first 5 years is matched by an equal aggregate increase in taxes over the last 25 years of the facility's life. If, however, tax rates fall in the post-5-year period, the full amount of the taxes deferred during the amortization period will not be repaid to the Government. Assuming no change in tax rates over the full useful life of the certified facilities, the ultimate cost to the Government is measured by the interest cost on the deferred taxes.

Secretary of the Treasury Humphrey, in appearing before the Subcommittee on Legal and Monetary Affairs of the House Government Operations Committee on July 18, 1955, estimated the decrease in tax collections from special amortization at \$880 million for the fiscal year 1956 and \$810 million for the fiscal year 1957. For fiscal years 1958 through 1960, an additional decrease in tax collections, amounting to \$1.1 billion, was estimated. In the fiscal years 1961 through 1965, on the other hand, tax collections would increase, as a result of the exhaustion of amortization allowances by an aggregate amount of \$1.7 billion. For the whole period 1951 through 1965, a net loss in tax collections of \$2.8 billion was estimated, although some portion of this would be recovered, presumably, following 1965. These estimates, however, were based on certificates outstanding as of June 29, 1955, and must be revised upward in view of the substantial increase in certified investment since that time. The Treasury's estimates are presented in tables 3 and 4.²²

It is sometimes argued that this type of computation overstates the cost of special amortization allowances by failing to take into account the higher level of income generated by the investment for which certificates of necessity were issued. On the other hand, since the current amortization program has coincided with a generally high level of economic activity, marked on the whole by very low levels of idle resources, any investment induced by special amortization allowances may be presumed to have been at the expense on noncertified capital outlays. Accordingly, it is problematical whether the special amortization program has been responsible for any substantial net additional real investment.

Economic implications of further extension of special amortization

In his appearance before the Subcommittee on Legal and Monetary Affairs of the House Government Operations Committee, Secretary Humphrey stated the opposition of the Treasury Department to further extension of the special amortization program in the following terms:

"Emergency amortization served a useful purpose during the early phases of rebuilding and expanding defense-plant capacity to meet that emergency. However, the accelerated tax writeoff is an artificial stimulus of a dangerous type. Its indefinite continuance involves the very real danger that interests receiving the benefits of it come to rely upon it to the detriment of others who are not so favored. A defense mobilization program on a substantial scale may be essential for years to come. Expansion of our defense facilities should be an integral part of our broad, orderly, long-range, natural economic growth. Our basic defense capacity cannot soundly be separated from the broad base of productive capacity in general on which our Nation relies for its economic strength. Artificial stimulants may well become artificial controls. Because this one is not of universal application but is bestowed only upon some who especially qualify as against others who do not, it could become a hindrance to sound, balanced, vigorous growth of our whole free economy. It is not the American way.

²² Cf. Annual Report of the Secretary of the Treasury for the Fiscal Year Ended June 30, 1955, exhibit 26, pp. 233-235.

TABLE 3.—Effect of allowance of emergency amortization certificates: based on certificates of \$30,521 million issued through June 29, 1955

[In millions of dollars]

Calendar year	Value of completed projects ¹	Amount subject to accelerated amortization	Normal depreciation ²		Accelerated amortization	Excess of accelerated amortization		Decrease in tax liabilities under accelerated amortization ³ as compared to—	
			Straight line	Declining balance		Straight-line depreciation	Declining-balance depreciation	Straight-line depreciation	Declining-balance depreciation
1950.....	700	420	6	6	21	15	15	7	7
1951.....	4,167	2,500	87	87	292	205	205	113	113
1952.....	9,683	5,810	249	249	531	582	582	308	308
1953.....	16,000	9,600	463	463	1,541	1,078	1,078	593	593
1954.....	22,000	13,200	684	787	2,280	1,596	1,493	798	747
1955.....	26,594	15,956	875	1,132	2,895	2,020	1,763	1,010	882
1956.....	28,244	16,946	987	1,279	2,999	2,012	1,720	931	796
1957.....	29,479	17,637	1,038	1,289	2,633	1,595	1,344	718	605
1958.....	30,521	18,313	1,079	1,279	2,060	881	781	441	351
1959.....	30,521	18,313	1,098	1,228	1,883	285	155	128	70
1960.....	30,521	18,313	1,098	1,146	743	-355	-403	-160	-181
1961.....	30,521	18,313	1,098	1,080	372	-720	-708	-327	-319
1962.....	30,521	18,313	1,098	1,037	200	-898	-837	-404	-377
1963.....	30,521	18,313	1,098	1,000	63	-1,035	-937	-466	-422
1964.....	30,521	18,313	1,098	967	-----	-1,098	-967	-494	-435

¹ End of year. These estimates are based on the O. D. M. reported figures, but are modified in order to reconcile with corporate amortization deductions for 1951 and 1952.

² Straight-line depreciation rate assumed is 6 percent. Amounts shown for declining-balance depreciation assume that all certificate holders use this method for assets acquired after Jan. 1, 1954; switching to straight-line when it becomes advantageous.

³ Computations based on effective tax rates reflecting rate decrease on Apr. 1, 1956, scheduled under present law. Minus figures indicate tax liability increase.

Source: Annual Report of the Secretary on the State of the Finances, for the Fiscal Year Ended June 30, 1955, p. 234.

TABLE 4.—Effect of allowance of emergency amortization certificates

[In millions of dollars]

	Decrease in tax collections ¹		Decrease in tax collections ¹
1951.....	4	1959.....	370
1952.....	77	1960.....	87
1953.....	266	1961.....	-167
1954.....	509	1962.....	-310
1955.....	776	1963.....	-374
1956.....	830	1964.....	-420
1957.....	810	1965.....	-434
1958.....	625		

¹ Assumes certificate holders use declining-balance method for assets acquired after Jan. 1, 1954. Minus figures indicate tax-collection increases.

Source: Annual Report of the Secretary of the Treasury on the State of the Finances, for the fiscal year ended June 30, 1955, p. 235.

"Moreover, I think it important to remember, in any consideration of the problem, that several recent changes in the tax laws have substantially altered the tax picture which existed when accelerated amortization of emergency facilities was first adopted. Then we had an excess profits tax which took up to 82 percent of the profits from corporate business, and thereby tended to discourage large expenditures for new plant facilities. That tax was repealed as of January 1, 1954. The new liberalized depreciation methods under the 1954 Internal Revenue Code now permit faster capital recovery by all taxpayers equally and meet the basic needs of the whole economy. This reduces the need for singling out particular taxpayers or particular facilities for more favorable treatment than others receive.

"A highly selective program may well have merit if it is strictly limited to very special cases: where there is present and pressing need for goods that would be a 'must' in time of war and which cannot be met by present facilities and where Government contribution is necessary to meet those goals. I suggest, how-

ever, that the broader the program, the more it extends into areas other than the direct production of goods that are directly needed for war, the more difficult it becomes to administer wisely, without essentially arbitrary or discriminatory results.

"Indeed, the very existence of such a program may lead some taxpayers to construct facilities deliberately colored to meet supposed defense needs. The tax benefits often could more than absorb the waste and extra expense to the taxpayer, but it hardly would be good for the economy.

"The revenue effects of the program are significant. I shall present three statistical tables to the committee. They have been prepared by the Treasury staffs. These tables will give you the facts, and our estimates of the direct dollar impact of the present program on the revenue. You will note that the estimated revenue loss this fiscal year will be \$880 million. With our budget not in balance, this figure gives us serious concern. Extension of the program well may stand in the way of future more general tax reductions for all taxpayers which would be of important assistance to all business and to our continued economic growth and expansion.

"Finally, I should like to speak very frankly about this use of the tax laws to further special programs and accomplish purposes other than simply the collecting of taxes. The power to tax is the power to destroy and revenue laws should be used only to equitably raise revenue, not for other indirect purposes. It is dangerous to use the tax laws for social purposes, to favor one citizen or group of citizens over others, to exercise economic controls, or to indirectly subsidize any segment of our economy.

"If, in the wisdom of the Congress, such subsidies or assistance to special communities or for special purposes are desired, then appropriations should be made for the purpose which can be submitted to the Congress through regular channels where the amounts will be well known and where the Congress specifically can vote in favor of or in opposition to special treatment for any group. Under this program of tax reduction in special cases, our net revenues can be reduced and our deficits increased without formal action or appropriations by the Congress. This use of the tax laws, where the stimulants are applied by men, not by law, is appropriate only in an emergency or under special conditions under rigid restrictions when usual procedures are inadequate for our protection."²⁸

Perhaps the most serious implication of the special amortization program is the control over the allocation and use of resources which the program invests in the certifying authority. The authority of the Office of Defense Mobilization to establish expansion goals for industrial capacity and to extend substantial tax privileges on a selective basis as a means of meeting these goals serves to replace, at least in part, the impersonal operation of the free market system. A fundamental question, therefore, concerns the ability of a Government agency to affect the course of development of the entire economy through its authority to determine expansion goals. Moreover, companies obtaining special amortization allowances secure thereby relatively greater control over available resources at the expense of other companies not so privileged. In issuing certificates of necessity which confer this privilege, however, there is no way in which the certifying authority can be sure that the recipient company will use the additional resources it acquires as efficiently as other companies. This substitution of Government agency authority for impersonal market tests for the allocation of resources, therefore, involves a considerable danger of reduced efficiency in the economy's operation.

The recent acceleration of the special amortization program, with its emphasis on electric utility, railroad, air transport, and oil and gas facilities brings another aspect of this situation into sharp focus. There is widespread agreement with respect to the desirability of expansion of the economy's basic industrial resources. It has recently been emphasized, however, that it is necessary to avoid imbalances in the process of economic growth lest the resulting instability bring the growth process to a halt. Public policy which promotes the expansion of one kind of industrial activity at the expense of others necessarily involves "a value judgment with respect to the type of economic activity most essential to the process of economic growth. We must be keenly sensitive to the weight of responsibility we assume if such decisions, which traditionally we are inclined to leave to the mechanism of the price system in the market, are made. Errors in making these value judgments may prove very costly in terms of the efficiency with which scarce economic resources are used and therefore in terms of the

²⁸ Annual Report of the Secretary of the Treasury, op. cit.

growth in living standards and productive capacity of which the economy is capable."²⁴

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF DEFENSE MOBILIZATION,
Washington, D. C., May 17, 1956.

Mr. GROVER W. ENSLEY,
Executive Director, Joint Committee on the Economic Report, Congress of the United States, Washington 25, D. C.

DEAR MR. ENSLEY: I have read with interest the draft of the staff memorandum "Implications of recent expansion of special amortization program" and the covering note which you sent me on May 9, 1956.

Because of the very limited time available for commenting on the memorandum this letter cannot be as detailed as I would like.

The section devoted to the "Provisions for special amortization" seems to me to cover satisfactorily the question of the statutory authority on which the tax amortization program was based.

In general explanation of the recent increase in the number and value of certificates issued, as evidenced by the reports covering the fourth quarter of 1955 and the first quarter of 1956, it should be noted that certificates issued under three expansion goals, those covering aircraft, freight cars and electric power, constituted the majority of the totals for those quarters. A backlog of applications which had been held pending decisions as to when to close those goals, was certified when those decisions were made. The three goals in question have now been filled by pending applications.

The planes, freight cars and power generating stations which have recently been certified will contribute substantially to mobilization readiness. The remaining open goals, of which there are now 30 as compared with 220 in 1953, cover mainly Department of Defense and Atomic Energy Commission procurement requirements, research and development in the guided missile field and certain strategic materials. During the period beginning January 1, 1956, the number of new applications has been appreciably reduced and now averages around fifteen a week. The level of certification will decline correspondingly.

The recent increases in percentages certified have been due to the types of facilities still needed for defense, rather than to an increase in the percentage allowed for a given industry or product. The percentage of certification for aircraft is high, but the net advantage is reduced by the fact that normal depreciation is very rapid.

Your conclusion that accelerated tax amortization constitutes primarily an interest-free Government loan to the taxpayer and simply "postpones the payment of part of the taxes otherwise due on the income produced by the certified facility" is a fair statement, although computation of actual benefits varies widely among certificate holders, of course, because of many special factors in specific cases.

Accelerated tax amortization is commonly of assistance to the construction of a facility and entails some loss of revenue. The single justification for these results under the existing statute is a contribution to the national defense. The ultimate test of the program cannot be expressed in any other way: Is the gain to the national defense commensurate with the cost in tax revenue?

Sincerely yours,

ARTHUR S. FLEMMING, *Director.*

To Full Committee:

OCTOBER 17, 1956.

To: Senator Paul H. Douglas, chairman.
From: Grover W. Ensley, executive director.
Subject: Report on recent trip abroad.

ECAFE meeting in Bangkok, September 17-29

As you know, during the last half of September I served as chairman of the United States delegation to a working party on economic development and planning of the United Nations Economic Commission for Asia and the Far East. The discussion dealt with development policies and programs. A copy of my report to the State Department is attached.

²⁴ Federal Tax Policy for Economic Growth and Stability, report of the Joint Committee on the Economic Report, S. Rept. No. 1310, 84th Cong., 2d sess.

The working party agreed to a report which will be submitted to the United Nations. I was able to bring only one copy of this report from Bangkok, as approved. Additional copies will be available in due time for circulation to members of the committee. I have filed a confidential report with the Secretary of State dealing with individual countries, personalities and observations with respect to a number of matters. If you are interested in looking it over, I will bring it to your office for you to read at a time convenient to you.

Visit to Soviet Union

On my way to Bangkok I traveled 6 days in Russia. The highlight of this visit was a 3-hour discussion with seven top intellectual economists of the Academy of Science in Moscow. I was accompanied at this meeting by the chief of the economic section of the United States Embassy. The purpose of the interview was to gather information on "Trends in economic growth"—a study underway by the Subcommittee on Foreign Economic Policy.

I have been told that this was an unprecedented conference in that the Kremlin exposed me to so many of its top economists. The discussion was frank and covered basic differences in philosophy and approach. Working through our Embassy, I left additional written questions which the Soviet Government has indicated it may answer. When these materials are received by our Embassy in Moscow I will wrap the entire body of material in a memorandum or article. In the meantime, if you have specific questions with respect to this meeting, I will be happy to fill you in.

Visit to Tokyo

Returning via Tokyo I gathered some information on the Japanese textile industry. We are doing additional research on this important problem. Once these materials are assembled we will forward them to you.

The Swiss watch industry

On my way to Bangkok I visited the modern Gruen watch plant at Bienne, Switzerland. I also interviewed other representatives of the Swiss watch industry. This served as some followup of the recent study of the Foreign Economics Policy Subcommittee on defense essentiality. The Swiss watch industry, of course, is concerned about our future tariff policy, even though the increases in United States rates in 1954 were, by and large, offset by increased demand for Swiss watches from other parts of the world.

Everywhere I stopped, the United States embassies were very anxious to discuss economic trends in the United States, and in most cases meetings were held with local government officials, academic economists and research groups. We hope that these meetings will be beneficial to the committee staff in helping to serve the committee better in the months ahead.

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

OCTOBER 17, 1956.

The Honorable JOHN FOSTER DULLES,

Secretary of State,

Department of State, Washington, D. C.

(Attention: Office of International Conferences.)

DEAR MR. SECRETARY: Attached is a copy of my report as chairman of the United States delegation to the working party on economic development and planning of the United Nations Economic Commission for Asia and the Far East, September 17-29, 1956.

Sincerely yours,

GROVER W. ENSLEY, *Executive Director.*

REPORT OF THE UNITED STATES DELEGATE TO THE MEETING OF THE ECONOMIC COMMISSION FOR ASIA AND THE FAR EAST WORKING PARTY ON ECONOMIC DEVELOPMENT AND PLANNING, BANGKOK, THAILAND, SEPTEMBER 17-29, 1956

1. Background

The first ECAFE working party on economic development and planning met in Bangkok in October and November 1955. The subject of that meeting was: "Problems and Techniques of Economic Development Planning in Asia and the Far East." In its report, the first working party recommended that a second

meeting of the group be called to discuss means of implementation of development programs. Pursuant to that recommendation, a second meeting of the working party was held in Bangkok from September 17 through 29, 1956. The Secretariat prepared and circulated a working paper entitled "Development Policies and Means for Implementation of Development Programs, with Special Reference to ECAFE Countries" along with a provisional agenda for the meeting. This document was received in Washington August 18. Participating governments and several specialized agencies were invited to submit papers along with the Secretariat's paper, as a basis for the working party's discussions.

2. Agenda

The following agenda, the provisional draft of which was circulated to member governments on April 17, 1956, was unanimously adopted by the working party at its first session on September 17, 1956:

1. Major policy questions in economic development:
 - (a) Resolving possible conflicts among objectives;
 - (b) Determining the general approach;
 - (c) Deciding on the character and extent of planning and programming.
2. The government's "direct" means of implementation:
 - (a) Role of public investment;
 - (b) Magnitude and pattern of public investment;
 - (c) Forms and problems of organization and administration in public and semipublic enterprise.
3. Means of implementation that promote or regulate private action ("indirect" means):
 - (a) Monetary and credit policy;
 - (b) Fiscal policy and taxation;
 - (c) Foreign trade, exchange and investment policy;
 - (d) Direct controls;
 - (e) Social and institutional policies;
 - (f) Interrelation and coordination of "indirect" means.

3. Participation

Of the 22 member governments, Laos and Nepal were the only governments not represented at the meeting. A list of participants is attached (attachment No. 1). The United States representative was Dr. Grover W. Ensley, executive director, Joint Economic Committee, United States Congress. Mr. Edwin M. Cronk, first secretary, United States Embassy, Seoul, Korea, served as an adviser.

4. Election of chairman and vice chairmen

The working party unanimously elected the representative from Burma, U Mo Myit, chairman. The Australian representative, Mr. P. J. Lawler, and the representative of Thailand, Mr. Bundit Kantabutra, were elected vice chairmen.

5. Order of discussion

Mr. C. V. Narasimhan, the executive secretary, outlined in his opening remarks the general content of the discussion which was to follow. In his words, the discussion might "begin with an attempt to clarify certain major policy questions—the implications of the partly open and partly concealed conflicts often found to exist among the objectives of a development plan; the main considerations involved in deciding on how to combine the 'direct' and the 'indirect' means of enlarging the available resources, utilizing them more fully, and arranging them in better combinations or patterns; and the practical issues involved in deciding on the kind and amount of planning and programming needed. After this it is suggested that the meeting take up what we have called the question of the government's 'direct' means of implementation, that is, direct public investment and public enterprise. Here it should be possible to have a very useful exchange of experience and views on such subjects as the general role of public investment in different countries, its present and its desirable magnitude, its distribution among the various basic facilities and services (the economic and social overhead items or, seen from another angle, the 'infrastructure' items), its entry into industry as such, the forms of organization and administration in public enterprise, the problems encountered there, and so on. Finally—and in terms of bulk and complexity this is much the largest item on the proposed agenda—there is suggested for discussion a series of major 'indirect' means of implementation, or those which governments use in order to promote or regulate private action.

Monetary and credit policy (including the development of financial institutions); fiscal policy and taxation; foreign trade, exchange, and investment policy; direct controls over specific prices, quantities, priorities, etc; social and institutional policies on land reform, population, labor, cooperatives and community development, etc.; and, in the end, the question of the interrelation and proper coordination of the 'indirect' means."

The executive secretary pointed out that the working party is a forum to which experts come for a free exchange of professional views.

The Prime Minister of Thailand, in a statement read to the working party, welcomed the delegation on behalf of the Government of Thailand and stressed the importance of the discussion of the working party in exchanging, surveying, and evaluating knowledge and experience in the field of economic development.

The working paper of the ECAFE secretariat, referred to in paragraph 1 above, served as an extended annotated agenda and, together with the papers submitted by member governments and specialized agencies, constituted the written background for the discussions which followed. The secretariat's paper was not subjected to a detailed review by the working party and it did not necessarily (and was not intended to) represent the views of the working party. It served only as a guide to the discussions. Several delegates, including the United States delegate, expressed important reservations on particular sections of the paper.

6. *Appointment and work of drafting committee*

On the third day of the conference, September 19, the chairman appointed a three-man committee consisting of the delegates from India, Indonesia, and the United Kingdom to draft the working party's report. He stressed the need for a small group to facilitate the work of drafting, pointing out that the working party as a whole would have an opportunity to review and, if necessary, modify the drafting committee's report. At the morning session of September 20, the working party voted to expand the drafting committee to five members and added the representatives of the United States and Japan to those who had been appointed the day previous by the chairman. The drafting committee elected the delegate from Indonesia as its chairman. The working party's report, as approved, is currently being reproduced by the secretariat and will be available shortly.

7. *Principal conclusions of the working party*

The report of the working party is addressed to broad questions of policy determination and implementation. Many of the major conclusions, particularly in the section dealing with implementation of policy, suggest the need for substantial qualifications which have not been explicitly set forth, in the interests of avoiding prolonged dispute on matters which, in many respects, are secondary to questions of basic orientation. The report stated that the delegates all "participated in their capacity as experts, and the views expressed at the meeting and in this report are not necessarily those of their respective governments."

In its discussion of major policy questions in economic development, the report concludes:

1. Economic development is the continuing process of increasing the capacity of a nation to produce valued goods and services so as to achieve rising standards of living for the people. The goals of development cannot be generalized a priori, since they should be determined by the people themselves.

2. Limitations on the rate of economic development are the amount of available and potential resources and the effectiveness of their use. The basic economic principle to be observed in economic development policy is to secure the most efficient use of resources. While adherence to this principle will resolve many conflicts among policy objectives, other conflicts will remain, in many cases because of the difficulty in measuring the real costs of alternative policies.

3. The problem of resolving conflicting objectives is not a bureaucratic decision in a democratic society. The people register their choices among different objectives and their judgments as to the effectiveness and desirability of alternative means continuously in the market place and at the ballot box, and through various forums for the expression of public opinion. When plans, programs, and budgets do not conform to popular decisions they are changed.

4. Most of the ECAFE countries are essentially mixed economies. Public participation in development programs, therefore, is to be expected. At the same time, private investment should be encouraged. Private and government initiative need not be mutually exclusive.

5. The purpose of planning, programing, and budgeting in the public sector is to insure maximum efficiency of the economy as a whole in achieving policy ob-

jectives. The machinery of government participation will vary from country to country, depending on the nature and degree of direct participation in economic development, availability of information, skill in using techniques, and political organization. Whatever the character of government participation, a wide range of economic data are required and should be developed.

In discussing means of implementing policy, the report concludes :

1. Public investment is important in the initial stages of economic development in ECAFE countries to provide basic facilities upon which further development depends, where private initiative, capital, and know-how are lacking. Fundamentally, the role of public investment should be determined from the viewpoint of economic effectiveness which should be measured in terms of alternative uses of investible resources to meet the countries' objectives as well as the relative efficiency of public versus private investment. It is not enough to identify the "need" for specific types of public investment; it is also necessary to consider at what economic cost such investment can be made.

2. The pattern of investment, whether public or private, cannot be generalized for all countries. Public expenditures for development of technology and its research and application to the raising of productivity in high priority sectors are generally desirable in most ECAFE countries. This is one of the areas in which there is particular scope for foreign funds and experience.

3. The report also discusses problems of organization and administration of public enterprises and the need for establishing appropriate relationships between such enterprises and the governing legislature. It was observed that pricing policies of such enterprises should take into account their possible consequences for wasteful investment and misallocation of resources.

4. In discussing the role of monetary and credit policy, the report of the working party places considerable emphasis on the need for avoiding inflation. The need for credit creation and expansion is explicitly recognized but qualified by the need for maintaining reasonable price stability.

5. The report also discusses the function of central banks in underdeveloped economies, monetary policy problems related to balance of payment difficulties, and the use and limitation of monetary policy in offsetting or containing economic instability. Member countries are urged to adopt flexible attitudes with respect to the kind of monetary and credit institutions most appropriate to the circumstances of each.

6. The report places primary emphasis on fiscal policy among indirect means of promoting saving and investment, evening out fluctuations in demand, and achieving a satisfactory distribution of income and wealth. Problems with respect to the kinds of taxes to be employed and administration and enforcement are examined.

7. The working party report, in discussing foreign trade, exchange, and investment policy, points out a tendency common to all ECAFE region countries to run easily into balance of payments deficits. This results primarily from the general dependence of the countries on a few primary export commodities, whose prices tend to fluctuate sharply with changes in world supply and demand conditions, and from the general dependence of these countries on imports for capital goods. It is agreed by all the countries of the region that some government control over the foreign-trade situation is necessary. The desirability of encouraging the development of import-saving and export-promoting industries is recognized. The importance of encouraging foreign private investment and the limitations on such investment are also discussed.

8. The working party examined the use of direct controls to implement development policies. Its report points out the disadvantages of such controls, but agrees that some use may be necessary in particular sectors from time to time.

9. The report also deals in quite general terms with policies relative to social and institutional factors in the ECAFE countries, concluding that the ultimate goal of development should be the achievement of a pattern of society which conforms to the basic values of the people. At the same time, it is recognized that adjustments may be required in the social and institutional framework if the objectives of developmental policy are to be realized. The report notes the predominance of agriculture in the ECAFE region and the importance of a sound rural economy as the basis for industrialization, and observes that the social structure and outlook in the rural sector need to be changed in many fundamental respects, in order to achieve economic improvement. Agrarian reforms are briefly discussed. In this connection, the importance of community development programs, aimed at creating a new spirit among the people so that development activities can be pursued independently in small communities, is emphasized.

Problems in labor relations are also developed in a general way. High costs of skilled labor, upward pressures on wages from high prices and increasing scope of material wants, it is concluded, may be particularly troublesome factors in these economies, focused on rapid industrial development.

The working party report touches on the problems associated with population growth in the area but reaches no conclusions as to the significance of this growth for economic development nor with respect to solution to population problems.

10. The report also stresses the need for coordinating policies in all sectors, and suggests the usefulness of exchange of information by ECAFE countries about their respective programs and problems.

11. Finally, the working party recommends that its third meeting should be in collaboration with FAO on the problems and techniques of agricultural development planning and implementation in relation to economic development as a whole, and more particularly to industrialization.

8. Conclusions and recommendations of the United States delegate

(a) The United States delegate believes that the discussions of the ECAFE working party were useful and strongly recommends that the United States participate actively in any future work of ECAFE in the field of economic development. While it is obvious that there can be no unanimity of opinion among ECAFE member countries on matters involving basic economic philosophy or policies, the exchange of views, ideas, and experiences relating to economic development is of value to the countries of the area which are searching for and experimenting with ways and means of accelerating the rate of their development. To a considerable extent their economic objectives and policies and their techniques of promoting development are in the formative stages and they are anxious to learn and benefit from the experience of others. It is important that the United States use this forum to explain the workings and advantages of its democratic, free-enterprise system as contrasted with the Communist or other authoritarian economic systems. United States participation is welcomed by regional members as evidence of this country's continuing interest in their problems and the United States benefits from direct knowledge of these problems.

(b) The ECAFE Secretariat and several member governments and specialized agencies submitted papers for use in connection with the discussions of the working party. The United States submitted two papers especially prepared for the meeting: Means of Implementation that Promote or Regulate Private Action in the Field of Foreign Trade and Foreign Investment in the United States, prepared by the Department of Commerce, and Instruments of Monetary Policy: A Comparative Analysis, prepared, as a personal contribution, by a member of the staff of the Federal Reserve System. In addition, copies of the Employment Act of 1946, as amended, the January 1956 Economic Report of the President, the Report of the Joint Committee on the Economic Report, dated March 1, 1956, and the August 1956 Economic Indicators were distributed. While these papers and publications were of interest to the other delegates, they were pertinent only to particular and limited aspects of the broad subject which the working party discussed. It is the view of the United States delegate that it would have been useful to have had a paper prepared and distributed which described in some detail the approach of the United States Government to economic "planning, programming and budgeting" and the methods, direct and indirect, used by the Government to influence the economic life of the country. Such a paper might have explained why the United States places primary emphasis on the private sector of the economy, how the limited public sector is subject to the democratic process of review through elected officials, the free press, etc., how and why stress is placed on creating an environment conducive to risktaking and entrepreneurship, why (except in an emergency situation) free market forces are believed to be superior to direct government action in allocating resources, and in guiding the general course of economic development. These thoughts were expressed orally by the United States delegate during the course of the discussions. It is suggested, however, that a paper be prepared for circulation to the next working party dealing directly and at some length with the subject which is to be discussed. For this purpose, it is essential that the competent United States Government agencies accord appropriate priorities to this task.

(c) As noted above, the Secretariat's paper was used as a guide for the working party's discussions. In general, the paper served this purpose. However, in a number of respects, the United States delegate considered the paper to be in-

complete and to lack proper balance which, it is believed, could have been largely corrected by a prior review by member governments. This point was also made by the Executive Secretary during the course of the discussions. For future meetings of this and other ECAFE groups, it would be desirable to have a small group of delegates from member countries appointed (possibly from their respective embassies in Bangkok) to meet prior to the convening of the full meeting for the purpose of reviewing papers prepared by the Secretariat for use at the meeting. Such a review would doubtless be of considerable use to the Secretariat in improving the accuracy, completeness, and hence the usefulness of its conference papers and reports.

(d) The United States delegate was encouraged to note the emphasis placed by the representatives of the underdeveloped countries of the region on self-help and the almost complete absence of "pressure" for increased foreign aid. Aid, particularly that provided by the United States, was frequently referred to as an important factor contributing to development, but there was no suggestion that such aid is or could be more than a partial contribution to resolving the problem of economic development in the area.

[For participants only]

DPWP.2/INF/1 Rev.1
September 25, 1956
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**ECONOMIC COMMISSION FOR ASIA AND THE FAR EAST WORKING PARTY ON
ECONOMIC DEVELOPMENT AND PLANNING**

**Second meeting: Development policies and the means for implementation of
development programs**

BANGKOK, THAILAND, September 17-29, 1956.

LIST OF PARTICIPANTS

Member States

AFGHANISTAN

**Representative: Mr. Hamidullah Tarzi, Director, Foreign Trade Contracts and
International Relations, Ministry of National Economy, Kabul**

AUSTRALIA

**Representative: Mr. P. J. Lawler, assistant secretary, Prime Minister's Depart-
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**Alternate: U Thet Tun, additional director, Central Statistical and Economics
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¹ Accompanied by wife.

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Mr. T. Soebekti, senior official attached to the Directorate of National Revenue, Ministry of Finance, Djakarta

Secretary: Mr. R. Soegondo, commercial secretary to the Indonesian Embassy, Bangkok, Thailand

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Representative: Dr. Kazushi Ohkawa, professor of economics, Hitotsubashi University, concurrently, councillor, Economic Planning Board and Secretary of the Ministry of Foreign Affairs, Tokyo

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Mr. Hideo Suzuki, Chief Treasury Section, Financial Bureau, Ministry of Finance, concurrently Secretary of the Ministry of Foreign Affairs, Tokyo

Advisers:

Mr. Takehei Miyashita, Chief, Economic Research Division, Research Department, Japan Development Bank, concurrently Researcher of the Ministry of Foreign Affairs, Tokyo

Mr. Yoshiya Kato, attaché of the Embassy of Japan in Thailand, Bangkok

KOREA

Representative: Mr. Ha-chung Chang, Director, Bureau of Planning, Ministry of Reconstruction, Seoul

Alternate: Mr. Imkeun Oh, Director of Bureau of Budget, Ministry of Finance, Seoul

NETHERLANDS

Representative: Mr. J. Sandee, Head, Structural Problems Division, Central Planning Bureau, The Hague

Alternate: Mr. J. C. van den Berg, second secretary, Netherlands Embassy, Bangkok, Thailand

NEW ZEALAND

Representative: Mr. M. J. Moriarty, chief research officer, the Treasury, Wellington
 Alternate: Mr. R. L. G. Challis, chargé d'affaires, New Zealand Embassy, Bangkok, Thailand

PAKISTAN

Representative: Mr. Abdul Sattar Gandhi, Deputy Secretary, Ministry of Economic Affairs, Karachi

PHILIPPINES

Representative: Mr. Conrado S. Ramirez, Assistant Director of National Planning, National Economic Council, Manila.

THAILAND

Representative: Mr. Bundit Kantabutra, Chief, National Income Division, Office of the National Economic Council, Bangkok.

Alternates:

Mr. Chalong Pungtrakul, Acting Chief, Economic Affairs Division, Office of the National Economic Council, Bangkok.

Mr. Chanchai Leetavorn, Chief of the International Bank Section, Ministry of Finance, Bangkok.

Mrs. Suparb Yossundara, Division Chief attached to Research Division, Bank of Thailand, Bangkok.

Mr. Visit Tansacha, economic officer, Department of Economic Relations, Ministry of Economic Affairs, Bangkok.

UNION OF SOVIET SOCIALIST REPUBLICS

Representative: Mr. S. V. Shmanenko, Deputy Chief, Industry and Transport Division, Economic Relations Department under the U. S. S. R. Council of Ministers.

Alternate: Mr. I. A. Evenko, Deputy Chief, Summary National Economic Plan Division, State Economic Commission of the U. S. S. R.

Advisers:

Dr. A. N. Mamin, counsellor of the Permanent Mission of the U. S. S. R. to ECAFE, Bangkok, Thailand.

Mr. V. M. Lessiovski, First Secretary of the Permanent Mission of the U. S. S. R. to ECAFE, Bangkok, Thailand.

Dr. M. P. Mironov, U. S. S. R. Embassy in Burma, Rangoon.

Interpreter: Mr. E. V. Koudriavtsev, interpreter of the Permanent Mission of the U. S. S. R. to ECAFE, Bangkok, Thailand.

UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND

Representative: Mr. A. C. L. Day, Economic Section, Treasury, London.

Adviser: Mr. A. F. Maddocks, First Secretary (United Nations), British Embassy, Bangkok, Thailand.

UNITED STATES OF AMERICA

Representative: Dr. Grover W. Ensley, Executive Director, Joint Economic Committee, United States Congress, Washington.

Adviser: Mr. Edwin M. Cronk, First Secretary, United States Embassy, Seoul, Korea.

VIETNAM

Representative: Mr. Vu-Van-Thai, Administrator-General of Foreign Aid, Presidency of the Republic, Saigon.

OTHER STATES

CZECHOSLOVAKIA²

Observer: Mr. Karel Dobes, commercial attaché for Czechoslovakia, 40/53, Phayre Street, Rangoon, Burma.

² Participating in a consultative capacity under par. 9 of the terms of reference of the Commission.

FEDERAL REPUBLIC OF GERMANY³

Observer: Dr. H. Michelsen, commercial secretary, German Embassy, Bangkok, Thailand

SPECIALISED AGENCIES

Food and Agriculture Organization (FAO): Dr. E. M. Ojala, chief, Agriculture Division, ECAFE

World Health Organization (WHO): Dr. L. W. Fitzmaurice, area representative for Thailand, Bangkok

NONGOVERNMENTAL ORGANIZATIONS

International Chamber of Commerce (ICC):

Mr. K. Mahai Sombatsiri, Vice President, the Thai National Committee of the ICC, 730 Anuwongse Road, Bangkok, Thailand

Mr. Thonglaw Punyanitaya, Secretary-General, the Thai National Committee of the ICC, 150 Rajbopit Road, Bangkok, Thailand

Mr. Seri Kupkitbhandu, the Thai National Committee of the ICC, 150 Rajbopit Road, Bangkok, Thailand

Mr. Azusa Morishima, Manager, The Mitsui Bank Ltd., Representative of Japan National Committee of the ICC, 1195 New Road, Bangkok, Thailand

Mr. Shingo Ushiki, Representative, Bank of Tokyo, Representative of Japan National Committee of the ICC, Room 310, Manida Building, New Road, Bangkok, Thailand

Mr. P. Subrahmaniam, Representative, Indian National Committee, International Chamber of Commerce, secretary, Sahu Jain, Ltd., 11 Clive Row, Calcutta, India

International Confederation of Free Trade Unions (ICFTU): Mr. H. K. Choudhury, Financial Secretary of National Union of Plantation Workers, Kuala Lumpur, Malaya

World Federation of Trade Unions (WFTU): Mr. K. B. Panikkar, Representative, WFTU, 1-C/15 Rohtak Road, Delhi 5, India

World Federation of United Nations Associations (WFUNA): Dr. Joseph S. Gould, Member of the UNAT Committee, Adviser to Office of Council of Ministers, c/o National Economic Council, Bangkok, Thailand

SECRETARIAT

Mr. C. V. Narasimhan: Executive Secretary

Dr. John H. G. Pierson: Director, Research and Planning Division

Dr. Antoni B. Wojcicki: Acting Senior Officer, ECAFE Division of Social Affairs and Regional Community Development Officer

Dr. S. C. Yang: Economic Affairs Officer, Research and Planning Division

Mr. A. R. Ayazi: Economic Affairs Officer, Research and Planning Division

Mr. W. Tanzer: Information officer

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

JULY 12, 1956.

MEMORANDUM

To: Members of the Joint Economic Committee.

From: John W. Lehman, clerk.

Subject: Report on the working group on short-term indicators of economic changes of the Conference of European Statisticians.¹

The following report of my recent European trip is sent to you at the suggestion of Grover Ensley, executive director, that individual committee members might find it interesting and helpful.

As you know, I was the United States delegate at the first session of the working group on short-term indicators of economic changes of the Conference of

³ Participating in a consultative capacity under ECOSOC Resolution 617 (XXII) dated July 27, 1956.

¹ A regional technical group sponsored by the United Nations, composed of the chief statisticians of countries participating in the Economic Commission for Europe.

European Statisticians, held at Geneva, Switzerland, during the period May 22 through May 26. The meeting was attended by delegates from 19 nations. Twenty-seven selected technical papers were submitted on the experience of the various participating countries in collecting, processing and publishing short-term economic indicators generally, or in a particular subject field. All major papers were reproduced by the Secretariat in advance of the meeting in order that the discussions might concentrate on evaluating the various methods and programs presented—with a view to recommending to the plenary session the kind of statistics which are most useful as indicators of short-term economic changes.

In response to the conference request to the United States for papers on statistics of current and prospective fixed capital formation and surveys of consumers intentions, the Office of Statistical Standards of the Bureau of the Budget supplied each delegate with a copy of the hearings held last fall before the Subcommittee on Economic Statistics of the Joint Economic Committee. As you recall, the hearings contain the reports of Federal Reserve Board consultant committees, two of which dealt with these subjects in great detail.

The working group on indicators of short-term economic changes prepared a 33-page report which contains not only the findings and recommendations of the group, but also a review of all the items considered during the meetings. A final copy of this report has just been received in the Committee offices.

In addition to participating in the working group at Geneva, I discussed current economic statistics and other aspects of the Joint Economic Committee's work with technicians in Paris and London. In these conferences and in discussions with other delegates at Geneva, there is evidence that a growing amount of reasonably comparable statistical data is becoming available for many European countries as a result of the exchange of techniques and ideas through such organizations as the Conference of European Statisticians, the Statistical Commission, the Economic Commission for Europe, and other technical groups.

There is increasing recognition, too, of the contribution adequate economic statistics can make to a healthy economy, whether it be a free economy or in one of the countries with state control. This apparently has not only resulted in improvements in, and the publication of, a great deal of statistical data for use in their own countries but even the Eastern European nations have increased their contributions to the various volumes on international statistics. Almost all delegates felt their country needed more and better economic statistics. At the same time, there was no thought of adding statistics for statistics' sake. Any statistical series to be included, it was made clear, must have some immediate usefulness for economic analysis.

Poland, Czechoslovakia, Hungary, and Yugoslavia seemed to have much the same idea of what constitutes a full complement of statistical tools as did the other nations represented. The Polish delegate, for example, said that in his opinion a minimum national statistical program should include statistics on: industrial production, collected frequently and in great detail; overall investment and fixed capital; prices, including the Consumer Price Index; current balance of payments; income and expenditures of the population; government, receipts and expenditures, etc.; and employment, inventories, and monetary questions. With the exception of monetary and government statistics, this also reflects about the order of importance that many of the European statisticians would use. For short-term analysis there appears to be much more interest in detailed information on production statistics than there is, for example, in employment statistics. For longer run analysis and policymaking purposes, the European statistician seems to depend heavily on a fairly complete system of national accounts, unfortunately available sometimes only annually.

In general discussions during the meetings the training of statisticians and and mathematicians was given great emphasis as one of the most important factors contributing to the success of a nation's statistical programs. It was interesting to note that the Eastern European countries include the need for training statisticians as a significant part of their programs of accelerating generally the training of technical personnel. Both the Hungarian and the Polish delegates stated that their countries had established special schools for training statisticians. Other countries reported a growing interest among students in their colleges in majoring in statistics. The French delegate, who is head of their institute of national statistical and economic studies, pointed also to the increasing number of firms in his country that are now employing full-time statisticians. Unfortunately, the major source of experienced statisticians

in France is still the Government and Mr. Du Montier has found it difficult to maintain his senior staff with the modest salaries he can offer.

Throughout the meeting there was much interest in learning about statistical techniques, procedures, and programs in the United States. I was called upon to provide information not only on the two papers which were formally presented for discussion on new plant and equipment expectations and consumer expectations but on our statistics on inventories and sales, employment, private statistics using the business-test method of Dun & Bradstreet, and many other series as well. The attitude of the European statistician toward the participation of the United States in the working group was perhaps best summed up by the delegate from the Netherlands during the Friday afternoon meeting when he asked that a formal note be carried in the proceedings complimenting and thanking the United States for the contributions of its papers and its delegate. Without objection this was done.

Not only is the work of the United States as a whole in the field of statistics becoming more widely known and used but the reports and hearings of the Joint Economic Committee and its subcommittees are also receiving recognition in technical circles abroad. This is especially true of the Subcommittee on Economic Statistics and the Subcommittee on Foreign Economic Policy. In England the work of the Subcommittee on Economic Stabilization in the field of automation was also of broad interest since automation is a major problem in one of their current labor controversies.

There is one other aspect of the increasingly widespread interest in improving economic statistics on which I should report. As you know, I discussed economic statistics with the Secretariat of the Interparliamentary Union at Geneva and in London with Mr. Harry Hynd, M. P., who is Secretary of the Interparliamentary Union Committee on Economic and Financial Questions. Both discussions gave encouragement to Congressman Talle in his effort to bring before representatives of legislative bodies of the nations of the world at the Interparliamentary Union the contribution of economic statistics to national economic stability and international understanding. It was requested that he prepare a statement for further discussion at the meetings in Bangkok this fall.

I have attached to this memorandum a complete list of the delegates attending the May meetings. Mr. George Tesoro of the United States Resident Delegation for International Organizations at Geneva, who was assigned to assist me, was most helpful in matters of conference procedure and local arrangements. I greatly appreciated also the courtesies which Mr. Franklin C. Gowen, the United States Representative for International Organizations and Consul General at Geneva, and his staff, extended me, and the excellent cooperation which I received from our State Department representatives and our representatives in the various international offices in Paris and London, as well as in Geneva. The Secretariat which was supplied by the European Office of the United Nations and headed by Mr. Barrie N. Davies, Chief, Statistical Cooperation Unit, Research and Planning Division, did a superb job of keeping up with the conference actions and preparing the draft materials for its final report.

LIST OF DELEGATES

Chairman: Mr. Lennart Fastbom (Sweden)

Austria:

Dr. W. Zeller: Head of the Division of Economic Statistics, Austrian Central Statistical Office.

Mr. H. Seidel: Austrian Institute of Economic Research.

Belgium: Mme. Martin-Olislagers: Institut National de Statistique.

Czechoslovakia: Dr. Miroslav Zdarsky: Vice President, l'Office National de Statistique.

Denmark: Mr. Leo Meyer: Danish Statistical Department.

Federal Republic of Germany:

Dr. G. Furst: President of the Federal Statistical Office.

Dr. H. Bartels: Head of Division, Federal Statistical Office.

France:

Mr. J. E. L. Dumontier: Directeur de la Conjoncture et des Etudes Economiques a l'Institut National de la Statistique et des Etudes Economiques.

Mr. C. Alphantery: Chef du bureau du Budget economique, Ministere des Finances.

Greece:

Mr. S. Geronymakis: Director, National Accounts Division, Ministry of Coordination.

Mr. A. Stathis: Division d'Etudes de la Banque de Grece.

Hungary: Mr. J. Redei: Chief of Department, Central Statistical Office.

Italy:

Mr. Ubaldo Felici: Central Statistical Institute.

Mr. Armando Agostinelli: Central Statistical Institute.

Luxembourg: Mr. Joseph Heinen: Service d'Etudes et de Documentation, Ministère des Affaires Economiques.

Netherlands:

Mr. H. G. C. Nanninga: Head of Division for Statistics of Manufacturing and Construction, Central Bureau of Statistics.

Mr. J. B. D. Derksen: Chief, Division of National Accounts and Statistical Analysis, Central Bureau of Statistics.

Norway: Mr. Odd Aukrust: Director of Research, Central Bureau of Statistics.

Poland: Mr. B. Minc: Directeur de l'Institut Economique de l'Academie Polonaise des Sciences.

Switzerland: Mr. E. Wenk: Chef de la Section "Statistiques économiques," Bureau Federal de statistique.

United Kingdom:

Mr. W. Stedman Jones: Chief Statistician, Central Statistical Office.

Miss J. M. Maton: Chief Statistician, Board of Trade.

United States:

Mr. John W. Lehman: Clerk, Joint Economic Committee, and Economist, Subcommittee on Economic Statistics, United States Congress.

Mr. George A. Tesoro: Senior Economic Officer, United States Resident Delegation.

Yugoslavia: Mr. Ante Novak: Directeur de l'Office Federal de Statistique.

Experts attending from the secretariats of international organizations:

Mr. J. Burtle: Economic Division, International Labor Office.

Mr. Milton Gilbert: Director of Economics and Statistics, Organization for European Economic Cooperation.

Mr. Vittorio Paretti: Chief, Statistical Division, Organization for European Economic Cooperation.

Sales of long term State and local Government bonds, holdings by insured banks, and certain bond yields

Date	Sales ¹	Bank holdings ²			Bond yields ³					
		Amount	Net acquisitions	Per cent	Municipal (Standard and Poor's)		U. S. Government		Aaa corporate (Moody's)	
					Level	Percent Change	Level	Percent Change	Level	Percent Change
1946.....	1,157	3,975			1 55		2 16		2 49	
1947.....	2 354	4 828	853	+21 5	1 92	+23 9	2 22	+2 8	2 55	+2 4
1948.....	2,990	5,436	608	+12 6	2 26	+17 7	2 41	+8 6	2 76	+8 2
1949.....	2 996	5,766	330	+6 1	2 28	+0 1	2 38	-1 3	2 71	-1 8
1950.....	3,694	7,262	1,496	+25 9	2 09	-8 3	2 33	-2 1	2 62	-3 3
1951.....	3,278	8,344	1,082	+14 9	2 22	+6 2	2 65	+13 7	2 94	+12 2
1952.....	4,401	9,652	1,308	+15 7	2 10	-5 4	2 61	-1 5	2 94	0
1953.....	5,558	10 334	682	+7 0	2 99	+42 4	3 09	+18 4	3 40	+15 6
1954.....	6,969	11,716	1,382	+13 4	2 48	-17 1	2 70	-12 6	2 90	-14 7
1955.....	5,977	12,483	867	+7 4	2 48	0	2 76	+2 2	3 05	+5 2
1956.....	5,409	12,731	148	+1 2	2 75	+10 9	2 89	+4 7	3 26	+6 9
Dec. 15, 1956.....					3 43	+24 7	3 34	+15 6	3 72	+14 1

¹ Sales in millions of dollars for calendar years shown

² Bank holdings in millions of dollars on June 30 of year shown; net acquisitions in millions of dollars for years ended on June 30 of years shown

³ Bond yields are averages for month of June for years shown except last, which is weekly average for week ended Dec 15, 1956

Sources: Sales—The Bond Buyer, Bank Holdings—Federal Deposit Insurance Corporation; Bond yields—Economic Indicators.

Representative TABLE. The hearing is hereby adjourned.
(Whereupon, at 12:44 p. m., the hearing was adjourned.)

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